

KIRTANE & PANDIT



From Shadow to Structure

India's NBFCs at a Regulatory Inflection Point

MAY 2026

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01. EXECUTIVE SUMMARY



India's NBFC sector has become a central pillar of the financial system, with total credit reaching nearly ₹48.39 lakh crore in FY25 and growing at 19.4% year-on-year. NBFCs now account for almost one-fourth of the credit extended by scheduled commercial banks, driven by their strong presence in retail lending, MSME finance, rural credit, and small-ticket personal loans. Their operational flexibility and localised underwriting continue to support financial inclusion in segments underserved by traditional banks.

The sector is currently undergoing a major regulatory and structural transition. Recent reforms, including the RBI's Master Directions 2025 and the recognition of the Finance Industry Development Council as a self-regulatory organisation, signal a shift toward tighter governance, stronger compliance standards, and greater accountability. Simultaneously, digital lending norms, microfinance regulations, and data protection requirements under the DPDP framework are reshaping lending practices across the industry.

A key development is the introduction of the Co-Lending Arrangements Directions 2025, effective from January 2026. These guidelines expand co-lending beyond priority sector lending and reduce minimum retention requirements, allowing NBFCs to increasingly function as credit originators and servicing partners alongside banks. This model is expected to improve capital efficiency, reduce funding pressure, and support scalable lending growth, though it also raises operational and technological challenges.

Business models within the sector are also evolving. Many NBFCs are shifting from unsecured consumer credit toward secured products such as gold loans, vehicle finance, and mortgage-backed lending. Securitisation activity is also increasing as institutions seek alternative capital management strategies and attract institutional investors. These changes reflect a broader move toward diversified and risk-aware lending structures.

Despite strong growth, asset quality pressures are emerging. Gross stressed assets rose to around 5.9% by March 2025, particularly in microfinance and unsecured retail portfolios. Rising borrower over-indebtedness and delinquencies have prompted stricter supervisory intervention and greater focus on underwriting discipline and responsible lending practices. Funding remains another structural challenge due to dependence on bank borrowings and market instruments, although sector-wide capital adequacy remains strong at around 25.9%, providing resilience against near-term stress.

Overall, the NBFC sector is transitioning from balance sheet-led expansion toward a more regulated, technology-driven, and collaborative financial ecosystem. Digital infrastructure, AI-based underwriting, and co-lending partnerships are becoming increasingly important, while compliance and governance standards are now central to long-term sustainability. The sector's ability to adapt to these changes will shape both its future growth and the broader efficiency of credit delivery in India.



02. THE INDIAN NBFC SECTOR: CONTEXT AND SCALE



2.1 What are NBFCs? Definition and Taxonomy

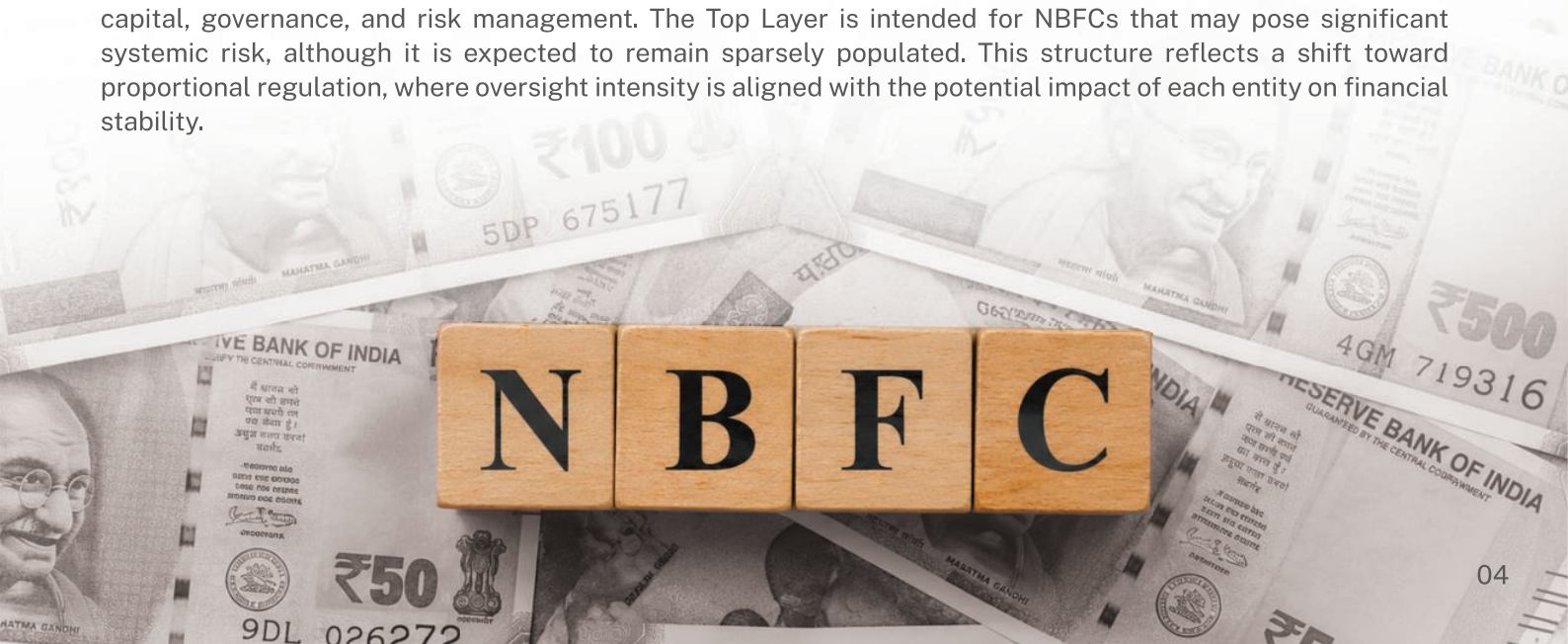
Non-Banking Financial Companies, commonly referred to as NBFCs, are financial institutions that provide credit and related financial services without operating as full-service banks. Under the regulatory framework of the Reserve Bank of India, an NBFC is defined as a company registered under the Companies Act that engages in activities such as lending, acquisition of shares or securities, leasing, hire-purchase, insurance, or chit business. The defining condition is that financial activity must constitute the entity's principal business. In practice, this is assessed through the “50-50 test”, where financial assets must account for more than 50% of total assets and income from financial assets must account for more than 50% of gross income.

The distinction between NBFCs and banks is foundational to understanding their role in the financial system. NBFCs are not permitted to accept demand deposits, which limits their ability to offer savings or current account services. They are also not part of the payment and settlement system, meaning they cannot issue cheques drawn on themselves. Regulatory requirements further differentiate the two. NBFCs are not subject to Cash Reserve Ratio or Statutory Liquidity Ratio mandates that apply to banks, although they are governed by capital adequacy, provisioning, and liquidity norms that have been progressively tightened over time. These differences allow NBFCs greater operational flexibility, particularly in niche and underserved markets, while also making their funding structures more dependent on wholesale sources such as bank borrowings and market instruments.

Within this regulatory boundary, NBFCs are classified based on the nature of their activities. Asset Finance Companies focus on financing physical assets such as vehicles, equipment, and machinery, and are closely linked to sectors like transportation and logistics. Loan Companies primarily provide unsecured or secured loans to individuals and businesses, without being tied to any specific asset class. Investment Companies are engaged in acquiring securities, often acting as holding or investment entities within larger corporate structures.

More specialised categories reflect the evolving needs of the financial system. NBFC-MFIs operate in the microfinance space, extending small-ticket loans to low-income borrowers, typically through joint liability group models. NBFC-HFCs focus on housing finance and play a major role in expanding access to home loans, especially in semi-urban and rural markets. Infrastructure Finance Companies and Infrastructure Debt Funds are designed to support long-term infrastructure financing, addressing a segment where traditional bank lending is often constrained by asset-liability mismatches. NBFC-Factors specialise in receivables financing, providing liquidity to businesses by purchasing their trade receivables.

The sector is also shaped by a layered regulatory approach introduced through Scale-Based Regulation. This framework categorises NBFCs into Base, Middle, Upper, and Top layers based on their size, activity, and systemic importance. Entities in higher layers are subject to progressively stricter requirements regarding capital, governance, and risk management. The Top Layer is intended for NBFCs that may pose significant systemic risk, although it is expected to remain sparsely populated. This structure reflects a shift toward proportional regulation, where oversight intensity is aligned with the potential impact of each entity on financial stability.





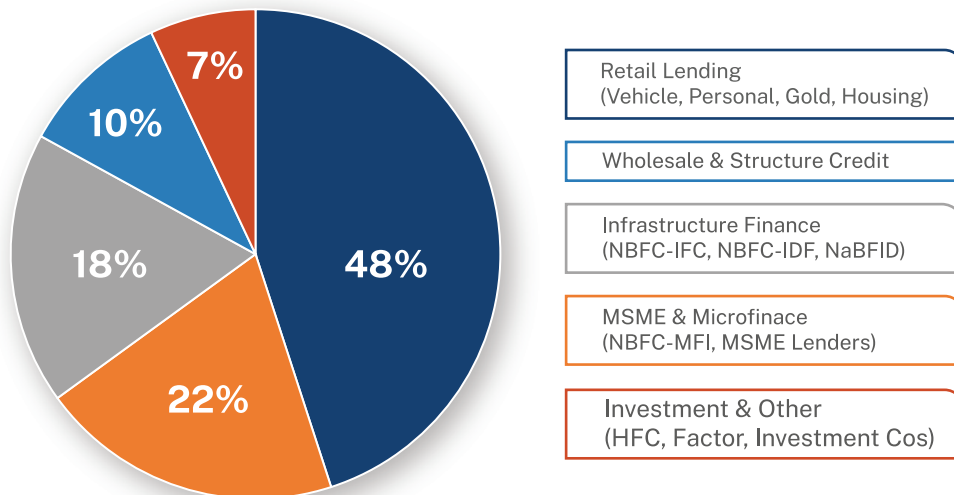
In a broader context, the evolution of NBFCs in India mirrors global trends in non-bank financial intermediation. Following the 2008 Global Financial Crisis, there has been a visible shift toward more formal regulation of shadow banking activities across jurisdictions. India’s approach has followed a similar trajectory, moving from a fragmented and lightly supervised ecosystem to one characterised by clearer definitions, tighter prudential norms, and increasing integration with the formal financial system. NBFCs today operate not as parallel institutions but as complementary components of the credit architecture, filling gaps in distribution, risk appetite, and product design that remain outside the traditional banking model.

2.2 Sector Scale and Key Metrics

The scale of the NBFC sector today reflects both its rapid expansion and its deep integration into India’s credit architecture. By September 2025, aggregate lending by upper and middle layer NBFCs had grown by nearly 21.3% year on year, driven largely by strong retail and MSME demand. Industry estimates suggest that overall NBFC assets under management crossed the ₹50 lakh crore mark by March 2026, continuing to outpace the broader banking system in credit growth.

