

Review of Performance of the NBFC Sector

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Non-banking Financial Companies (NBFCs) play a vital role in India's economic growth. These institutions by providing finance for infrastructure, vehicles, housing, and consumer goods, improve aggregate demand, create jobs, and contribute to economic expansion. The growing contribution of NBFCs to credit, particularly to the industrial and retail sectors, is evident in their rising credit-to-GDP ratio. Furthermore, the financial health of the sector continued to be robust in terms of key indicators viz., return on assets, return on equity, net interest margin, capital to risk-weighted assets ratio and non-performing assets ratios. The increase in their share in overall credit along with inter-connectedness with banks and financial markets, have implications for monetary policy transmission.

Introduction

Non-Banking Financial Companies (NBFCs) represent a critical and dynamic segment of India's financial system. Registered with the Reserve Bank under the RBI Act, 1934, NBFCs¹ are engaged in a variety of financial activities, including, *inter alia*, provision of loans and advances, acquisition of shares

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¹ Although merchant banking companies, stock exchanges, companies engaged in the business of stock-broking/sub-broking, nidhi companies, alternative investment fund companies, insurance companies and chit fund companies are NBFCs, they have been exempted from the requirement of registration with the Reserve Bank under Section 45-IA of the RBI Act, 1934.

and bonds, hire-purchase finance, and factoring. They play an important role in financing key economic sectors such as infrastructure development, vehicle purchases (both commercial and personal), housing, and consumer durables, thereby stimulating aggregate demand, fostering employment opportunities, and contributing to overall economic growth. The proliferation of NBFCs in India also points to their ability to adapt to market conditions through customised product offerings and quick service delivery to diverse and niche segments.

Over time NBFCs have grown in size and significance, implying that any significant disruption in the sector could have repercussions on the financial system and the real economy. The growing systemic significance of NBFCs is underscored by the vigilant and nuanced regulatory oversight adopted by the Reserve Bank. A landmark development in this regard was the implementation of the Scale-Based Regulation (SBR) framework since October 2022, which signified a shift to a more nuanced, risk-calibrated system that acknowledges the heterogeneity within the NBFC sector. This reflects a delicate balancing act by the Reserve Bank, between ensuring financial stability and facilitating innovation in the sector.

The growing role of NBFCs in credit intermediation, along with their interconnectedness with banks and financial markets has highlighted their increasing significance in the transmission of monetary policy impulses to the real economy, even as banks continue to serve as the primary conduit.

In this light, this article presents the recent performance of India's NBFC sector. The subsequent article is organised into the following sections. Section II situates India's non-banking sector in the global context. Section III examines NBFCs' balance

sheet, highlighting their growing significance within India's financial system. Building on this, section IV explores the issue of the effectiveness of monetary policy transmission in this increasingly important segment. Section V details financial and prudential indicators of the NBFC sector followed by the last section which concludes and discusses key emerging challenges.

II. NBFIs: A Global Perspective

At the global level, the total financial assets of non-banking financial institutions² (NBFIs) sector demonstrated robust expansion, with a growth of 8.5 per cent outpacing the banking sector's growth of 3.3 per cent, at end-December 2023. The share of NBFIs in global financial assets stood at 49.1 per cent at end-December 2023. Lending by NBFIs across globe also increased by 4.1 per cent, compared to a 3.4 per cent rise in bank lending. Despite the prevailing high-interest rate environment, borrowings by NBFIs also remained strong.

The narrow measure of Financial Stability Board (FSB) includes NBFIs entities involved in credit intermediation activities that could give rise to bank-like vulnerabilities. NBFIs under the narrow measure constituted around 30 per cent of total NBFIs assets. Narrow measure for advanced economies grew at 10.8 per cent whereas for emerging market economies, it expanded at 5.7 per cent. All economies except India and Saudi Arabia witnessed growth in narrow measure³. For India, this can be attributed to economic function (EF2) which accounts for the largest share in India and reported a contraction due to the merger of a large NBFIs with a bank (Table 1). EF2 includes lending institutions dependent on short-term funding and is dominated by finance companies which specialise in areas such as consumer finance, auto finance, retail mortgage provision, commercial property finance, and equipment finance.

The FSB conducted a survey on policy tools being utilised in jurisdictions where EF2 is present, such as

Table 1: Composition of Narrow Measure

(At end-December 2023)

Economic Function (EF)	Entity Type	Share		Growth	
		(Per cent)			
		Global	India	Global	India
EF1	Collective investment vehicles with features that make them susceptible to runs (e.g., money market funds, real estate funds)	74.1	19.1	10.1	-10.5
EF2	Lending dependent on short-term funding (e.g., consumer credit companies, leasing companies)	8.5	79.7	7.6	-2.3
EF3	Market intermediation dependent on short-term funding (e.g., broker-dealers, custodial accounts)	7.0	0.7	16.2	49.8
EF4	Facilitation of credit intermediation (e.g., credit insurers, monoline insurers)	0.2	0.0	0.2	96.1
EF5	Securitisation-based credit intermediation (e.g., Securitisation vehicles, structured finance vehicles)	7.5	0.4	3.8	7.4

Note: "Share" denotes the proportion of a specific EF relative to the total, *i.e.*, the sum of EF1, EF2, EF3, EF4, and EF5, for either Global or India, as applicable. Similarly, the growth of a specific EF refers to its Y-o-Y growth, comparing December to December.

Source: Global Monitoring Report on Non-Bank Financial Intermediation, 2024.

² The Financial Stability Board (FSB) defines NBFIs sector as a broad measure of all non-bank financial entities, comprising all financial institutions that are not central banks, banks, or public financial institutions.

³ The narrow measure comprises of five economic functions (EFs), namely EF1 to EF5.

India. The survey responses indicated that the primary policies adopted included prudential requirements akin to those for banks, capital requirements, leverage limits, restrictions on significant risk exposures among others. Moreover, majority of responding jurisdictions reported enforcing limits on liabilities that NBF entities can take on from banks and risky clients (Chart 1). Additional measures involved disclosure mandates, registration and authorization procedures, as well as constraints on the range of activities, including the issuance of credit cards.

