Journal of Advances and Scholarly Researches in Allied Education
Vol. 18, Issue No. 3, April-2021, ISSN 2230-7540

The Impact of Government Intervention on the NBFC Crisis

Mr. Harshil Sharma[1]* Dr. Rinku Batrani[2]

[1] M.Com (Finance), Hemwati Nandan Bhauguana Gharwal University (A Central University), Srinagar, Uttarakhand

[2] Assistant Professor, Department of Commerce, Mahila Mahavidyalaya (P.G) College, Haridwar, Uttarakhand

Abstract – NBFC is an enterprise established in accordance with the Companies' Act of 1956 which is involved in the purchase of government-issued shares and loans. Non-bank financial firms (NBFCs) are financial entities that provide diverse banking services but have no banking licence, thus they are also known as non-bank financial institutions (NBFIs). In the financial accounts of the banking sector, non-performing assets evaluate profitability & assets quality. The quality of assets is one of the most essential aspects for evaluating a bank and NBFC's overall health. AQR is one of the key responsibilities when evaluating a bank/overall NBFC's performance. AQR should analyse the borrower's accounts. The personal loan information must be obtained by AQR. Asset quality assessment is to determine the recipient's financial health. The NBFCs sector is to be reviewed by AQR. The principles and procedures followed by qualitative methods should be determined by AQR. The ICRA except that at the conclusion of the present fiscal year the incompetence of NBFC (NPAs) would grow from 4.5% reported at the end of fiscal 2020 to 5.60% to 6.80% in loans.

Keywords – NBFC Crisis, Non-Performing Assets, Assets Quality, IL & FS

---------------------------------x---------------------------------

INTRODUCTION

Recently, the NBFC business has grown very popular. NBFC industry. NBFCs play a key role in addressing the many financial needs of bankers excluding customers to promote integrated development in the national market. NBFCs have a key role to play in implementing new financial services for micro, small and medium-sized companies (MSMEs). NBFCs are companies formed in accordance with the Companies Law (1956) which provide for loans and advances, acquisition of shares, bonds and debentures issued by government or local authorities, or other marketable securities, such as loans or leased insurance undertakings. Asset quality for evaluation of NBFCs is one of the most important criteria. The NBFCs' business is to take credit risk and profit after taking the anticipated credit expenses into account. Asset quality assessment is an asset assessment to evaluate the credit risk associated with an asset quality review. Assets quality assessment It also analyses the procedures of credit management. For NBFCs to function as an ongoing concern for future development, profitable transactions are vital. To examine the total effect, the contributing elements to the profitability of an NBFC are evaluated. Analyze the historical coverage, solvency, liquidity and profitability statistics for Assets Review. The grade of asset quality indicates the amount of possible credit risk connected with the loan and investment portfolios. Assets Quality Review follows various types of risk process i.e. operational risk, Financial Risk, Market Risk, Procedural Risk.

- **Operational Risk:** Project Status, Offices, Business Cycle
- **Financial Risk:** Debt Equity Ratios, Profitability Ratios, Liquidity Risk
- **Market Risk:** Industry Analysis, Market Demand & Supply Condition
- **Procedural Risk:** Submission with rules & Procedure related to penalty of loan.

NBFCs and Indian Economy -The following are the major contributions of NBFCs towards the growth of Indian Economy:

- Mobilization of Financial Resources
- Providing long term Credits
- Enhancing the Financial Market
- Future improvements with NBFCs

Asset Quality – overall condition. The quality of the loan portfolio and the credit administration procedure are the main variables that influence the overall quality of the assets. Loans usually include the bulk of the assets of a bank and entail the highest risk. Securities may also include a substantial part of the assets and include considerable risks. Other elements that may affect the quality of assets include other properties, other assets, off-balance sheet items, cash and accounts, properties and fixed assets to a lesser degree.

Asset Quality Review- Asset Quality Review ("AQR") is the evaluation of an asset to measure the credit risk associated with it. It also evaluates the credit administration processes and helps identify the deficiencies in the processes. As a concept, an AQR endeavors to ascertain the true value of the asset/loan on the books of a lender, considering the Repayment capacity of the borrower, value of collateral security provided by the borrower, analysis of financial statement of the borrower, legal enforceability of the collateral security, other industry and market factors. AQR provides important guidance to value the loan closer to its realistic value and make timely provision/ write off, as the case may be.