The composition of this growth highlights the sector’s evolving strengths. Retail and MSME lending remain the primary engines of expansion, supported by rising formalisation, improved digital credit assessment, and deeper penetration into Tier II and Tier III markets. Services sector lending has continued to expand strongly as NBFCs cater to trade, logistics, small enterprises, and self-employed borrowers who often require more flexible underwriting than traditional banks can provide. Secured retail products such as gold loans, loans against property, vehicle finance, and affordable housing finance are increasingly driving incremental growth as lenders rebalance away from unsecured consumer credit.

Infographic 1: NBFC Sector - Sub-Sector Composition



Source : Credit Share, Estimated FY25

A defining feature of NBFCs remains their dominance in small-ticket and underserved credit segments. RBI-linked assessments show that NBFCs continue to account for a disproportionately large share of low-value personal loans and last-mile retail lending. Their strength lies in distribution reach, faster turnaround times, and the ability to assess borrowers with limited formal credit histories. This has reinforced their importance in rural and semi-urban credit delivery, particularly for micro-enterprises and lower-income households that remain outside the core customer base of many banks.



From a balance sheet perspective, the sector remains relatively resilient despite emerging pockets of stress. Capital adequacy levels continue to remain comfortably above regulatory requirements, while profitability and liquidity indicators remain broadly stable. However, pressures in microfinance portfolios and unsecured retail credit have become more visible through FY25 and H1 FY26, prompting many NBFCs to adopt a more cautious, secured-lending-oriented strategy. Regulatory tightening and supervisory scrutiny have also accelerated the shift toward stronger underwriting standards and more disciplined growth models.

Looking ahead, medium-term projections remain structurally positive. Industry estimates indicate that NBFC credit is expected to grow at a CAGR of roughly 15–17% through FY28, with total sector credit projected to reach nearly ₹74–77 lakh crore by FY28. Growth is expected to be driven by retail lending, MSME formalisation, infrastructure financing, and the increasing adoption of co-lending and securitisation structures. Gold loans, secured MSME finance, and affordable housing are projected to remain among the fastest-growing segments over the next three to five years.

At a systemic level, NBFCs are no longer peripheral participants operating in niche segments. They have become integral to India’s broader credit ecosystem, complementing bank lending through co-lending arrangements, risk-sharing structures, and specialised financing models. Their growth trajectory is closely tied to consumption demand, MSME activity, infrastructure investment, and financial inclusion objectives. The sector’s future relevance will depend not only on sustaining growth, but also on how effectively institutions manage funding risks, asset quality pressures, and increasingly stringent regulatory expectations in a more formalised financial environment.

Table 1: NBFC Sector - Key Financial Metrics (FY23–FY25)

Metric	FY23	FY24	FY25
Total Credit (₹ lakh crore)	30.1	36.8	48.4
YoY Credit Growth (%)	18.3%	18.4%	19.4%
CRAR (%)	27.1%	26.6%	25.9%
Gross Stressed Assets (%)	5.8%	4.8%	5.9%
Combined Write-off Ratio (%)	38.2%	42.1%	46.4%
Upper Layer Write-off Ratio (%)	58.4%	65.3%	72.9%
Services Sector Credit Growth (%)	22.5%	25.1%	29.8%
NBFC Credit as % of SCB Credit	21.8%	23.4%	~25%

03 . REGULATORY ARCHITECTURE & THE 2024-25 POLICY OVERHAUL

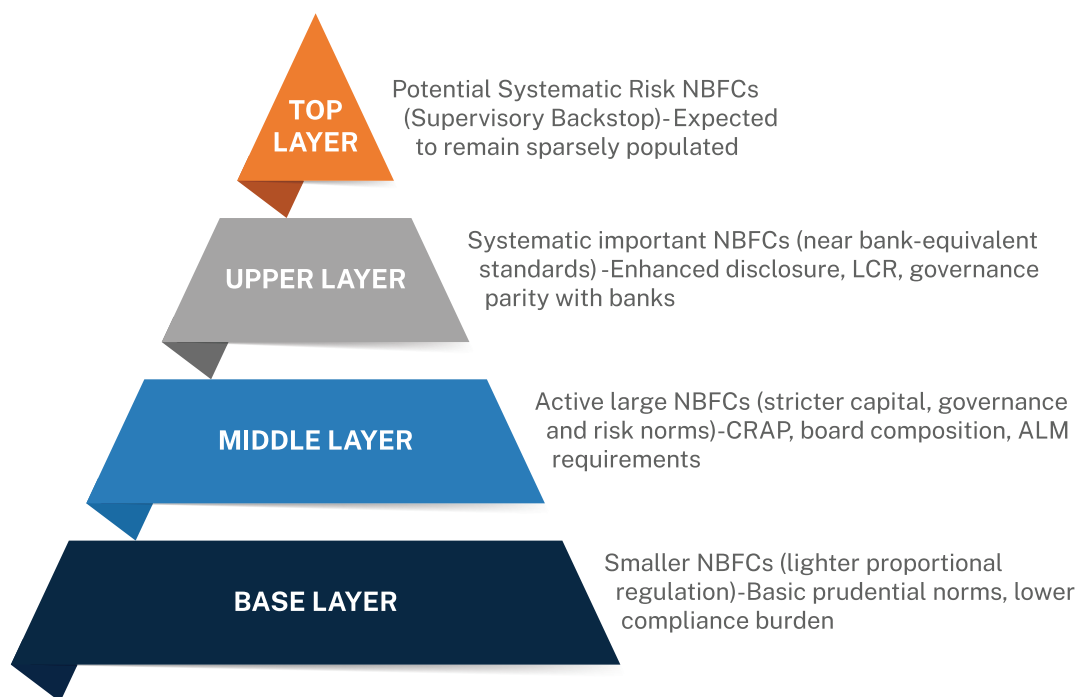


3.1 Current Regulatory Framework

The regulatory framework governing NBFCs in India has undergone a fundamental transformation over the past decade, with the most decisive shift occurring after the IL&FS Crisis 2018. That episode exposed structural weaknesses in liquidity management, governance standards, and regulatory oversight within large NBFCs. In response, the Reserve Bank of India moved away from a relatively uniform regulatory approach toward a more calibrated system that aligns regulatory intensity with the size and systemic importance of entities. This shift laid the foundation for the current Scale-Based Regulation framework, which now anchors NBFC supervision in India.

Scale-Based Regulation, introduced in 2021 and operationalised through subsequent directions, classifies NBFCs into four layers: Base Layer, Middle Layer, Upper Layer, and Top Layer.

Infographic 2: NBFC Regulatory Pyramid - Scale-Based Regulation Framework



A key feature of this framework is proportionality. Instead of imposing uniform rules across the sector, the regulatory approach scales requirements based on risk. This allows smaller NBFCs to operate without excessive compliance burden while ensuring that larger and more interconnected entities adhere to higher standards of oversight. The framework also reflects a broader convergence agenda, in which large NBFCs are gradually brought closer to banks in regulatory expectations, particularly in areas such as liquidity coverage, capital buffers, and corporate governance.

The Reserve Bank of India remains the primary regulator for NBFCs, responsible for registration, prudential regulation, and supervision. However, the regulatory landscape is not entirely centralised. Certain categories of NBFCs are subject to additional oversight based on their activities. Housing Finance Companies are regulated by the National Housing Bank, particularly in relation to housing finance-specific norms, while market-linked activities involving securities may bring NBFCs under the purview of the Securities and Exchange Board of India. This multi-regulator environment requires NBFCs operating across segments to manage overlapping compliance obligations and reporting requirements.



Another defining aspect of the current framework is the increasing emphasis on governance and risk management. Regulatory expectations now extend beyond capital adequacy and asset classification to include board-level oversight, internal controls, and accountability structures. NBFCs in higher regulatory layers are required to strengthen board composition, establish specialised committees, and implement robust risk management frameworks that cover credit, liquidity, and operational risks. There is also a growing focus on transparency through enhanced disclosure requirements, which aim to improve market discipline and investor confidence.

Liquidity regulation has also become more prominent following the lessons of past crises. Larger NBFCs are now subject to liquidity risk management frameworks that include monitoring asset-liability mismatches, maintaining liquidity buffers, and stress testing funding profiles. These measures are designed to reduce the likelihood of sudden funding disruptions and limit contagion effects within the financial system. At the same time, provisioning norms and asset classification standards have been tightened to ensure earlier recognition of stress and a more realistic reflection of balance sheet quality.

The current regulatory architecture, therefore, reflects a deliberate shift from reactive supervision to a more structured and forward-looking approach. It combines proportional regulation through the layering system, stronger governance expectations, and tighter prudential norms to create a more resilient sector. While this has increased compliance costs and operational complexity, it has also reduced systemic vulnerabilities and more closely aligned the sector with the broader financial stability objectives of the economy.

3.2 FIDC as SRO (October 2025) – Landmark Governance Shift

One of the most symbolically and structurally significant developments in the NBFC sector in recent years was the Reserve Bank of India's decision in October 2025 to grant Self-Regulatory Organisation status to the Finance Industry Development Council. This was the first time the RBI had conferred SRO status on an industry body with a mandate that covers the broader NBFC sector, marking a formal transition from a period in which the sector operated with limited institutional self-governance to one in which peer accountability, standard-setting, and conduct oversight are institutionalised through a recognised body.

FIDC's mandate as an SRO encompasses several distinct functions. It is empowered to set conduct standards and codes of practice that member NBFCs are expected to follow, particularly in areas such as fair lending, customer communication, and grievance handling. It operates a formal grievance redressal mechanism that offers borrowers and counterparties an avenue beyond direct engagement with individual lenders. It also undertakes compliance monitoring, meaning member institutions are subject to a layer of peer oversight that supplements direct RBI supervision. These functions collectively create a more formalised accountability architecture, particularly relevant for mid-sized and smaller NBFCs where RBI supervisory capacity is more limited.