In India, NBFCs are the largest component of EF2. Given their systemic importance and diverse business models, NBFCs are regulated through SBR, which envisages a layer-wise progressive increase in regulatory intensity. Thus, NBFCs in the base layer are subject to less stringent regulation than those in middle and upper layers in view of their small size and limited interconnectedness. Apart from capital, prudential, governance and disclosure guidelines, RBI has concurrently emphasised on, enhanced customer protection, with recent measures mandating Key Fact Statements for loans, issuing guidelines on penal

charges, ensuring fair practices in the charging of interest, and promoting responsible lending conduct.

III. Performance of the NBFC Sector⁴

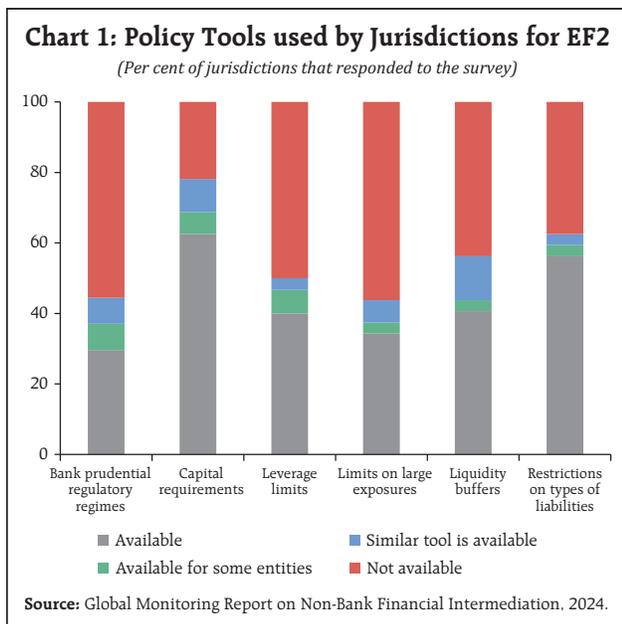
III.1. Balance Sheet

The NBFC sector in terms of total assets/liabilities continued to register double-digit growth as of end-December 2024. The increase in risk-weights on select categories of retail loans⁵ by NBFCs in November 2023 contributed to the moderation in the growth of unsecured loans and advances across layers. Borrowings, which are the main source of funds and constitute about two-third of the total liabilities of NBFCs, grew at a higher rate at end-December 2024 than a year ago (Table 2).

Assets

Loans and advances grew by 15.4 per cent at end-December 2024, at a slower rate than the preceding year (Chart 2). As at end-December 2024, unsecured loans constituted 24.0 per cent of gross loans and advances compared with 26.8 per cent a year ago. Unsecured loans of upper layer NBFCs recorded deceleration, broadly reflecting the impact of increased risk-weights.

The share of unsecured loans in the credit portfolio of middle layer NBFCs declined from around 32 per cent at end-December 2022 to 25 per cent at end-December 2024 (Chart 3a). In terms of growth, NBFC-UL witnessed a sharp decline in growth of unsecured credit, in relation to the middle layer, which recorded a marginal uptick (Chart 3b).



⁴ The analysis in this article is restricted only to NBFCs-UL and ML, excluding CICs, PDs and HFCs.

⁵ *Vide* notification dated November 16, 2023, RBI announced regulatory measures towards consumer credit and bank credit to NBFCs, which *inter alia* included increase in risk weights on the consumer credit exposure of NBFCs (outstanding as well as new) categorised as retail loans, excluding housing loans, educational loans, vehicle loans, loans against gold jewellery and microfinance/SHG loans.

Table 2: Consolidated Balance Sheet of NBFCs
(At end-December)

(₹ crore)

Items	2023			2024		
	NBFC	NBFC-UL	NBFC-ML	NBFC	NBFC-UL	NBFC-ML
Share Capital	1,37,265 (18.2)	4,552 (-36.3)	1,32,714 (21.8)	1,38,288 (0.7)	2,807 (-38.3)	1,35,481 (2.1)
Reserves and Surplus	9,08,398 (15.6)	2,10,254 (15.4)	6,98,144 (15.6)	11,30,508 (24.5)	2,37,014 (12.7)	8,93,494 (28.0)
Public Deposits	1,06,435 (-8.1)	85,779 (28.4)	20,656 (-57.9)	1,23,348 (15.9)	1,02,439 (19.4)	20,909 (1.2)
Borrowings	31,78,623 (14.6)	7,97,075 (13.9)	23,81,549 (14.9)	36,96,651 (16.3)	9,20,520 (15.5)	27,76,131 (16.6)
Other Liabilities	3,37,404 (15.3)	54,013 (1.8)	2,83,391 (18.3)	3,77,917 (12.0)	54,930 (1.7)	3,22,987 (14.0)
Total Liabilities/Assets	46,68,126 (14.3)	11,51,673 (14.2)	35,16,453 (14.4)	54,66,712 (17.1)	13,17,710 (14.4)	41,49,002 (18.0)
Loans and Advances	37,15,229 (17.9)	10,21,556 (18.4)	26,93,673 (17.8)	42,87,573 (15.4)	11,55,044 (13.1)	31,32,529 (16.3)
Investments	5,15,402 (0.3)	61,122 (-10.7)	4,54,280 (2.0)	7,27,957 (41.2)	75,128 (22.9)	6,52,830 (43.7)
Cash and Bank Balances	1,62,586 (0.8)	38,836 (-13.4)	1,23,749 (6.2)	1,80,396 (11.0)	54,982 (41.6)	1,25,413 (1.3)
Other Assets	2,74,909 (6.6)	30,158 (-7.5)	2,44,751 (8.7)	2,70,786 (-1.5)	32,556 (8.0)	2,38,230 (-2.7)

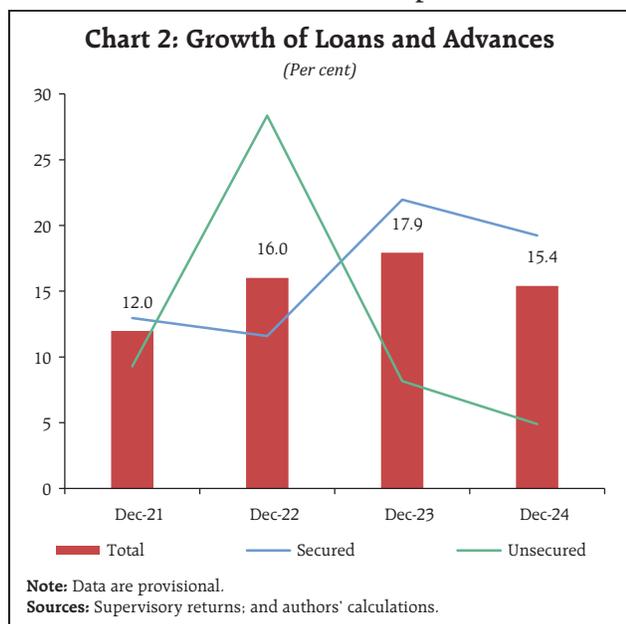
Notes: 1. Data are provisional.