Asset Quality Review (AQR) Process Flow – Parameters

S. No.	Type of Risks	Asset Quality Review (AQR) Process Flow - Parameters
1.	Operational Risk	Project Status, Apartments/Offices/ Shops booking %, Apartments / Offices / Shops booking due amount v/s collected, industry and business life cycle in which borrower is operating, stage of production of inventory, Ageing of the receivables.
2.	Financial Risk	Debt service coverage ratio, Debt to Equity Ratio, Profitability ratios, Liquidity and solvency ratios, Repayment track record (Default/Delays in the past), External Credit Rating, if available, Liquidity Risk, Risk Categorization, Access to multiple funding source.
3.	Security/Collateral & Market Risk	Loan to Value ratio, Escrow of Receivables, Marketability of collateral security, Industry Outlook, Demand & supply situation.
4.	Procedural Risk	Compliance with procedures related to sanction and disbursement of loans, end use and ongoing monitoring procedure post disbursal

OBJECTIVES OF THE STUDY:

- To study the reasons of NBFCs Crisis in India.
- To study the COVID-19 impact on NBFCs/Banks.
- To study the need of Assets Quality Review (AQR) on NBFCs.

RESEARCH METHODOLOGY:

The present study based on the descriptive type of research. This paper is based on secondary data mainly focuses on Literature review, Research Paper, Journals, websites. The data is also collected from Government websites.

1. **Need for AQR (Asset Quality Review) in Indian NBFCs-** The debt crisis in IL&FS has already to effect the growth of the NBFCs sector in India. Many corporate, mutual funds, and insurance companies have invested in Commercial papers of the IL&FS group. In January – March 2019, excluding gold and personal lending decreased by 31%. Overall, the loan from NBFCs to NBFCs reduces by 6.1 per cent from Rs. 9.65 lakh crores (2017-18). For the 2018-2019 financial year, NBFCs evaluated the trade sector funding stream for 29.6 percent. Such sector as Automobiles, MSME is the higher contribution of NBFCs.

1.1. NBFC Crisis in India:

NBFCs accounted for ~29.6% of the flow of funds to the commercial sector in FY 2018-19. In sectors such as automobile, real estate and Micro, Small & Medium Enterprises ("MSME"), the contribution of NBFCs is higher. Also, ~40% of the incremental consumer financing in FY 2018-19 was done by the NBFCs.

In addition to planning and developing infrastructure projects, IL&FS is also a "shadow bank" Infrastructure Leasing & Financial Services. "On Aug. 27, 2018 IL&FS defaulted in repayment of ~INR 450 crore of inter-corporate deposits (ICDs) to the Small Industries Development Bank of India (SIDBI). In September 2018, IL&FS and its subsidiary, IL&FS Financial Services, also delayed payments on ICDs and commercial papers, instruments that mature in less than a year. The consolidated debt of IL&FS is estimated at ~INR 90,000 crore. Rating agencies, such as ICRA and Care Ratings, downgraded IL&FS and its certain subsidiaries from investment grade to junk in September 2018. While the sudden and sharp downgrade in credit rating led to decline in the value of NCDs and bonds issued by IL&FS/ its subsidiaries and affected the mutual funds which invested in those instruments, it significantly dented the market sentiments on NBFCs in general.

In FY 17-18, the group incurred a net loss of ~INR 2,100 Crore while, in the same year, short-term debt (payable within 12 months) alone went up by ~INR 13,600 crore. Every subsidiary and every SPV have taken use of their reputation/market status (major parts of which, it should be noted, are not actually earning). The function performed by the board of directors is sharply concentrated here. The Board is always short in directing the policy and in overseeing the execution of the approved policy, and the Board has not carried out its fundamental responsibilities in this case. The risk management committee had not met after July, 2015 indicating complete negligence of corporate governance.

IL&FS's defaults had a significant impact on India's credit markets. According to Moody's Investor Services, the outstanding debentures and commercial papers of the company amounted to 1%

and 2% of the domestic debt markets in India as of 31 March 2018. Its borrowings of banks, on the other hand, range from 0.5% to 0.7% of banks' system loans, approximately INR 57 000 crore. Defaults have caused Indian lenders a greater difficulty, fighting already against a large pile of bad loans.

1.2. Reasons for the NBFC Crisis in India: The main reasons behind the NBFCs crisis are as follows:

(a) **Asset liability mismatch:** Indian NBFCs borrowed and lent the money for the short term. The failure to match this asset obligation was clearly a formula for a catastrophe. IL&FS crisis made the faulty business model of the NBFCs more weak. Since the NBFCs were not able to issue new debt in order to roll over the old debt.