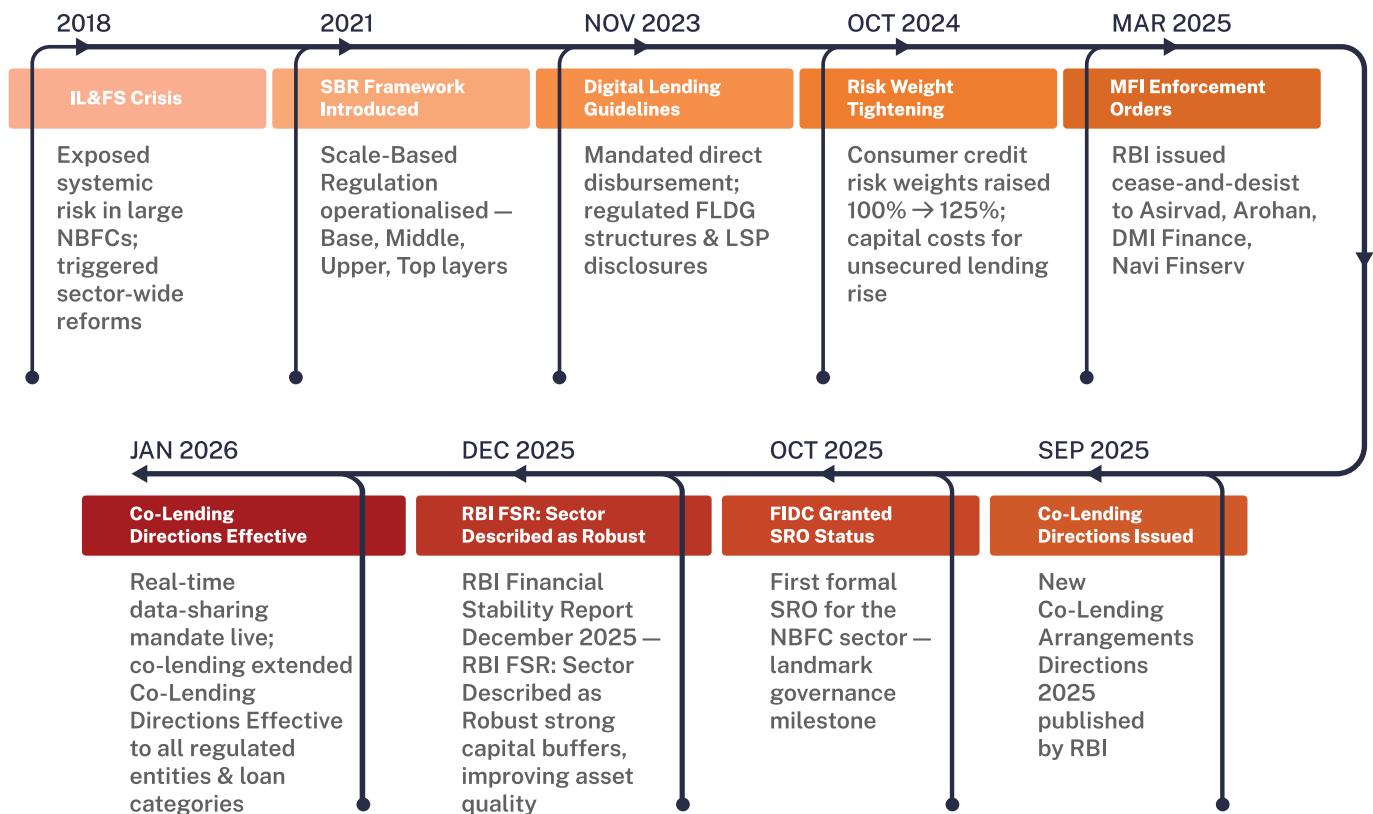


The operational implications for NBFCs are material. Membership of FIDC as an SRO is expected to become a baseline expectation for regulated entities, particularly those in the Middle and Upper layers of the Scale-Based Regulation framework. CFOs and audit committees at these institutions now face new obligations around conduct reporting, participation in SRO compliance reviews, and adherence to standards that may be more granular than what the RBI directly mandates. For governance functions within NBFCs, this introduces an additional layer of accountability that operates on a shorter feedback cycle than traditional regulatory examinations.

From a systemic perspective, the granting of SRO status to FIDC signals that the RBI views industry-level self-governance as a necessary complement to direct oversight, particularly as the sector continues to grow in size and complexity. The precedent is significant. It parallels the role that self-regulatory organisations play in securities markets and in the payments ecosystem, where entities like AMFI and NPCI operate with delegated standard-setting and oversight functions. The NBFC sector’s integration into a similar institutional architecture reflects a maturation of its regulatory standing.

The longer-term implication is a sector in which conduct standards are enforced not only through periodic RBI interventions but through continuous industry-level monitoring. Entities that fall short of FIDC standards may face reputational consequences within the industry before any formal regulatory action is triggered. This changes the calculus for governance investment at the firm level, particularly for entities seeking to access co-lending partnerships, institutional funding, or external ratings, all of which increasingly incorporate governance quality as an assessment criterion.

Infographic 3: NBFC Regulatory Timeline – Key Milestones (2018–2026)





3.3 Co-Lending Arrangements Directions, 2025

The Co-Lending Arrangements Directions 2025, issued by the Reserve Bank of India and effective from January 1, 2026, represent the most consequential structural reform to the NBFC lending model in recent years. These directions supersede the Co-Lending Model circular issued in 2020, which was limited in scope to priority sector lending between banks and NBFCs. The 2025 framework expands the eligible universe substantially, applying co-lending norms to all regulated entities, including commercial banks, All India Financial Institutions, and all categories of NBFCs, including Housing Finance Companies, regardless of whether the lending is in the priority sector.

The architecture of the new directions reflects several deliberate design choices. The minimum loan retention requirement per participating entity has been reduced from 20% to 10%, thereby lowering the capital commitment required for each co-lending arrangement and making the model more accessible to smaller NBFCs with constrained balance sheets. The framework introduces an irrevocable commitment structure, under which each party's obligation to fund its share of the loan is binding from the point of disbursement. This reduces operational ambiguity and protects borrowers from funding gaps mid-loan. The directions also clarify the basis on which risk and returns are apportioned between co-lenders, providing greater commercial certainty for deal structuring.

For NBFCs, the economic implications are significant. The co-lending model creates a pathway to originate credit volume without proportionate increases in on-balance-sheet exposure. An NBFC that retains 10% of each loan while passing 90% to a bank partner effectively uses its origination capabilities and distribution network as the primary source of value, generating fee income through servicing while managing a fraction of the credit risk. For mid-tier NBFCs that face constraints on wholesale funding or are approaching leverage limits, this changes the scalability parameters of their business models. The ability to grow the loan book without equivalent growth in borrowings is particularly valuable in the current environment of elevated funding costs.

The technology requirements of the 2025 directions are among their most operationally demanding aspects. Real-time loan-level data sharing between co-lending partners is now mandatory, requiring both parties to maintain compatible data infrastructure, application programming interfaces, and reporting systems. This mandate has been flagged by both banks and NBFCs as a significant readiness challenge ahead of the January 2026 effective date. Many institutions are investing in core banking upgrades, middleware integration, and data governance frameworks to meet these requirements. The compliance cost is high, particularly for smaller entities that may lack the technical capacity to implement real-time data exchange at scale.

Beyond the operational dimension, co-lending is reshaping competitive dynamics within the sector. Banks benefit from access to NBFC distribution networks and underwriting expertise in segments where their own penetration is limited. NBFCs gain access to lower-cost bank funding and the ability to serve larger loan volumes. However, the arrangement also introduces dependency and alignment risk. Divergences in credit assessment standards, risk appetite, and customer-servicing norms among co-lenders can create friction. The RBI's framework requires joint accountability for customer outcomes, placing additional obligations on both parties to align on fair practices and conduct standards throughout the loan lifecycle.





3.4 Other Key 2024-25 Regulatory Actions

The co-lending framework and FIDC SRO are the most prominent developments of the 2024–25 regulatory period, but they are accompanied by several other actions that collectively constitute one of the most active regulatory years for the NBFC sector. Together, these measures reflect a deliberate effort by the RBI to modernise the regulatory architecture, address emerging risks, and bring NBFC oversight into closer alignment with the governance standards applied to the banking system.

The RBI Master Directions 2025 represent a consolidation exercise of considerable scope. Prior to this, NBFC regulation in India was distributed across a large number of individual circulars, notifications, and master directions issued over many years, creating a complex and sometimes inconsistent compliance landscape. The 2025 Master Directions consolidate this body of rules into a unified framework, simplifying navigation for regulated entities and reducing the risk of inadvertent non-compliance arising from outdated or conflicting guidance. While the consolidation does not introduce entirely new requirements in most areas, it does clarify ambiguities and, in several places, raises standards incrementally. For compliance teams, the shift to a consolidated framework reduces interpretive uncertainty and creates a clearer baseline for regulatory examination.

The NBFC-MFI Directions 2025 strengthen the regulatory framework specifically applicable to microfinance institutions. Key changes include more rigorous qualifying asset norms, which specify the minimum proportion of an NBFC-MFI's portfolio that must consist of microfinance loans meeting defined characteristics. Board oversight requirements have been tightened, with increased expectations around board-level review of lending practices and borrower protection. Credit bureau reporting obligations have been expanded to improve the visibility of individual borrower indebtedness across the sector. Importantly, the directions also formalise SRO membership as a compliance obligation for NBFC-MFIs, integrating the FIDC framework directly into the microfinance sub-sector's governance structure.

On risk weights, the period saw a partial reversal of the tightening cycle. In November 2023, the RBI had increased risk weights on consumer credit exposures from 100% to 125%, raising the capital cost of unsecured lending and prompting many NBFCs to rebalance their portfolios toward secured segments. In March 2025, risk weights on microfinance loans were restored to 100%, providing some capital relief to NBFC-MFIs at a time when the sector was already managing elevated delinquency levels. The differential treatment reflects the RBI's intent to calibrate capital requirements to risk levels rather than applying uniform tightening across product categories.

The Project Finance Directions 2025, effective from October 2025, introduce a mandatory provisioning requirement of 1% on loans to under-construction infrastructure projects. This is relevant primarily to NBFC-IFCs and NBFC-IDFs, which hold significant infrastructure loan portfolios. The provisioning norm is designed to ensure that credit risk in long-gestation infrastructure projects is recognised earlier in the loan lifecycle, rather than only when a project encounters delays or funding stress. For infrastructure-focused NBFCs, this increases provisioning costs during the construction phase but improves the transparency and consistency of balance sheet reporting.





The Account Aggregator framework, now fully operationalised, has begun to demonstrate its practical value for NBFC underwriting. By enabling real-time, consent-based sharing of financial data from banks, insurance providers, and investment platforms, the AA framework allows NBFCs to conduct more comprehensive and accurate assessments of borrower cash flows and financial health. Early adopters among large NBFCs report meaningful reductions in turnaround time for loan approvals, particularly for small-ticket personal and MSME loans where traditional documentation is limited. The AA framework is also a critical enabler of the co-lending model, as it supports the shared data environment required for real-time loan-level reporting between co-lenders.

Digital lending guidelines continue to be actively enforced. The key provisions, including requirements for direct credit disbursement to borrower accounts, restrictions on first-loss default guarantee structures, and obligations on loan service providers to disclose their relationship with regulated entities, have materially changed the commercial arrangements between NBFCs and fintech partners. Compliance with these norms has required significant restructuring of partnership agreements, fee-sharing arrangements, and customer communication practices across the digital lending ecosystem.

The Digital Personal Data Protection Act has moved from a legislative milestone to a live compliance obligation for NBFCs with digital operations. Requirements around data minimisation, purpose limitation, and consent management are now being operationalised across lending platforms, mobile applications, and partner integrations. The compliance cost is significant, particularly for NBFCs that have built their digital infrastructure over many years without a unified consent architecture. Chief Data Officers and legal teams at these institutions are actively investing in DPDP-compliant data governance frameworks, consent management systems, and data residency controls.





3.5 Regulatory Actions Currently Reshaping the Sector

While much of the regulatory activity in 2024–25 involved framework-building and consolidation, a series of enforcement actions and targeted policy interventions have had immediate and tangible effects on specific segments of the NBFC sector. These actions signal a more consequential and interventionist supervisory posture by the RBI, one that is willing to impose direct operational constraints when conduct or risk-management standards fall short.