2. Figures in parentheses are y-o-y growth in per cent.

Sources: Supervisory returns; and authors' calculations.

Liabilities

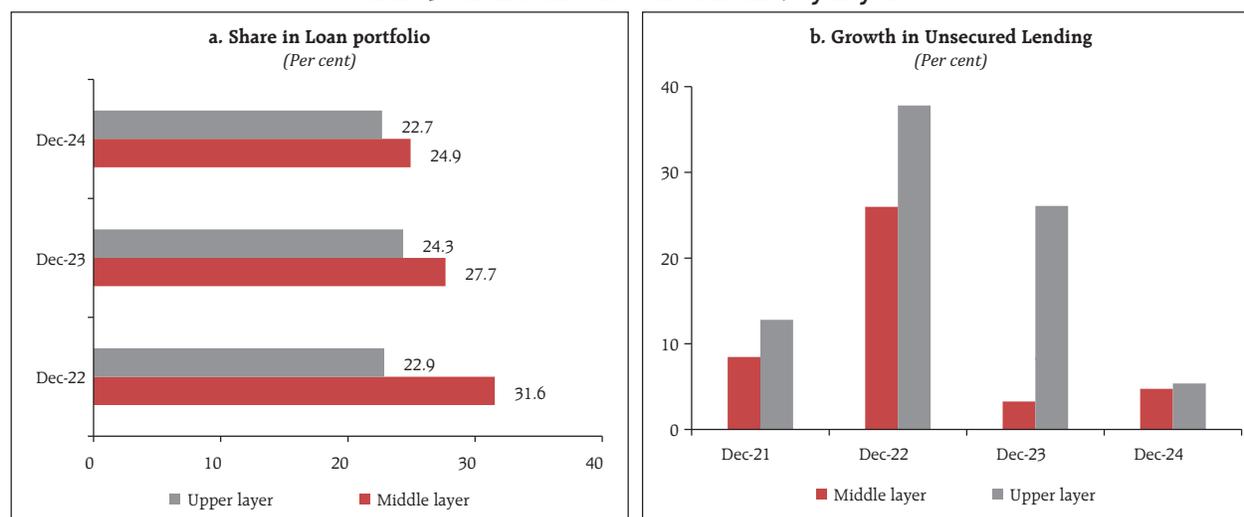
NBFCs primarily raise funds from market and banks, which accounted for 38.7 per cent and 37.4



per cent of their total borrowings, respectively, at end-December 2024 (Chart 4). The sector witnessed considerable deceleration in growth of share capital, partly due to uncertainty in market conditions. NBFCs in the upper layer continued to experience decline in share capital at end-December 2024.

Funds raised via issuance of debentures and inter-corporate borrowings grew at a higher rate, while growth in bank borrowing recorded moderation at end-December 2024 (Table 3).

Apart from domestic market, NBFCs are taking recourse to external commercial borrowings (ECBs). ECBs also contributes to diversification of sources of funding. The share of NBFCs in total ECBs (registrations) has been rising over the years (Chart 5).

Chart 3: Trends in Unsecured Loans, by Layers

Note: Data are provisional.

Sources: Supervisory returns; and authors' calculations.

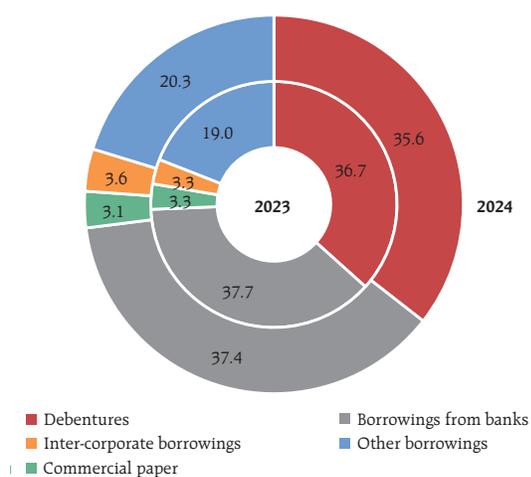
III.2. Sectoral Credit

Credit portfolio of NBFCs is dominated by loans to industry and retail segment, constituting around 72 per cent of total outstanding of the sector (Chart 6a). At end December 2024, credit to agriculture sector grew at a fast pace owing to robust kharif foodgrain production and good rabi prospects (RBIa,

2024). Retail loans have been resilient growing in double digit, but weakness in industry and services outlook has contributed to moderation of their credit growth (RBIb, 2024). However, credit growth in both segments continued to remain in double digits (Chart 6b).

Chart 4: Sources of Borrowings

(At end-December, per cent)



Note: Data are provisional.

Sources: Supervisory returns; and authors' calculations.