(b) **Bank and Mutual Funds:** Mutual Funds which bought short term securities issued by NBFCs for 90-120 days and which also subscribed to their NCDs/Bonds.

(c) **Asset quality issues:** The Major reason for the crisis was the high cost of borrowing, the contribution of asset quality i.e portfolio concentration of the NBFCs cannot be ignored.

(d) **Domino Effect:** The exposure to the NBFC sector came down due to IL&FS issue and we saw a decline in consumption & decline in its financing.

1.3. Overall Effect on NBFCs crisis in India:

► The NBFCs sectors were giving the real estate sectors funds to start newly projects, construction.

► The real estate sector is conflicting to secure liquidity.

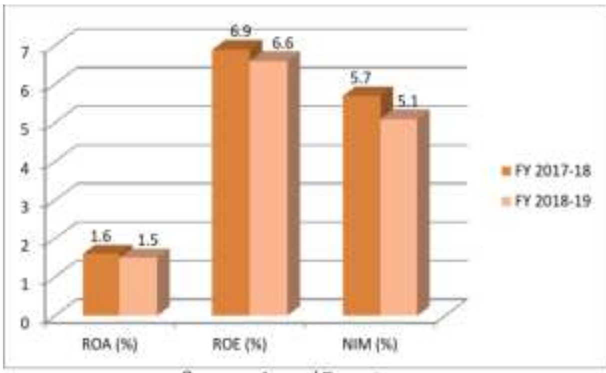
► The profitability indicators of NBFCs is to return on assets, return on Equity down by financial year 2018-2019.

► The NBFCs crisis has also historically reduced the borrowings of the aspect homebuyers.

1.4 Profitability of NBFC in India:

Although the NBFC industry expanded from 26.2 LKH crore in FY 2017-18 to 30.9 LKH crore in FY 2018-19, in the post-IL&FS events rating declines and liquidity stress have led to a weaker growth rhythm than in FY 2017-18. Return on assets (RoA), equity rates (RoE) and net interest margin (NIM) metrics were decreasing in FY 2018-19, indicating industry stresses. In almost every category, NBFCs NDSI led to the overall decline in profitability.

Profitability ratio of NBFCs in India



Source - *Annual* Reports

1.5. Assets Liability Mismatch in Indian NBFCs

NBFCs have been ongoing a large assets-liability mismatch. NBFCs are given to run mismatches in the short term maturity periods. Liabilities in every class are increasing compare to the assets with the same period of maturity.

LIC Housing Finance

Time Horizon	Liabilities Maturity (%)	Asset Maturity (%)
<6 months	13	7
6-12 months	21	9
1-3 years	33	10
3-5 years	14	10
> 5 years	20	64

Source-*RBSA ADVISORS*

As we can see in above table, the subject company has asset-liability mismatch in mostly all categories of assets/liabilities classified with respect to their maturity. Liabilities in every class are exceeding compare to the assets with same period of maturity (except maturity above 5 Years).

India bulls Housing Finance

Time Horizon	Liabilities Maturity (%)	Asset Maturity (%)
<6 months	18	25
6-12 months	11	11
1-3 years	40	33
3-5 years	25	21
> 5 years	5	9

Source-*RBSA ADVISORS*

As we can see in above table, the subject company has asset-liability mismatch in category with maturity 1-5 years. Liabilities maturing in 1 – 5 years are exceeding compared to the assets with same period of maturity.

1.6. Assets Quality of Indian NBFCs

The worsening of asset quality was recorded for the NBFCs in FY 2018-19. While the GNPA ratio was increasing, the net income ratio (NNIAs) was slightly reduced, while capital adequacy deteriorated. The asset quality of the industry showed a marginally rise in the GNPA ratio in FY 2019-20 (up to September).

Assets Quality of Indian NBFCs

Years	GNPA Ratio (%)	NPA Ratio (%)	CRAR (%)
FY15	4.1	2.5	26.2
FY16	4.5	2.5	24.3
FY17	6.1	4.4	22.1
FY18	5.3	3.3	22.1
FY19	6.1	3.4	20.0
H12020	6.3	3.4	19.5

Source-*RBI's Financial Stability Report, Dec 19*

In terms of composition of assets, the share of standard assets decreased, part of which in FY 2018-19 was reduced to the class of under standard assets. While the percentage of under standard assets remained constant in H1 of fiscal year 2019-20, there was a rise in the proportion of dubious assets throughout the review period.