The most significant enforcement episode was the RBI's decision in October 2024 to issue cease-and-desist orders against four NBFC-MFIs: Asirvad Micro Finance, Arohan Financial Services, DMI Finance, and Navi Finserv. The restrictions prohibited these entities from sanctioning or disbursing loans until remediation was achieved. The stated grounds included charging usurious interest rates, violations of Income Recognition and Asset Classification norms, and evidence of systematic household over-indebtedness, with aggregate debt-service obligations exceeding 50% of monthly household income. For institutions operating in the microfinance segment, these orders served as a clear signal that the RBI's tolerance for aggressive lending practices, even in segments associated with financial inclusion, had reached a firm limit. The episode also highlighted systemic concerns about the effectiveness of the joint liability group model when credit discipline breaks down across multiple lenders serving the same borrower pool.

The NaBFID partial credit enhancement facility, approved by the RBI in January 2025, represents a structurally important new instrument for infrastructure finance. The PCE facility allows NaBFID to partially guarantee infrastructure bonds issued by NBFCs and project entities, thereby raising their credit ratings and making them eligible for investment by pension funds and insurance companies that operate under investment-grade mandates. This is significant because it creates a new channel for long-duration institutional capital to flow into infrastructure financing, addressing one of the sector's structural constraints. For NBFC-IFCs and NBFC-IDFs, the PCE facility opens the possibility of bond issuances that were previously impractical due to rating constraints, thereby reducing dependence on bank borrowings for long-tenor infrastructure lending.

Gold loan guidelines issued in 2025 have introduced tighter loan-to-value norms and more prescriptive auction procedures for defaulted gold loans. These changes are reshaping the economics of gold lending for institutions such as Muthoot Finance, IIFL Finance, and the broader mid-tier gold loan sector. The lower LTV ceiling reduces the revenue-generating capacity of each gram of pledged gold, while stricter auction norms limit the flexibility lenders previously exercised in managing recoveries of pledged gold. The net effect is a compression of margins for gold-loan NBFCs and an incentive to diversify into adjacent secured-lending segments. IIFL Finance, which had already faced a lending restriction on gold loans in 2024, has been restructuring its gold loan operations in response to both the earlier regulatory action and the subsequent guidelines.

The co-lending technology gap deserves recognition as a near-term operational risk for the sector. While the January 2026 effective date of the Co-Lending Arrangements Directions 2025 provides some runway, feedback from both banks and NBFCs indicates that a significant proportion of the sector is not yet equipped to handle real-time loan-level data sharing. Core banking systems at many mid-tier NBFCs do not currently support the required API connectivity and data granularity. On the bank side, legacy infrastructure and risk management frameworks were not designed with real-time co-lending reporting in mind. The IT investment required to bridge this gap is substantial, and implementation delays could limit the practical uptake of co-lending even after the regulatory framework is in force.



04 . BUSINESS MODELS, EMERGING PLAYERS, & DIGITAL TRANSFORMATION



4.1 Core Business Models

NBFCs operate across a range of business models that reflect the diversity of financing needs they serve. The common thread is their ability to operate in segments where distribution intensity, localised underwriting, and operational flexibility are required characteristics in markets with limited or structurally constrained bank penetration.

Retail lending constitutes the largest and fastest-growing segment. Vehicle finance, gold loans, personal loans, and home loans extended through NBFC-HFCs collectively represent the core of NBFC retail credit. Vehicle finance NBFCs such as Cholamandalam Investment and Finance, Mahindra Finance, and Shriram Finance operate deep distribution networks in semi-urban and rural markets, financing commercial vehicles, tractors, passenger cars, and two-wheelers to a customer base that often lacks the documentation profiles required by banks. Gold loan NBFCs occupy a distinctive position: they offer instant, collateral-based liquidity to a wide range of income levels, from small traders to rural households, with turnaround times that no bank-based product can match. NBFC-HFCs extend home loan financing to tier-2 and tier-3 markets, where formal income documentation is often limited and property titles may be unclear, requiring underwriting expertise that goes beyond standard credit bureau checks.

MSME and microfinance lending represent the inclusion dimension of the NBFC model. NBFC-MFIs primarily operate through the joint liability group model, under which small groups of borrowers, typically women in rural or semi-urban areas, guarantee each other's loan repayments. This peer accountability mechanism reduces default risk in the absence of formal collateral and enables lending to households that are otherwise outside the formal credit system. NBFC-MFIs serve as a central distribution channel for government credit programmes, including PM SVANidhi, which provides working capital loans to street vendors, and MUDRA Yojana, which targets micro-enterprise financing. Their reach in last-mile lending is difficult to replicate through bank branch networks.

Infrastructure finance is handled primarily through NBFC-IFCs and NBFC-IDFs, operating alongside NaBFID, which has scaled rapidly since commencing disbursements in December 2022, had cumulative loan sanctions of ₹2,03,029 crore and disbursements of ₹73,748 crore as of March 31, 2025, with an outstanding loan book of ₹56,620 crore. By July 31, 2025, cumulative sanctions had grown further to ₹2,30,626 crore across 232 infrastructure projects, with roads, power, and renewable energy accounting for approximately 73% of the sanctioned portfolio. The institution's balance sheet has since crossed ₹90,000 crore and disbursements have exceeded ₹1 lakh crore. Roads, logistics, and the power sector collectively account for approximately 70–75% of NaBFID's overall portfolio, with lending extended across 16 infrastructure sectors. These institutions fund roads, energy projects, ports, and other long-gestation assets under structures that require duration matching and specialist project appraisal. Infrastructure lending requires long-term funding and an appetite for construction-phase risk that most banks manage conservatively due to asset-liability constraints, making NBFC-IFCs a structural complement to the banking system in this segment.

Wholesale and structured credit has emerged as an area of growing overlap between traditional NBFC activity and private credit. Corporate lending, real estate finance, and structured products such as mezzanine debt and cash-flow-based facilities are increasingly arranged or co-originated by NBFCs collaborating with private credit funds. This convergence reflects both the deepening of India's private capital markets and the growing sophistication of NBFC balance sheets in pricing and managing complex credit exposures.





4.2 Funding Structure

The funding profile of NBFCs remains a defining structural feature and a persistent vulnerability. Unlike banks, which can mobilise stable retail deposits, NBFCs are dependent on wholesale funding sources: bank borrowings, bond issuances, commercial paper, and securitisation. Each source carries its own cost dynamics and liquidity characteristics.

Bank borrowings continue to be the dominant funding channel despite the risk weight increase imposed in November 2023. That increase, which raised the capital cost of bank lending to NBFCs, led to a temporary tightening of credit availability and a widening of spreads. The partial rollback in March 2025 specifically for microfinance exposures has begun to ease conditions, though full normalisation is expected to take an additional six to nine months. For NBFCs, bank credit lines remain attractive due to their relative stability and lower cost compared to market instruments.

Bond issuances through non-convertible debentures recorded strong volumes in FY25, reflecting continued investor appetite for NBFC paper. Securitisation has grown into a capital recycling channel, enabling NBFCs to convert loan portfolios into pass-through certificates and direct-assignment transactions that attract mutual funds, insurance companies, and provident funds. This allows NBFCs to replenish balance sheet capacity, reduce on-book exposure, and optimise return on equity. Securitisation volumes are expected to increase further as co-lending structures and the need for capital efficiency become more prominent.

Funding cost pressure has been flagged explicitly in the Non-Banking Stability Indicator published in the RBI's Financial Stability Report for June 2025. With policy rates elevated and wholesale funding markets sensitive to credit conditions, the cost of funds for many NBFCs has risen, compressing net interest margins. The co-lending framework offers a partial structural solution: reducing on-balance-sheet loans lowers funding requirements, but this benefit will only materialise progressively as the co-lending model scales.

4.3 Business Model Shifts Currently Underway

The most consequential shift in the NBFC business model landscape is the transition from pure balance-sheet lending to a co-lending or originate-and-share model. Under the co-lending model, the NBFC's value proposition shifts from being primarily a credit investor to being primarily a credit originator and servicer. The economics change accordingly: revenue from loan spreads is replaced or supplemented by origination fees, servicing income, and management fees. The balance sheet is less loaded, and the model becomes more capital-efficient. For mid-tier NBFCs, this shift is particularly significant because it allows them to compete on distribution and underwriting quality without the capital constraints that limit balance sheet growth.

The recalibration from unsecured to secured lending is another visible shift. Following the RBI's November 2023 risk weight increase on unsecured consumer credit, many NBFCs that had built significant unsecured personal loan books began rebalancing their portfolios toward gold loans, vehicle finance, and mortgage-backed products. The logic is both regulatory and commercial: secured lending attracts lower capital charges, typically exhibits a lower loss-given-default, and is better insulated from the over-indebtedness dynamics currently affecting the unsecured microfinance segment. Institutions such as Bajaj Finance, which had grown significantly through unsecured lending, are among those publicly signalling a measured shift in product mix.





4.4 New and Emerging Participants

The NBFC sector has seen significant new entry and competitive reshaping over the past three to five years. The most visible new category is digital-first NBFCs, often fintech firms that have obtained or acquired NBFC licences to underwrite and hold credit on their own balance sheets. Entities such as Navi Technologies, DMI Finance, Moneyview, and Uni Cards represent different points on the spectrum from consumer personal loans to MSME credit, with common characteristics including technology-led underwriting, data-driven customer acquisition, and scalable operational models. The regulatory enforcement actions of October 2024, which included DMI Finance and Navi Finserv, have introduced a corrective dimension to this category's trajectory, signalling that rapid growth financed by aggressive lending practices will attract supervisory intervention.

Foreign-backed NBFCs have reinforced their presence in the Indian market. SMFG India Credit, backed by Sumitomo Mitsui Financial Group, has expanded in MSME and consumer lending following its acquisition of Fullerton India. MUFG-backed entities have similarly strengthened their strategic positioning. These institutions provide access to lower-cost foreign capital, parent-level risk management frameworks, and technology investment capacity that is difficult for domestically funded peers to match. Their growing market share in MSME and upper-middle consumer segments adds a competitive dimension to segments previously dominated by domestic NBFCs.

Embedded finance is an emerging structural development with significant implications for customer acquisition and distribution. E-commerce platforms, B2B marketplaces, and enterprise software providers are increasingly acquiring or partnering with NBFCs to offer credit directly within their platform ecosystems. A merchant financing product embedded in a GST-filing platform, or a buy-now-pay-later option integrated into a B2B procurement tool, represents a fundamentally different customer acquisition model from the branch- or sales-team-based approaches of traditional NBFCs. The borrower relationship begins within an existing transactional context, reducing acquisition costs and enabling underwriting informed by real-time business activity data.