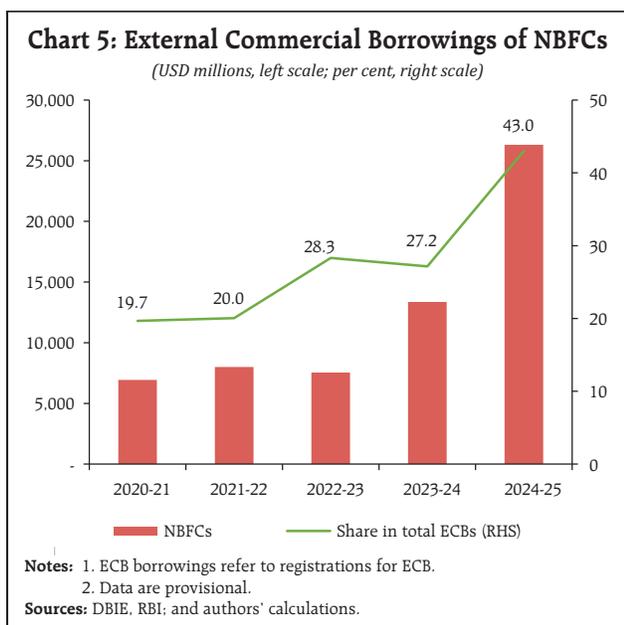
Table 3: Sources of Borrowings of NBFCs

(₹ crore)

Items	End-December 2023	End-December 2024	Percentage Variation	
			Dec-23 over Dec-22	Dec-24 over Dec-23
1. Debtentures	11,65,408	13,14,517	9.6	12.8
2. Borrowings from Banks	11,98,257	13,84,385	16.8	15.5
3. Borrowings from FIs	96,193	93,943	31.4	-2.3
4. Inter-corporate borrowings	1,03,699	1,33,754	2.0	29.0
5. Commercial paper	1,05,903	1,14,820	37.1	8.4
6. Borrowings from Government	20,206	22,620	-6.0	11.9
7. Subordinated debts	65,468	74,374	-7.2	13.6
8. Other borrowings	4,23,489	5,58,237	24.6	31.8
Total borrowings	31,78,623	36,96,651	14.6	16.3

Note: Data are provisional.

Sources: Supervisory Returns; and authors' calculations.

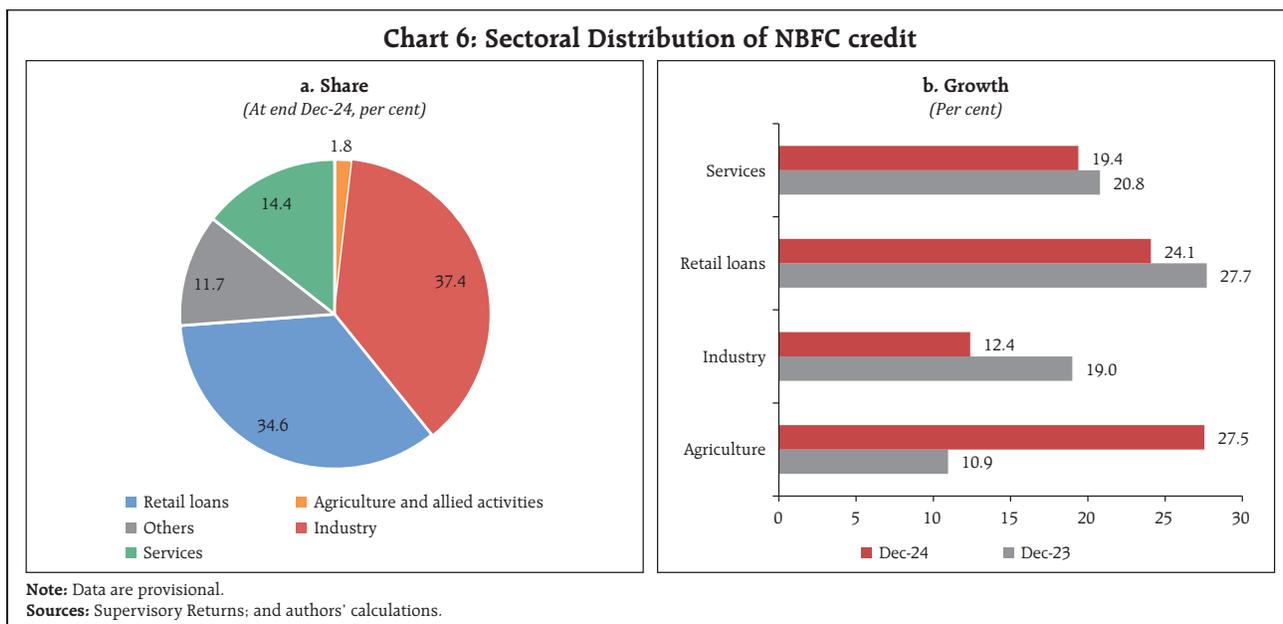


A layer wise analysis of the sector shows the dominance of credit to industry by NBFCs in the middle layer due to the presence of government owned NBFCs, followed by retail and services loans. Whereas upper layer is mainly concentrated in retail loans segment with a share of more than 60 per cent, followed by services (Chart 7).

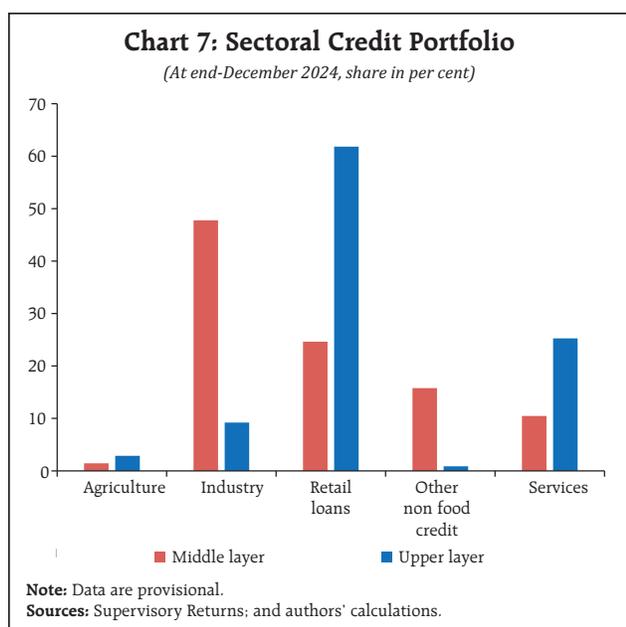
Vehicle and loans against gold are the largest segments in retail portfolio of NBFCs, comprising 34.9 per cent and 12.6 per cent of total retail loans respectively. Vehicle loans grew robustly in line with rising demand, growing population, and rising annual sales in passenger vehicle market in 2023-24 (SIAM, 2025). Gold loans which have a strong presence in rural and semi urban markets also grew at double digit catering to underserved sections of the society. Micro finance loans saw a sharp deceleration in growth (Table 4). Microfinance Industry Network (MFIN) has issued guardrails⁶, which capped loan outstanding per borrower.