Classification of NBFC assets

Type of NBFC Assets	FY 18 (%)	FY19	FY20(H1)
Standard	94.7	93.9	93.7
Sub-Standard	3.0	3.9	3.9
Doubtful	2.1	2.0	2.3
Loss	0.20	0.20	0.10

Source-*RBI's NBFC Report*

CONCLUSION

A complete AQR has not yet been passed on to NBFC (and Housing Finance Corporations). NBFCs are also more exposed than banks to stressful industries like immobilisation and construction. Some NBFC loans continue to show up as performing with substantial, back-end scheduled repayments even if the borrower is unable of repayment. Reported bank advance fraud increased from FY18 to Rs 64500 crore in FY19 from INR 22,500 crore.

Under a shadow of governance problems and, in some instances, suspected wrongdoing, top profile managers/management team had to go on. Severe failures in IL&FS governance continue to occur. In an outstanding June 2019 analysis by REDD, many NBFCs may be utilising "box arrangements" to cover up financing from their own developers and associated parties. A serious misbehaviour is waged on the ecosystem by some financial, promotional, political, bureaucrat, auditors, rating agencies and other players. A confidence gap of this magnitude is the greatest nightmare and must be addressed of any financial environment.

The administration needs to develop a system that allows NBFCs to sell and raise liquidity. The right NBFCs for banks to expand their credit lines, especially in the car and real estate sectors, need to be identified. Banks may establish a debt settlement system so that the money that arrives may be utilised to repay and not be diverted to bank lending. The entire loan comprising NBFCs should be monitored every quarter by the RBI, aside from banks. At now, the apex bank monitors just banks. It should also look at the NBFCs and system liquidity in order to take up borrowing in the economy, including both NBFCs and banks. Undertake an AQR for NPAs in NBFCs to be identified/recognized. A customised approach is needed to overlap NPAs. In order to resolve our NPAs, the Insolvency and Bankruptcies Code (IBC) is an useful law. However, lawsuits, delays and the full magnitude of the issue have delayed this proceeding. The judicial system has strongly to be strengthened and the IBC implemented effectively, to guarantee that the resolution procedure is implemented in a timely way. The whole of the ecosystem — banks, capital markets, auditors and rating agencies as well as regulators, as well as industries like real property and electricity – has to be reformed thoroughly. We are waiting for acceptance and execution, ready and practical suggestions.

REFERENCES

Vansh Chowdhary (2019). "Liquidity Crisis in the Indian Economy," Money Wise, Vol. 7, pp. 5-8.

Priyanshu Agarwal, Vaishanvi Vyas (2020). "Analysing the NBFC Crisis vis-a-vis its Impact on Crippling Economy of India," ACCLAIMS, Vol. 9.

Vijaya Kittu, M., & Prasada Rao, S. (2019). Lessons from the IL&FS Financial Crisis. 2nd International Conference on Business and Management (ICBM 2019) (pp. 644-648). Dhaka, Bangladesh: BRAC University.

Richard Paul Vethamuthu (2019)."Impact of Asset Quality on Financial Performance of Banks in India: A Comparative Study of Public and Private Sector Banks".

International Research Journal of Commerce, Arts and Science,Volume 10 Issue 7.

Dolly Gaur , Dipti Ranjan , Paratp Ranjan (2020)"ASSET QUALITY OF INDIAN BANKING SECTOR AND THE ROLE OF GOVERNMENT DIRECTED CREDIT SCHEMES"Journal of Critical Reviews,VOL 7, ISSUE 15, 2020.

Websites

https://www.rbi.org.in/

https://www.bseindia.com/

https://rbsa.in/

https://economictimes.indiatimes.com/industry/banking/finance/nbfcs-to-face-funding-constraints-in-2020-reports/articleshow/72576625.cms https://www.businesstoday.in/opinion/columns/nbfc-crisis-domino-effect-on-indian-economy-ilfs-scam-gdpgrowth/story/378109.html

https://www.managementstudyguide.com/great-indian-nbfc-crisis.htm

https://theprint.in/economy/nbfc-crisis-is-a-big-hurdle-in-indias-path-out-of-the-pandemic/406412/

https://www.livemint.com/industry/banking/the-ripple-effect-of-the-nbfc-crisis-on-the-economy1557242882381.htm

Corresponding Author

Mr. Harshil Sharma*

M.Com (Finance), Hemwati Nandan Bhauguana Gharwal University (A Central University), Srinagar, Uttarakhand

hkaushik345@gmail.com