At the other end of the size spectrum, regulatory pressure through the Scale-Based Regulation framework is raising the compliance costs and capital requirements for large NBFCs to a level that makes the distinction from banks increasingly marginal. The RBI's convergence agenda implies that entities in the Upper Layer are expected to progressively align with bank-equivalent standards. This creates an incentive for some large NBFCs to explore conversions to universal bank or Small Finance Bank licences. Shriram Finance, Bajaj Finance, and certain NBFC-MFIs have been subjects of market speculation or official consideration regarding SFB conversion. These transitions, where they occur, will redraw the competitive map of the sector.





4.5 Competitive Landscape

The competitive environment for NBFCs has become more complex as traditional advantages have been partially eroded while new opportunities have opened. Banks represent the most significant competitive pressure, particularly as their own digital infrastructure has improved. The rate cycle also creates a timing asymmetry: banks with a lower cost of funds benefit proportionately more from rate reductions than NBFCs that rely on wholesale funding. In retail and housing finance, large private banks such as HDFC Bank and ICICI Bank have been expanding aggressively in segments where NBFCs have historically led, including vehicle finance and affordable housing.

Small Finance Banks are the most direct competitors to NBFC-MFIs. SFBs such as AU Small Finance Bank, Equitas, and Ujjivan were themselves converted from MFI structures and retain institutional knowledge of the microfinance customer base. As they grow their deposit franchise and reduce funding costs, they can offer more competitive loan pricing in the lower-income lending segment. The RBI's regulatory push encouraging large NBFC-MFIs to consider SFB conversions may accelerate competitive consolidation, with converted entities gaining access to deposit-taking while remaining licensed for microfinance.

Consolidation through mergers and acquisitions has already reshaped the sector's competitive structure in several areas. The Shriram Group's internal consolidation of Shriram Transport Finance and Shriram City Union Finance created a diversified retail NBFC of significant scale. The SMFG acquisition of Fullerton India created a foreign-backed entity with broad market reach. KKR's investment in InCred is among several private equity transactions that have provided growth capital and governance support to mid-tier digital NBFCs. These transactions signal continued institutional confidence in the sector's long-term trajectory, even as near-term asset-quality concerns prompt selective caution.





4.6 Technology and Digital Transformation

Technology adoption has become a primary differentiator within the NBFC sector, affecting the speed, cost, and quality of credit delivery across segments. The Account Aggregator framework has moved from a regulatory construct to an operational tool deployed at scale by leading institutions. Bajaj Finance, Cholamandalam, and several mid-tier NBFCs report using AA-sourced financial data for a substantial share of their digital loan applications, with measurable reductions in turnaround time and improvements in underwriting accuracy. For sub-₹50,000 personal and MSME loans — the segment where NBFCs hold over 84% of market volume, the ability to assess actual cash flows rather than relying on salary slips or tax returns is transformative.

Artificial intelligence and machine learning in credit decisioning have progressed from experimentation to production deployment at leading NBFCs. Models are now used for application scoring, fraud detection, early warning systems, and collections prioritisation. The RBI has signalled its expectation that NBFCs deploying AI/ML models in credit decisions should be able to explain model outputs. The explainable AI standard is increasingly a regulatory baseline rather than a best practice. This creates a compliance dimension to model governance: Institutions unable to demonstrate explainability in their credit decisioning systems risk regulatory exposure and borrower grievance escalation.

The Open Credit Enablement Network provides standardised application programming interfaces that allow NBFC credit products to be embedded within GST platforms, ONDC storefronts, and enterprise commerce ecosystems. OCEN-enabled credit journeys allow a small business owner to apply for working capital financing without leaving the platform through which they manage their invoicing or inventory, creating a frictionless borrowing experience backed by real-time business data. For NBFCs with strong underwriting capabilities but limited brand presence, OCEN offers a distribution channel that reduces customer acquisition cost and reaches borrowers at the point of financial need.

The co-lending technology mandate under the 2025 Directions is driving a concentrated wave of IT investment. Real-time loan-level data-sharing requires NBFCs to develop or procure API connectivity, data standardisation capabilities, and reporting infrastructure that many did not previously need. This investment, while costly in the short term, modernises core operational systems across the sector. Institutions that achieve co-lending readiness will also find themselves better positioned for subsequent digital initiatives, as the underlying infrastructure data quality, API architecture, and real-time reporting are foundational to a range of future capabilities.

The DPDP Act compliance obligation is reshaping how NBFCs handle customer data across their digital channels. Consent management systems, data retention policies, and purpose limitation frameworks are being built into lending platforms, mobile applications, and partner integrations. For NBFCs that have historically accumulated large customer data sets with limited consent architecture, the compliance exercise involves both technical remediation and process redesign. Chief Data Officers and legal teams are central to these programmes, which are expected to run through 2025 and into 2026 as enforcement mechanisms under the DPDP Act become more defined.



05 . FINANCIAL PERFORMANCE AND INVESTMENT LANDSCAPE

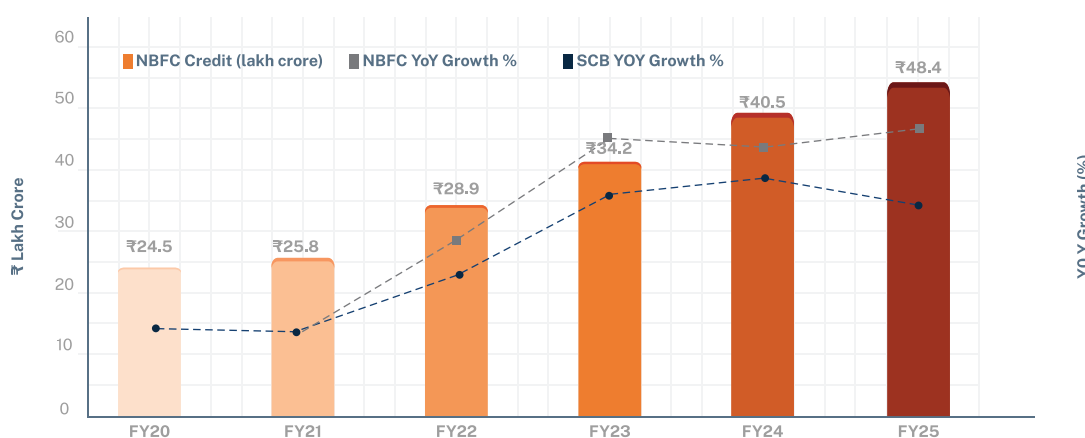


5.1 Profitability, Capital Adequacy, and Asset Quality

The financial profile of the NBFC sector as of December 2025 reflects a balance between structural resilience and evolving credit pressures. While stress in unsecured retail and microfinance portfolios became a concern during FY25, the broader sector entered FY26 with strong capitalisation, stable profitability, and improving balance sheet indicators. The RBI Financial Stability Report, December 2025, described the NBFC sector as “robust,” supported by strong capital buffers, solid earnings, and improving asset quality. This marks a notable shift from the more cautious supervisory concerns evident in late FY24, when rapid growth in unsecured lending had raised concerns about borrower leverage and underwriting discipline.

Capital adequacy remains a significant strength for the sector. As of September 2025, the sector-wide Capital-to-Risk-Weighted Assets Ratio remained around 25%, comfortably above regulatory minimum requirements. This provides a substantial buffer against potential deterioration in asset quality and allows institutions to absorb credit losses without immediate pressure on solvency. Upper and Middle-Layer NBFCs, which account for the majority of sectoral assets, have maintained CRAR levels broadly consistent with this aggregate. Strong capital buffers also support continued loan book expansion, as institutions with excess capital can grow their portfolios without immediate reliance on external equity issuance. Unlike earlier growth cycles with aggressive leverage, the current phase shows stronger balance-sheet discipline among larger NBFCs. Prudential and proportional regulation, where oversight intensity is aligned with the potential impact of each entity on financial stability.

Figure 1: NBFC Sector Credit Growth vs Scheduled Commercial Banks



Source: RBI Financial Stability Report June 2025; RBI Annual Report 2024-25

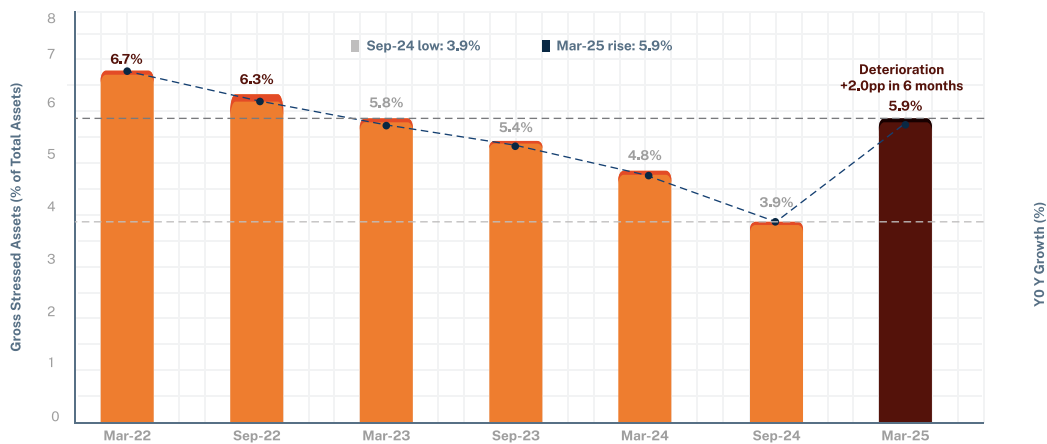
Sector-level credit growth has remained robust through FY25 and into FY26. Upper and Middle Layer NBFCs continued to record credit growth above the broader banking system, supported by strong demand across retail finance, MSME lending, vehicle finance, affordable housing, and gold loans. Services sector lending has remained one of the fastest-growing segments, driven by financing requirements of small businesses, logistics operators, trade enterprises, and self-employed borrowers. At the same time, the composition of growth has gradually shifted toward secured lending products following regulatory tightening on unsecured consumer credit. Gold loans, loans against property, and vehicle finance have consequently gained a larger share within overall NBFC portfolios. Based on industry estimates projecting NBFC credit growth of roughly 15–17% annually over the medium term, sector assets could approach ₹75 lakh crore by FY28, supported by continued expansion in retail lending, MSME finance, affordable housing, and co-lending structures. This medium-term expansion outlook reflects the increasing systemic importance of NBFCs within India’s broader credit architecture and their growing role in financing underserved borrower segments across retail and enterprise categories.



Profitability indicators for the sector remain broadly healthy despite pressure from funding costs and provisioning requirements. Large NBFCs reported stable earnings growth through FY25 and H1 FY26, supported by strong credit demand, operating leverage, and improved portfolio mix. Net profits across leading NBFCs expanded due to growth in secured retail lending, gold loans, and vehicle finance, while co-lending and securitisation structures also contributed to better capital efficiency and fee-based income generation. However, profitability performance has become increasingly uneven across the sector. Institutions with significant exposure to unsecured retail lending and microfinance continue to face pressure from higher credit costs and provisioning requirements. In contrast, NBFCs with diversified portfolios, stronger liability franchises, and higher secured lending exposure have maintained relatively stronger earnings momentum. Return on Assets and Equity for leading NBFCs stay competitive against banking benchmarks, but sector-wide profitability margins have slightly declined since FY23 and FY24 peaks.