IV. Monetary Policy Transmission

Owing to their substantial credit intermediation to crucial sectors of the economy and interlinkages with banks and other financial entities, NBFCs have gained salience in facilitating the transmission of monetary policy to the broader economy, even as banks continue to be the primary channel of transmission. NBFCs' dependence on bank and market borrowings results



⁶ MFIN - a Self-Regulatory Organisation (SRO) - monitors emerging developments in the sector and based on it issues Directives and Advisories to members. During the year 2024, MFIN issued directive guardrails on 8 July, thereby limiting the number of microfinance lenders to a client to 4 and capping the total microfinance loans to a client at ₹ 2 lakhs.



in a transmission mechanism that is more indirect⁷ as compared to banks. A change in policy rate impacts NBFCs *via* their cost of funds, which moves when market and bank interest rates respond to monetary policy.

In this regard, an attempt has been made to examine whether NBFCs' borrowing and lending rates respond to changes in relevant rates by a representative sample of top 100 NBFCs based on asset size. The methodology of loan pricing is not uniform across NBFCs. While some NBFCs adopt their own prime lending rates as interest rate benchmarks, others rely on base rates/MCLR of banks as external benchmarks; a few do not have any interest rate benchmark for their loan pricing. The lack of transparency has resulted in difficulty in assessing transmission of monetary policy in this segment of financial market (RBI, 2021; Patra, 2022).

A dynamic panel model is estimated using generalised method of moments (GMM) methodology on an unbalanced panel⁸, covering the period from March 2019 to December 2024 covering 86 per cent of the assets of NBFC sector (at end-March 2024).

To understand transmission on the liabilities side of NBFCs' balance sheet, weighted average borrowing

Table 4: Retail Loans of NBFCs

(₹ crore)

Items	End-December 2023	End-December 2024	Percentage Variation	
			Dec-23 over Dec-22	Dec-24 over Dec-23
1. Housing Loans	26,364	38,106	-4.4	44.5
2. Consumer Durables	42,343	50,297	43.6	18.8
3. Credit Card Receivables	53,479	60,603	28.7	13.3
4. Vehicle/Auto Loans	4,28,654	5,18,408	25.6	20.9
5. Education Loans	39,500	62,572	75.6	58.4
6. Advances against Fixed Deposits	124	174	-58.2	40.9
7. Advances to Individuals against Shares, Bonds	16,813	22,432	33.3	33.4
8. Advances to Individuals against Gold	1,43,745	1,87,350	20.0	30.3
9. Micro finance loan/SHG Loan	1,31,795	1,32,819	39.2	0.8
10. Others	3,13,740	4,11,962	27.0	31.3
Total Retail Loans	11,96,557	14,84,724	27.7	24.1

Note: Data are provisional.

Sources: Supervisory returns; and authors' calculations.

⁷ As NBFCs lack direct access to the liquidity adjustment facility (LAF) window, monetary policy transmission occurs indirectly through market-based channels, affecting borrowing cost and, consequently lending rates.

⁸ The analysis focusses on a sample of top 100 NBFCs owing to constraints on data availability and quality.

rate (WABR) of NBFCs is considered as the dependent variable, which is calculated by using available instrument-wise borrowing rate of every NBFC, weighted by their respective outstanding amounts. Similarly, on the asset side, weighted average lending rate (WALR) is calculated by using available sectoral lending rates weighted by their respective outstanding amounts. Repo rate, weighted average call rate (WACR; operating target of monetary policy), and the 91-day T-bill rate (benchmark rate representing broader financial conditions) are used as independent variables. Additionally, two other rates which are relevant to NBFCs are also considered: average bond yield of AAA and AA-rated NBFCs and the WALR of bank lending to NBFCs. This is because NBFCs are largely dependent on banks and markets for their funding requirements⁹. A change in these rates affects the cost of funds for NBFCs, in turn affecting their lending rates.

NBFC-specific factors such as size (log of total assets), capital adequacy, (capital to risk-weighted assets) and profitability (return on assets, taken as a ratio of net profit to total assets) are used as controls. To control for the macroeconomic environment, real GDP growth rate and consumer price inflation are included. A dummy for the COVID-19 pandemic, which takes the value one during June-September 2020, and zero otherwise is also included.

The following specification for regression is used:

$$Y_{it} = \alpha Y_{it-1} + \sum_{j=1}^n \beta MP_{t-j} + \delta_c X_{it-1}^c + covid_t + \theta_i + \varepsilon_{it}$$

where Y_{it} is WABR or WALR of NBFC i in period t , as the case may be. MP_t is main variable of interest, which in different specifications stands for repo rate, WACR, or 91-day T-bill rate. In the regressions with WALR as the dependent variable, NBFCs bond yield or WALR of bank lending to NBFCs are also included

⁹ At end December 2024, bank borrowings (37.4) and debentures (35.6) together accounted for 73 per cent of NBFCs total borrowings.

as additional variables of interest. The vector X_{it-1}^c represents various controls, which have been taken with a one-quarter lag to address potential endogeneity concerns. θ_i are the controls for unobservable NBFC fixed effects.

Results indicate that changes in the various aforementioned relevant rates have a positive and significant effect on NBFCs' WABR and WALR, implying transmission *albeit* incomplete. The summed coefficient of repo rate, WACR, 91-day T bill rate, NBFC bond yield and WALR of banks to NBFCs is reported, which gives the cumulative impact of change in the relevant interest rate on the WABR/ WALR of NBFCs over three quarters. On the borrowing side, a one percentage point change in repo rate is associated with a 0.24 percentage point change in WABR of NBFCs over three quarters. Similar results with WACR (0.21) and 91-day T bill rate (0.19) are reported as well. In all specifications, the coefficient of the lagged dependent variable is positive and highly significant, indicating persistence. Among controls, the coefficient for the size and return on assets variables are negative and significant, indicating that larger and more profitable NBFCs can borrow at lower rates (Table 5).

On the lending side, a one percentage point change in repo rate is associated with a 0.33 percentage point change in WALR of NBFCs over three quarters (0.36 percentage point change when WALR of Banks to NBFCs is considered). Similarly, WALR of NBFCs is found to be positively associated with WACR (0.22), 91-day T-bill rate (0.24) and NBFC bond yield (0.17) as well (Table 6).

On the borrowing side, a key impediment to transmission could be the higher cost of funds faced by NBFCs. NBFCs rely on bank and market borrowings for their funding requirements and unlike banks, do not have direct access to the liquidity adjustment facility (LAF) window. Consequently, reductions in the repo rate may not immediately translate into

Table 5: Transmission to Weighted-Average Borrowing Rate of NBFCs

	Dependent Variable: WABR		
	Repo rate	WACR	91-day T-Bill rate
WABR (-1)	0.443*** (0.112)	0.442*** (0.119)	0.448*** (0.113)
Size	-0.407* (0.209)	-0.418* (0.214)	-0.400* (0.210)
CRAR	-0.00413 (0.00269)	-0.00425 (0.00265)	-0.00442* (0.00252)
ROA	-0.0659** (0.0281)	-0.0714** (0.0313)	-0.0721** (0.0334)
GDP	-0.00440 (0.00345)	0.000782 (0.00366)	0.00216 (0.00398)
Inflation	0.0216 (0.0301)	0.0230 (0.0256)	0.0367 (0.0236)
Covid Dummy	-0.0369 (0.162)	-0.0651 (0.194)	-0.0928 (0.205)
$\sum_{j=0}^2 \beta MP_{t-j}$ Summed Coefficient	0.244*** (0.0613)	0.206*** (0.0496)	0.190*** (0.0437)
Constant	7.391*** (2.229)	7.752*** (2.433)	7.494*** (2.350)
Observations	1684	1684	1684
AR1 (p-value)	0.00	0.00	0.00
AR2 (p-value)	0.32	0.27	0.27
Hansen-J (p-value)	0.51	0.58	0.54

Notes: 1. Standard errors in parentheses.
2. * p<0.10, ** p<0.05, *** p<0.010.

Source: Authors' estimates.

reduced cost of funding. Further, bank and market funding to NBFCs may also be dependent on liquidity conditions and perceived levels of riskiness, which may further dampen transmission. On the lending side, since NBFCs cater relatively to riskier borrower segments, they charge higher interest rates to account for potential defaults, which may further dampen adjustment of lending rates to changes in relevant rates.

V. Financial and Prudential Indicators

Profitability as indicated by return on assets (RoA), return on equity (RoE) and net interest margin (NIM) remained at healthy levels across the layers at end-December 2024 (Chart 8).

Table 6: Transmission to Weighted-Average Lending Rate of NBFCs

	Dependent variable: WALR				
	Repo rate	WACR	91-day T-bill rate	NBFC bond yield	WALR of banks to NBFCs
WALR (-1)	0.492*** (0.0859)	0.500*** (0.0847)	0.502*** (0.0824)	0.507*** (0.0830)	0.519*** (0.0851)
Size	-1.299*** (0.405)	-1.251*** (0.410)	-1.226*** (0.395)	-1.212*** (0.389)	-1.106*** (0.371)
CRAR	-0.0146 (0.0128)	-0.0137 (0.0138)	-0.0157 (0.0130)	-0.0163 (0.0134)	-0.0165 (0.0123)
ROA	-0.0518 (0.108)	-0.0416 (0.116)	-0.0405 (0.0986)	-0.0116 (0.0907)	-0.00700 (0.110)
GDP	-0.0119* (0.00615)	-0.0175** (0.00781)	-0.0137 (0.0114)	-0.0112 (0.00772)	-0.0110 (0.00837)
Inflation	-0.0307 (0.113)	-0.0617 (0.0997)	-0.0703 (0.0910)	-0.0361 (0.0857)	-0.0710 (0.0836)
Covid Dummy	0.233 (0.474)	0.175 (0.515)	0.647 (0.728)	-0.00467 (0.453)	-0.129 (0.503)
$\sum_{j=0}^2 \beta MP_{t-j}$ Summed Coefficient	0.329*** (0.117)	0.221** (0.0844)	0.242*** (0.0818)	0.166** (0.0709)	0.357* (0.210)
Constant	18.64*** (4.055)	18.92*** (4.164)	18.63*** (4.009)	18.40*** (3.891)	14.91*** (3.648)
Observations	1624	1624	1624	1624	1624
AR1 (p-value)	0.00	0.00281	0.00	0.00	0.00
AR2 (p-value)	0.27	0.26	0.23	0.27	0.25
Hansen-J (p-value)	0.48	0.41	0.40	0.47	0.36

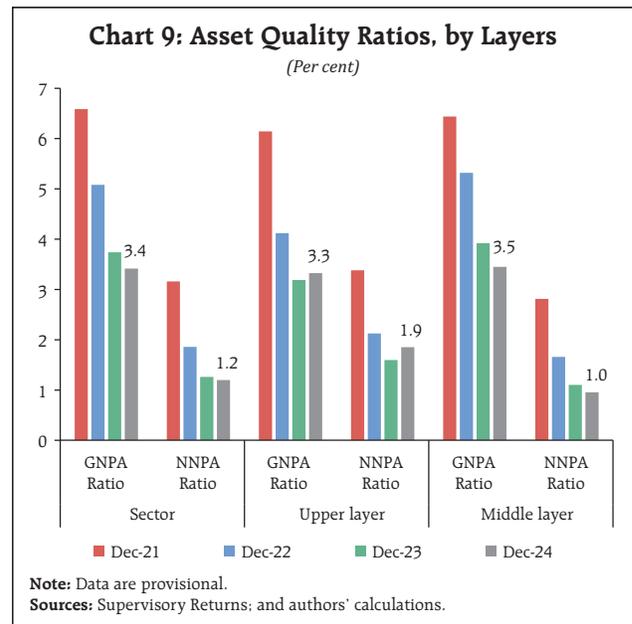
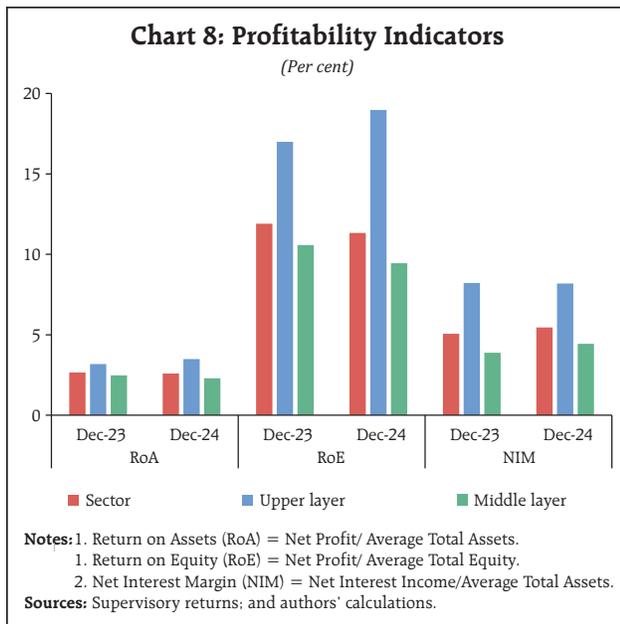
Notes: 1. Standard errors in parentheses.
2. * p<0.10, ** p<0.05, *** p<0.010.