Asset quality indicators, while still under pressure in specific segments, have shown signs of stabilisation through the second half of 2025. Earlier deterioration was concentrated largely within NBFC-MFI portfolios and unsecured retail lending, where rapid credit expansion during FY23 and FY24 contributed to higher borrower leverage and rising delinquencies. However, stronger regulatory intervention, tighter underwriting standards, and portfolio rebalancing toward secured products have helped moderate stress accumulation. According to the RBI's December 2025 Financial Stability Report, asset quality across larger NBFCs improved modestly as provisioning coverage strengthened and legacy stress was recognised more transparently. Regulatory measures, including tighter digital lending oversight and enhanced scrutiny of microfinance practices, also contributed to improved risk management across vulnerable borrower categories.

Figure 2: NBFC Sector Gross Stressed Asset Ratio Trend (Mar-22 to Mar-25)



Source: RBI Non-Banking Stability Indicator, June 2025

Write-off activity remained elevated during FY25 and early FY26, particularly among larger NBFCs seeking to clean up legacy unsecured portfolios and strengthen balance sheet transparency. While higher write-offs affect retained earnings in the short term, they have also contributed to healthier reported asset quality ratios and improved provisioning buffers. For systemically important NBFCs, aggressive recognition of stress appears to have reduced the risk of prolonged balance sheet deterioration later in the cycle. The clean-up process has therefore strengthened investor confidence regarding the quality and transparency of reported assets.

Net Interest Margins continue to face pressure due to elevated funding costs across wholesale borrowing channels. Unlike scheduled commercial banks, NBFCs do not have access to low-cost CASA deposits and therefore remain dependent on bank borrowings, market-linked debentures, securitisation structures, and commercial paper issuances. This structural funding asymmetry remains one of the defining constraints within the NBFC business model.

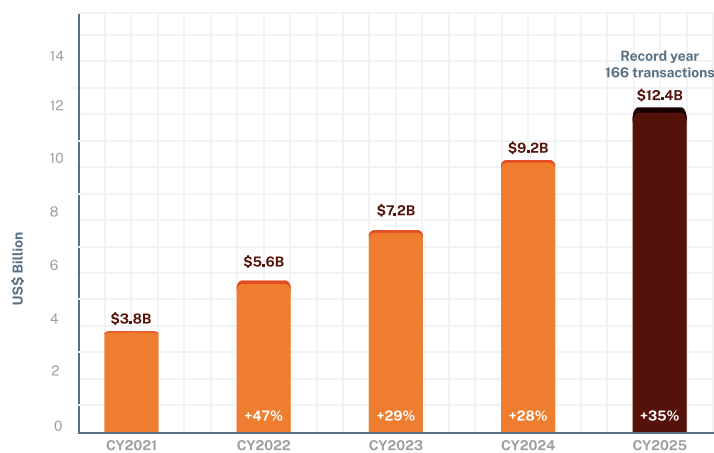


However, margin pressures moderated somewhat through FY26 as liquidity conditions improved and larger NBFCs diversified funding access through co-lending arrangements, securitisation transactions, and institutional debt placements. Institutions with stronger credit ratings and diversified liability structures have generally been better positioned to protect spreads compared to smaller or mid-tier lenders. Overall, the financial position of the NBFC sector at the end of 2025 reflects a system that remains well-capitalised, operationally profitable, and more stable than earlier concerns had suggested. The sector’s resilience today is increasingly being supported not only by growth momentum but also by stronger governance standards, tighter supervision, improved provisioning discipline, and a gradual shift toward more sustainable lending practices.

5.2 Private Credit and Investment Flows

The investment landscape for the NBFC sector remains robust, with strong interest from both domestic and international institutional investors. Private credit has emerged as one of the defining themes of India’s capital markets in the current cycle, and the NBFC sector is both a recipient of private credit and a participant in its deployment.

India Private Credit Deployment (CY2021-CY2025)



Source: CRISIL Research Private Credit Report 2025; RBI Financial Stability Report June 2025

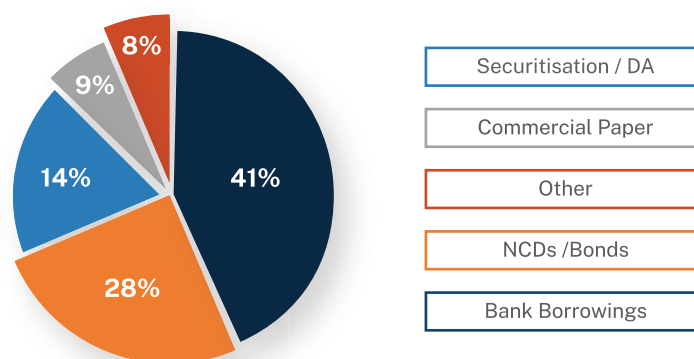
In calendar year 2025, private credit deployment in India reached approximately US\$12.4 billion across 166 transactions, representing nearly 35% year-on-year growth in value compared with CY2024. The first half of 2025 alone recorded approximately US\$9.0 billion in deployments across 79 transactions, making it the highest half-year volume on record for India’s private credit market. These trends reflect the increasing institutionalisation of private credit as an alternative asset class within India’s financial system, with both domestic and international fund managers allocating capital to higher-yielding structured credit opportunities and special-situations financing. According to the EY Private Credit in India: H2 2025 Update, the dominant sectors attracting private credit deployment during CY2025 were real estate, healthcare, and industrial products/manufacturing, supported by relatively predictable cash flows, underlying asset backing, refinancing demand, and sustained capital expenditure activity. Renewable energy also continued to attract significant investor interest due to policy support and long-duration revenue visibility. An EY Private Credit Pulse Survey conducted in December 2025 found that 84% of private credit fund managers expected competition in the Indian asset class to intensify further over the coming years, reflecting growing institutional participation and greater market depth.



Private Credit in India: H2 2025 Update, the dominant sectors attracting private credit deployment during CY2025 were real estate, healthcare, and industrial products/manufacturing, supported by relatively predictable cash flows, underlying asset backing, refinancing demand, and sustained capital expenditure activity. Renewable energy also continued to attract significant investor interest due to policy support and long-duration revenue visibility. An EY Private Credit Pulse Survey conducted in December 2025 found that 84% of private credit fund managers expected competition in the Indian asset class to intensify further over the coming years, reflecting growing institutional participation and greater market depth.

Private equity and venture capital flows into NBFC equity have remained significant. The SMFG acquisition of Fullerton India (rebranded SMFG India Credit) and KKR's investment in InCred are illustrative of the sustained interest from global financial institutions and alternative asset managers in gaining direct exposure to India's credit growth. Warburg Pincus has maintained a long-standing presence in the Indian NBFC and financial services sector. These investments are not purely financial; they often bring operational expertise, governance frameworks, and access to global funding networks that enhance the institutional quality of the recipient entities.

Figure 4: NBFC Sector Funding Mix (FY25)



Source: RBI Non-Banking Stability Indicator; ICRA NBFC Sector Outlook 2025

The NBFC bond market has been active, with record NCD issuance volumes in FY25 reflecting strong demand from mutual funds, insurance companies, and provident funds for higher-yielding investment-grade paper. Green bond issuances by NBFCs have also increased, driven by both the growing ESG mandates of institutional investors and the availability of projects, such as renewable energy, green infrastructure, and electric-vehicle financing, that qualify for green labelling under established frameworks. These issuances allow NBFCs to access a broader and increasingly price-sensitive investor base while supporting environmental objectives. Credit rating dynamics continue to play an important role in shaping access to funding and costs. Following the IL&FS crisis, spreads for mid-tier NBFCs widened significantly as investors repriced the sector's systemic risk. While spreads have partially normalised for well-rated and transparently governed institutions, the dispersion between higher and lower-rated NBFCs has remained elevated. Rating migration trends serve as a leading indicator of sector health: an increase in downgrades or negative outlook changes signals deteriorating asset quality or governance concerns before they are fully reflected in financial statements. Monitoring agencies such as CRISIL, ICRA, and CARE Ratings provide ongoing assessments that institutional investors use in their credit allocation frameworks.

The convergence of strong private credit inflows, active participation in the bond market, and continued interest in equity investment creates a broadly supportive capital environment for the NBFC sector. However, this capital is not uniformly accessible. Larger, better-governed, and more transparent institutions command disproportionate access to institutional capital at favourable terms. Mid-tier entities with less robust governance, opaque ownership structures, or concentrated sectoral exposures face a structurally higher cost of capital. This bifurcation in funding access is itself a market-driven force for governance improvement and concentration within the sector.

06 . KEY CHALLENGES AND RISKS



6.1 Asset Quality and the MFI Stress Episode

The most immediate and consequential challenge facing the NBFC sector is the deterioration in asset quality, particularly concentrated in the microfinance segment. Gross stressed assets rose from 3.9% of total assets in September 2024 to 5.9% in March 2025, a two-percentage-point increase over a six-month period that is notable both for its speed and the severity of the deterioration it represents in absolute credit quality. The trajectory stands in contrast to the sector’s performance between FY22 and early FY24, when stressed assets were on a sustained downward path following the pandemic-era normalisation. The reversal is therefore not simply a continuation of a pre-existing trend but a genuine inflection, driven by specific structural failures rather than broad economic weakness.

The microfinance episode illustrates a structural fragility that has been building for several years. During the FY22–FY24 period, NBFC-MFI credit expanded at rates well above sustainable levels, with multiple institutional lenders simultaneously extending credit to the same borrower households. The joint liability group model, which relies on mutual accountability among borrowers within a group, breaks down when aggregate household debt service obligations exceed households’ income capacity. The RBI’s enforcement actions in October 2024, imposing cease-and-desist orders on Asirvad Micro Finance, Arohan Financial Services, DMI Finance, and Navi Finserv, crystallised supervisory recognition of these dynamics, but the underlying credit stress was already reflected in rising portfolio-at-risk indicators across the sector.

The slippage ratios and write-off acceleration among upper-layer NBFCs add a further dimension of concern. Upper-layer entities have reported combined write-off ratios of 72.9% as of March 2025, which, while reflecting deliberate balance sheet cleaning, also signals the magnitude of credit losses crystallised over the preceding twelve months. For investors and rating agencies, the combination of rising gross stressed assets and elevated write-offs creates uncertainty about underlying portfolio quality: the write-offs reduce reported NPAs but do not recover cash, and the persistence of fresh slippages suggests that the cleaning cycle is not yet complete.