Source: Authors' estimates.

The Reserve Bank has been closely monitoring key indicators, viz, Capital to Risk-weighted Assets Ratio (CRAR), Tier-1 capital ratio and net NPA ratio (NNPA) under the prompt corrective action (PCA) framework, which has been effective for NBFCs¹⁰ since October 2022. So far, no NBFC has been placed under the PCA framework by the Bank.

Asset quality of the NBFC sector has continued to improve in the recent years as reflected in consistent decline in NPA ratios. At end-December 2024, GNPA and NNPA ratios stood at 3.4 and 1.2 per cent, respectively. While asset quality of middle layer is in

¹⁰ <https://www.rbi.org.in/scripts/NotificationUser.aspx?Id=12208&Mode=0>



alignment with the overall sectoral trend, the upper layer witnessed a mild uptick in NPA ratios at end-December 2024 (Chart 9).

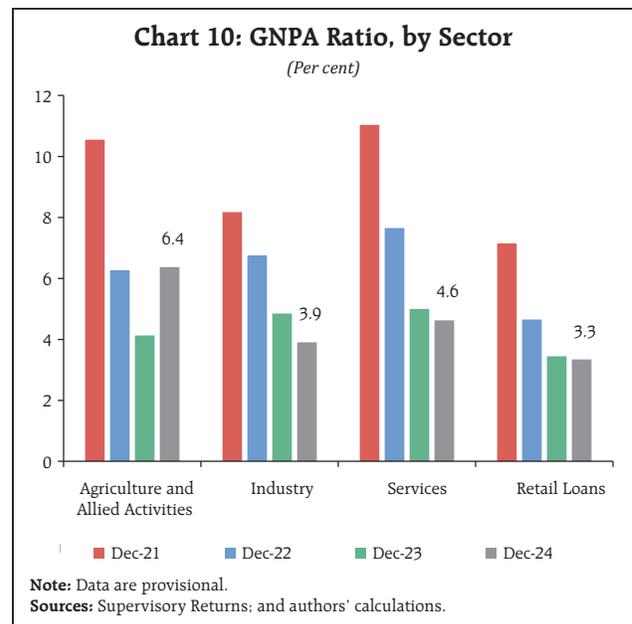
At end-December 2024, NBFCs' credit portfolio has stayed healthy, with moderation in GNPA ratios across sectors, except agriculture and allied activities (Chart 10).

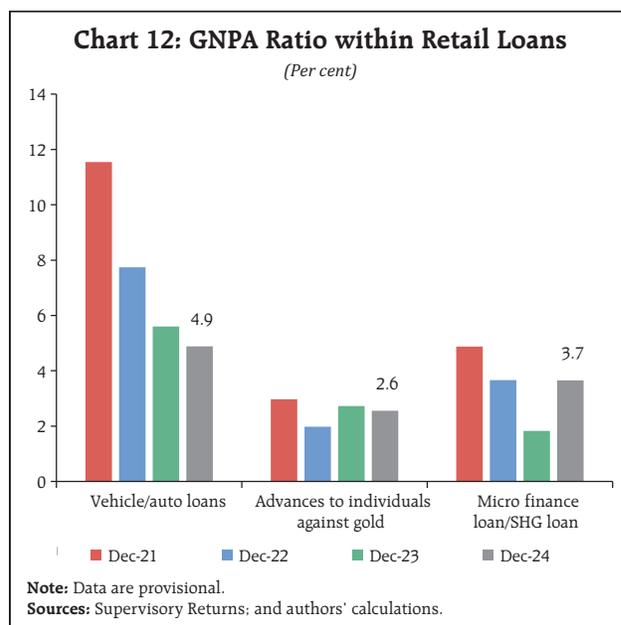
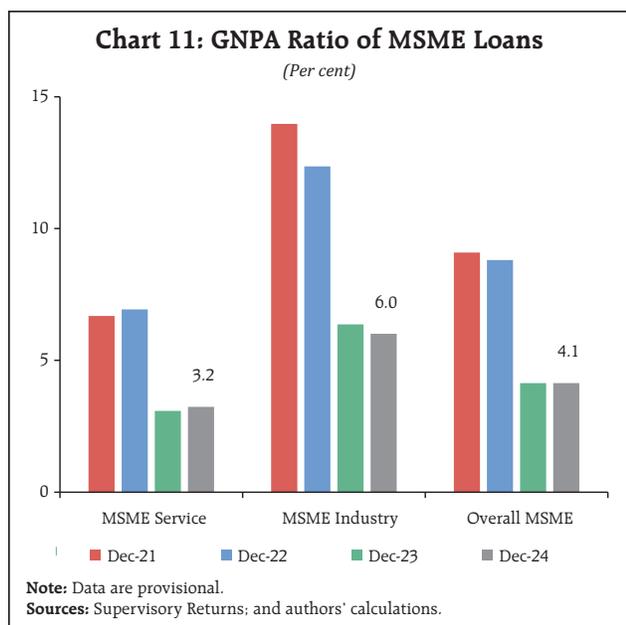
After a significant improvement in the asset quality at end-December 2023, MSME credit portfolio of NBFCs has continued to remain strong with stable level of GNPA ratio at end-December 2024 (Chart 11).