Table 2: RBI Enforcement Actions on NBFC-MFIs (October 2024)

Institution	Layer (SBR)	Action Date	Stated Grounds
Asirvad Micro Finance	Upper Layer	Oct 2024	Usurious interest rates; IRAC violations; household over-indebtedness
Arohan Financial Services	Middle Layer	Oct 2024	Excessive interest rates; breach of fair practices code; household debt-service > 50% income
DMI Finance	Middle Layer	Oct 2024	IRAC norm violations; aggressive collection practices; multiple-lender over-exposure
Navi Finserv	Middle Layer	Oct 2024	Usurious pricing; lack of transparent interest disclosure; IRAC breaches

Source: Reserve Bank of India Enforcement Actions, October 2024



The risk to unsecured retail portfolios is a secondary but closely related concern. Growth in unsecured personal loans reached exceptionally high levels during FY22–FY24, driven by rising consumer demand, fintech-led distribution models, and digital lending infrastructure that enabled rapid customer acquisition and loan disbursement. These portfolios are now entering a phase where early-vintage performance offers limited guidance, as borrowers who accumulated debt in a relatively favourable macroeconomic environment may behave differently under tighter financial conditions and higher repayment burdens. The RBI Financial Stability Report, June 2025, highlighted growing stress among small-ticket borrowers, noting that more than two-thirds of borrowers who availed personal loans in the preceding quarter already had more than three active loans at origination. This points to increasing borrower leverage and layered indebtedness within the unsecured retail segment, particularly among lower-income and financially vulnerable households. The RBI's November 2023 increase in risk weights on consumer credit was therefore a forward-looking intervention aimed at slowing excessive growth in unsecured lending and strengthening underwriting discipline. The subsequent portfolio rebalancing by large NBFCs towards secured lending products such as gold loans, vehicle finance, and loans against property reflects a broader recalibration of risk appetite across the sector.

6.2 Liquidity and Funding Risks

Asset-liability mismatch is a structural and recurring vulnerability in the NBFC model. NBFCs predominantly fund themselves through short-and medium-term wholesale instruments — commercial paper with tenors of 90 to 180 days, bank credit lines typically renewable annually, and NCDs of one-to-three-year maturity while their loan portfolios include medium-to-long-duration assets in vehicle finance, housing, and infrastructure. This duration mismatch means that any disruption to refinancing access can create acute liquidity pressure even for institutions with performing loan books.

The IL&FS crisis of 2018 demonstrated this vulnerability in the most direct terms. When the credit quality of IL&FS was questioned, mutual fund redemption pressure across the NBFC commercial paper market created a sector-wide funding squeeze that forced several entities into distress or fire-sale asset disposals. The memory of this episode shapes the risk management and regulatory architecture of the sector to this day. The RBI's introduction of a Liquidity Coverage Ratio requirement for upper-layer NBFCs mirroring the bank-level LCR standard is a direct response to the mismatch dynamics exposed by IL&FS.

The Non-Banking Stability Indicator published in the RBI's Financial Stability Report for June 2025 explicitly flags funding cost pressure as a rising risk dimension. The specific concern relates to the elevated cost of wholesale borrowings relative to the lending rates that market conditions will support. For NBFCs operating in competitive segments microfinance, MSME credit, vehicle finance the ability to pass on higher funding costs through loan pricing is constrained by competition from banks with lower deposit-based funding costs and by regulatory scrutiny of interest rates in inclusion-oriented segments. The result is NIM compression that, if sustained, reduces the earnings buffer available to absorb credit losses.

Commercial paper dependence is a specific vulnerability that the RBI has flagged. The use of perpetual or frequently rolled-over short-term credit lines as a funding mechanism introduces refinancing risk that is difficult to fully hedge. During the November 2023 to March 2025 period, when the RBI had increased risk weights on NBFC exposure for banks, the effective cost of bank credit lines for NBFCs rose materially, and some entities reported difficulty in maintaining existing credit line volumes. The six-to-nine month normalisation lag identified by market participants reflects the time required for banks to reassess and resize their NBFC exposure books following a policy change.





6.3 Regulatory and Compliance Risk

The January 2026 effective date of the Co-Lending Arrangements Directions 2025 represents the single most concentrated near-term compliance risk facing the sector. The real-time loan-level data-sharing mandate requires both NBFC and bank co-lending partners to implement API connectivity, data standardisation frameworks, and reporting infrastructure that most institutions do not currently operate at the required level of granularity. Core banking system upgrades, middleware integration, and data quality controls involve significant lead time and capital expenditure. Market feedback from both banks and NBFCs indicates that a substantial proportion of potential co-lending participants are not yet compliant-ready, and that delays may push full-scale operationalisation to mid-2026 or beyond even after the formal effective date.

The Digital Personal Data Protection Act compliance timeline is creating a parallel compliance investment cycle. The DPDP Act came into force in 2023 and the compliance obligations data minimisation, purpose limitation, consent management, data localisation are now live for all digitally active NBFCs. Building consent management systems, redesigning data collection practices, and implementing data retention policies across lending platforms, mobile applications, and partner integrations requires sustained investment in both technology and legal/compliance infrastructure. For NBFCs that have historically operated with limited data governance formality, the transition is materially resource-intensive.

Interest rate scrutiny in the microfinance segment remains an active regulatory risk. Many NBFC-MFIs continue to charge effective annual percentage rates in the range of 28 to 40%, reflecting the high operating cost structures of last-mile lending as well as, in some cases, the prioritisation of margin expansion over borrower welfare. The RBI's enforcement posture demonstrated by the October 2024 cease-and-desist orders signals that tolerance for rates at the upper end of this range has narrowed, particularly where household debt-service ratios are already elevated. NBFC-MFIs operating near these rate thresholds face persistent regulatory exposure.

6.4 Systemic and Competitive Risks

Large NBFCs' connections with banks, mutual funds, and co-lending create systemic risk channels. A sudden credit decline in a big NBFC could impact bank balance sheets, mutual fund portfolios, and the credit market. The IL&FS crisis highlighted this risk, prompting RBI to focus on governance, liquidity, and oversight of large non-bank entities.

Competitive erosion is a longer-term structural risk for the NBFC model. The advantages that NBFCs historically held over banks distribution reach, underwriting flexibility, faster processing, and willingness to serve under-documented segments are being progressively narrowed as banks invest in digital infrastructure and as Small Finance Banks expand their coverage. In specific segments such as personal lending, housing finance, and urban MSME credit, bank competitive intensity has increased materially. NBFCs that are unable to differentiate through superior underwriting, distribution networks, or technology capabilities face the prospect of margin compression and market share erosion over a three-to-five year horizon.

The correction risk in unsecured retail lending, if it materialises, could generate credit losses across multiple segments simultaneously. An economic slowdown that impairs consumer income, particularly in the informal economy where NBFC borrowers are concentrated, would affect microfinance portfolios, unsecured personal loans, and small-ticket MSME credit at the same time. The absence of collateral in these segments means that recovery values would be limited, and write-off ratios already elevated at 46.4% across the sector could rise further. A concentrated stress event of this nature would test the capital adequacy of mid-tier NBFCs more severely than of upper-layer entities, given the latter's higher CRAR buffers and greater access to capital markets.

07. FUTURE OUTLOOK: WHERE THE SECTOR IS HEADED



7.1 Near-Term Outlook (12–24 Months)

The near-term outlook for the NBFC sector is one of continued growth alongside elevated operational and compliance demands. Credit growth for upper and middle layer NBFCs has remained robust through H1 FY26, with the sector recording approximately 17% year-on-year loan growth in the first half of FY26, led by strong expansion in the gold loan segment (38% growth), diversified NBFCs (19%), and stable housing finance companies, while NBFC-MFI portfolios contracted sharply by around 11%, reflecting ongoing stress remediation. Looking ahead, CRISIL projects NBFC credit to grow at a CAGR of 15–17% between FY25 and FY28, representing a measured deceleration from the 19.4% recorded in FY25 but remaining well above nominal GDP growth. This moderation reflects the deliberate tightening of underwriting standards in stressed segments, particularly microfinance and unsecured retail, alongside the temporary drag from asset quality remediation and elevated provisioning requirements.

The co-lending framework is the single most consequential near-term structural catalyst. The January 2026 effective date of the Co-Lending Arrangements Directions 2025 will mark the formal entry of co-lending into the mainstream NBFC operational model. Initial implementation will likely be concentrated among larger, better-capitalised NBFCs with existing bank relationships and technology infrastructure. As these entities demonstrate the commercial and operational viability of real-time co-lending, the framework is expected to spread more broadly across the Middle Layer over the following twelve to eighteen months. The impact on NBFC balance sheets will be a gradual reduction in on-book loan concentration, offset by growing fee and servicing income streams.

The microfinance sector is at an inflection point. The combination of cease-and-desist orders, tightened NBFC-MFI Directions 2025, and FIDC SRO oversight is expected to trigger a consolidation among smaller, less well-capitalised NBFC-MFIs over the next twelve to eighteen months. Entities that cannot achieve compliance with the new household income threshold norms, credit bureau reporting requirements, and SRO governance standards will face either regulatory remediation timelines or pressure to merge with stronger institutions. Well-capitalised NBFC-MFIs that navigate this period successfully are likely to gain market share as over-leveraged borrower pools are worked through and credit discipline is restored.

Gold loan business economics will be reshaped by the 2025 LTV guidelines. Leading gold loan NBFCs such as Muthoot Finance, IIFL Finance, and Manappuram Finance will need to adjust their pricing models to compensate for the lower revenue generated per gram of gold pledged under the new LTV ceiling. IIFL Finance, already operating under a restructured gold loan framework following its 2024 lending restriction, is furthest along in this adjustment. For mid-tier gold loan players, the margin compression from tighter LTV norms may accelerate consolidation with or acquisition by larger entities with more diversified revenue bases.

Funding mix normalisation is expected to proceed over the same twelve-to-twenty-four month horizon. Bank borrowings to NBFCs, which tightened following the November 2023 risk weight increase, are gradually recovering as banks reassess their NBFC lending books at normalised capital costs for most categories. Bond market conditions remain supportive, with institutional investor appetite for NBFC paper sustained by the yield differential versus government securities. Securitisation volumes are expected to grow as co-lending structures mature and as NBFCs increasingly use portfolio monetisation as a capital management tool.





Table 3: NBFC Sector — Medium-Term Outlook Summary (FY27–FY30)

Dimension	FY26 Actual/Est.	FY28/FY30 Projection	Key Driver
Credit Growth	19.4% YoY	15–17% CAGR (FY28E)	Co-lending ramp-up; MFI rebalancing
NBFC AUM	₹48.4 lakh crore	₹75–85 lakh crore (FY28E)	Retail + infrastructure expansion
Stressed Assets	5.9%	4.0–4.5% (FY28E)	MFI stabilisation; write-off cycle
Funding Cost	Elevated	Moderating (FY27–FY28)	Risk weight reversal; RBI rate easing
Co-Lending Volumes	Pre-scale (Jan 2026 start)	Rapid ramp-up FY27–FY28	New Directions; tech readiness
Private Credit Inflows	\$12.4B (CY25)	\$20–25B (CY28E)	Infra, renewable energy demand
Net Profit Growth	~15–16% YoY (FY25)	~14–17% CAGR (FY28E)	Credit growth; capital efficiency gains
NIM Trajectory	Under pressure	Stabilising FY27 onward	Funding cost moderation

Source: ICRA Ratings NBFC Outlook 2025; CRISIL Research; RBI FSR June 2025. Projections are estimates.