Asset quality of retail loans continue to remain stable despite the strong growth in retail loans. However, GNPA with regard to microfinance loans increased at end-December 2024 (Chart 12). NBFCs along with SROs in the microlending space should remain vigilant to ensure responsible lending practices and credit discipline among market participants.

NBFCs have consistently maintained capital buffers on their balance sheet, even beyond the regulatory requirement. At end-December 2024, at an aggregate level, the upper layer and the middle

layer kept CRAR of 20.6 per cent and 28.6 per cent, respectively (Chart 13). The disparity in the level of CRAR between the upper layer and the middle layer is mainly due to difference in ownership structure. Large government-owned NBFCs - which are placed in the middle layer by regulatory design have periodic capital infusion, resulting in higher CRAR. In contrast the upper layer, which comprises, private NBFCs are



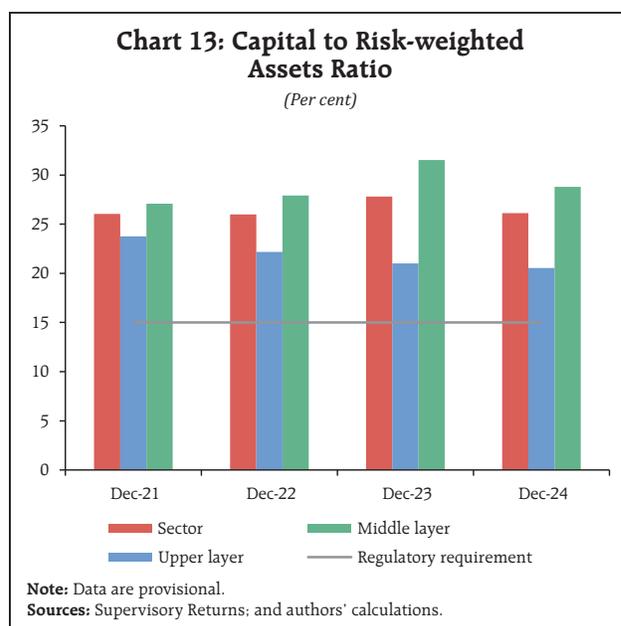


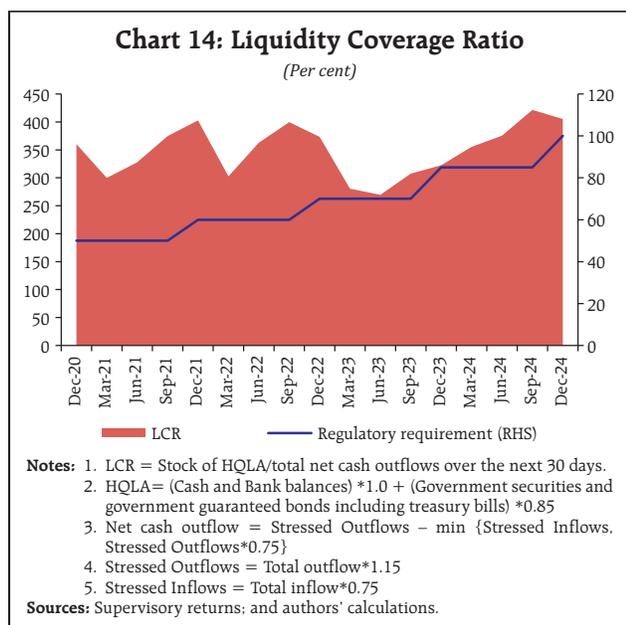
driven by profit and growth, often run with leverage and riskier loan books.

In November 2019, the Reserve Bank introduced Liquidity Coverage Ratio (LCR) framework for NBFCs to strengthen their liquidity risk management. By mandating a buffer of High-Quality Liquid Assets¹¹ (HQLAs) sufficient to cover net cash outflows over a 30-day stress scenario, the LCR enhances the short-term resilience of NBFCs. To ensure a smooth transition, the LCR requirement was implemented in a phased manner from December 1, 2020. All non-deposit taking NBFCs with assets of ₹10,000 crore and above, and all deposit-taking NBFCs, had to maintain a minimum LCR starting at 50 per cent on December 1, 2020, and reach 100 per cent by December 1, 2024. All non-deposit taking NBFCs with assets between ₹5,000 crore and ₹10,000 crore followed a similar trajectory starting at 30 per cent. This calibrated approach allowed NBFCs to gradually align with the new norms while preserving sectoral liquidity and credit flow.

¹¹ Due to data constraints, we utilise a conservative approach to estimate HQLA which might underestimate the quantum of actual HQLA maintained by NBFCs under extant regulations.

As on December 2024, the sector has been maintaining LCR beyond the regulatory requirement (Chart 14). This cautious approach may be due to the sector's reliance on short-term funding for long-term assets, which exposes them to liquidity mismatches and systemic risk. The LCR mitigates such vulnerabilities, promoting stability and market confidence.





VI. Conclusion

FSB in its report noted that, globally NBFIs sector's growth outpaced growth of the traditional banking sector. In India, NBFCs continued to record double-digit credit growth as of end-December 2024. This expansion is evident from a rising NBFC credit to GDP ratio sustained by lending to industry and retail sector, which continue to dominate their portfolio. NBFC sector remains robust in terms of various profitability and prudential indicators such as return on assets, return on equity, net interest margin, capital to risk weighted assets and non-performing assets. The spike in growth rate of unsecured loans was contained through increase in risk weights in November 2023. With regards to sources of finance, NBFCs continue to rely largely on bank borrowings and debentures. NBFCs' role in credit intermediation and

interlinkages with banks and other financial institutions have implications for transmission of monetary policy impulses to the financial sector and real economy. Empirical analysis points to the fact that there is monetary policy transmission to NBFCs' borrowing and lending rates, *albeit*, incomplete.

The prospects for segments like vehicle loans and loans against gold appear robust, buoyed by improvements in vehicle sales and rising gold prices. The introduction of LCR is set to further bolster NBFCs' short-term resilience. As the financial sector increasingly adopts artificial intelligence and machine learning, NBFCs must remain vigilant and proactively address cyber challenges by leveraging these new opportunities effectively.

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