7.2 Digital and Technology Trajectory

The technology trajectory of the NBFC sector over the next three to five years will be defined by three interlocking forces: the deepening of data infrastructure through the Account Aggregator framework, the maturation of AI and machine learning in credit decisioning, and the expansion of embedded finance through OCEN and related open-network architectures.

Account Aggregator adoption is accelerating. The sub-₹50,000 personal and MSME loan segment where NBFCs already account for 84.3% of national volumes is the natural proving ground for AA-enabled underwriting. Real-time cash flow visibility replaces the need for tax returns, salary slips, and audited financials, making it possible to assess creditworthiness for a substantially broader population of borrowers. Early adopters report turnaround time reductions from days to hours for digital loan applications processed through AA pipes. As AA connectivity becomes standard across banks and financial institutions, the quality and comprehensiveness of the data available for underwriting will continue to improve, creating a competitive advantage for NBFCs that invest in the analytical capability to use this data effectively.





AI and ML maturation in credit decisioning is progressing from pilot deployment to production-scale infrastructure. Leading NBFCs are moving beyond application scoring to deploy ML models for portfolio-level risk monitoring, early warning systems, and collections prioritisation. The RBI's expectation that AI/ML models deployed in credit decisions should be explainable with outputs that can be audited, challenged, and communicated to regulators and customers is shaping the architecture of these systems. Interpretable machine learning frameworks, model documentation standards, and audit trails for algorithmic decisions are becoming standard practice among upper-layer NBFCs. For mid-tier entities, the cost of building compliant AI infrastructure is a challenge, and the market is beginning to see the emergence of third-party explainable AI platforms designed for regulated lending institutions.

Embedded finance via OCEN represents the next frontier in customer acquisition. The OCEN protocol enables standardised lending API integration across any digital platform: a GST-filing portal can offer working capital credit based on invoice and tax data; an ONDC storefront can embed purchase financing at the product level; a payroll platform can provide salary advances anchored to verified employment data. For NBFCs, OCEN-based embedded finance channels offer lower customer acquisition costs, better initial data quality, and access to borrower segments that are difficult to reach through traditional branch or direct sales agent networks. The commercial model is still evolving, but the structural opportunity embedding credit delivery into platforms where borrowers already transact is a significant medium-term growth driver.

The DPDP compliance investment cycle will reshape data architecture across the sector. Consent management systems, data minimisation frameworks, and purpose limitation controls are being built into lending platforms from the ground up at institutions that are establishing new digital channels, and retrofitted into legacy systems at institutions with established digital operations. This investment, while initially a compliance cost, creates a data governance foundation that supports future capabilities including advanced personalisation, fraud detection, and cross-sell analytics based on explicit consented data. The long-run competitive advantage will accrue to institutions that treat DPDP compliance as an architectural opportunity rather than a procedural obligation.





7.3 Financial Inclusion and Rural Credit

The financial inclusion opportunity for NBFCs remains among the most structurally significant dimensions of the sector's medium-term outlook. Rural areas, which contribute approximately 47% of India's GDP, receive only around 9% of formal bank credit. This mismatch between economic output and credit access reflects the structural constraints of bank branch distribution, documentation-heavy underwriting models, and risk appetite frameworks calibrated to formalised income profiles. NBFCs, through their branch and business correspondent networks, agent distribution, and digital-enabled rural origination, are the primary mechanism through which formal credit reaches this population.

The MSME credit gap is one of the most frequently cited financing deficits in the Indian economy, estimated at approximately ₹20–25 lakh crore. The combination of AA-enabled cash flow assessment and co-lending partnerships with public sector banks is emerging as the most viable underwriting playbook for bridging this gap. Public sector banks bring lower funding costs and regulatory mandates to extend priority sector credit; NBFCs bring distribution reach, underwriting expertise, and technology infrastructure. Co-lending formalises this complementarity into a structured framework. The January 2026 Directions, by extending co-lending eligibility to all regulated entities and all loan categories, create the regulatory foundation for this playbook to scale.

Government credit programmes like PM SVANidhi, MUDRA Yojana, and Credit Guarantee Fund Trust for Micro and Small Enterprises rely heavily on NBFC-MFI and smaller NBFC channels for last-mile distribution. The FIDC SRO framework is expected to improve conduct standards and reduce abusive practices in these channels over time, supporting the policy goal of extending formal credit to underserved populations without exposing borrowers to predatory pricing. For NBFCs operating in these segments, the combination of government programme mandates, FIDC oversight, and improved data infrastructure creates a more structured and accountable framework for inclusion-oriented lending than has historically existed.





7.4 Infrastructure Finance and Green Capital

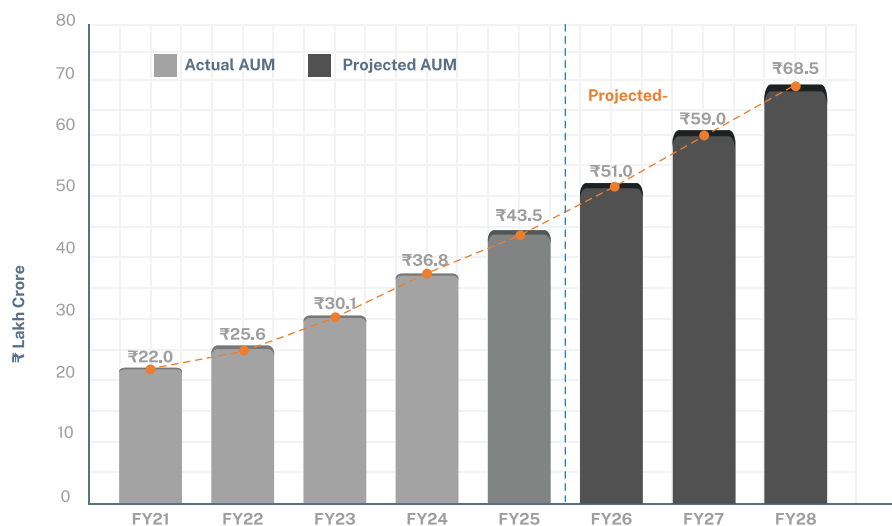
The National Infrastructure Pipeline, requiring ₹143 lakh crore investment through 2030, drives demand for capacity expansion of NBFC-IFCS and NBFC-IDFS. Covering roads, railways, airports, ports, energy, urban infrastructure, and digital connectivity, it demands long-term capital matching project lifespans of 15-30 years. Banks are limited in holding long-term infrastructure paper due to asset-liability constraints, while NBFC-IFCs, NaBFID, and NBFC-IDFs aim to fill this funding gap.

The NaBFID Partial Credit Enhancement facility, approved by the RBI in January 2025, is a meaningful catalyst for unlocking pension and insurance fund participation in infrastructure finance. By providing a partial guarantee on bonds issued by infrastructure entities, NaBFID enables these instruments to achieve investment-grade ratings that meet the mandated investment criteria of Provident Fund and insurance regulations. The PCE facility effectively translates the credit quality of NaBFID which benefits from government ownership and strong capitalisation into a risk mitigant for private infrastructure bond issuances. If scaled successfully, this mechanism could mobilise a substantial new pool of long-duration domestic institutional capital into infrastructure financing.

Green finance is emerging as a distinct and growing dimension of NBFC activity. The RBI's Financial Stability Report for June 2025 labels climate risk a national imperative and signals that regulatory frameworks will increasingly incorporate climate risk assessment for financial institutions. NaBFID and several large NBFCs have begun establishing dedicated climate and transition finance lines, targeting renewable energy projects, electric vehicle financing, green building finance, and sustainable supply chain lending. ESG-linked NCD issuances by NBFCs have attracted strong institutional investor interest, reflecting the growing alignment between NBFC product innovation and the ESG mandates of domestic and international institutional capital.

The Project Finance Directions 2025, with their mandatory 1% provisioning for under-construction infrastructure projects, represent a prudential tightening that initially increases provisioning costs for NBFC-IFCs. Over the medium term, however, this norm improves the transparency and consistency of risk recognition across the infrastructure lending portfolio, which should support investor confidence in NBFC-IFC balance sheets and, by extension, reduce the cost of capital for these institutions. A more predictable provisioning framework also enables better pricing of construction-phase risk in new project lending, improving the overall efficiency of infrastructure credit allocation.

Figure 5: NBFC Sector AUM Trajectory and Outlook (FY21–FY28E)



Source: RBI FSR 2025; ICRA Research; CRISIL Projections. FY26E-FY28E are estimates.



7.5 Structural Medium-Term Themes (3–5 Years)

The progressive convergence of large NBFC governance standards with those applicable to universal banks is one of the most consequential structural trends in the sector. Scale-Based Regulation is deliberately designed to raise capital, liquidity, governance, and disclosure requirements for upper-layer NBFCs toward bank-equivalent levels. The introduction of the Liquidity Coverage Ratio for upper-layer entities, the alignment of audit committee and board composition requirements with those of listed banks, and the expectation of SRO membership are all steps along this convergence path. For entities that have operated with the lighter regulatory touch historically available to NBFCs, the compliance and governance investment required to meet these standards is material. The convergence agenda simultaneously raises the baseline quality of the sector and creates a structural incentive for some large NBFCs to evaluate the cost-benefit of formal bank conversion. Sector consolidation will accelerate over the next three to five years, driven by the interplay of SBR compliance costs, capital requirements, and competitive dynamics. Smaller, undiversified NBFCs operating in the Base Layer face increasing cost pressure from technology investment requirements, SRO membership obligations, and credit bureau reporting mandates. Without the scale to spread these fixed costs across a large loan portfolio, their economics progressively deteriorate. This creates a structural imperative for merger, acquisition, or exit. Rating agencies and institutional investors, increasingly applying governance quality as a credit criterion, are amplifying the market pressure on sub-scale entities. The concentration of the sector's assets and credit quality among a smaller number of better-governed, better-capitalised institutions is a likely outcome of this process.

Private credit institutionalisation has long-term significance for Indian markets. At \$12.4 billion in CY2025, India's private credit market is developing like in more mature markets. As pension funds, insurance, and sovereign wealth funds develop their private credit strategies, the asset class will grow in size and sophistication. NBFCs, as originators and providers of structured credit, are key players. The evolution of private credit and co-lending creates a pathway for increased institutional investment into NBFC-intermediated credit over the next five years.

Profitability and the earnings outlook for the sector over the medium term are broadly positive if asset quality is contained and the co-lending model scales as intended. India's financial services sector is projected to nearly double profits by FY30, with NBFCs contributing disproportionately as high-growth segments of the credit market. Annual NBFC profit growth of approximately 16% consistent with credit growth at the mid-point of the projected range and stable NIMs is achievable for well-managed institutions. The primary downside risk to this scenario is a sustained asset quality deterioration in the microfinance or unsecured retail segments that generates credit losses above current provisioning levels, requiring capital replenishment that dilutes near-term ROE.

ESG and sustainable lending will move from a positioning exercise to a structural competitive differentiator over the next five years. Domestic institutional investors particularly EPFO-managed provident funds and LIC-related insurance vehicles are developing ESG screening criteria for bond investments. International limited partners in private credit and PE funds are imposing ESG due diligence requirements on Indian portfolio companies. NBFCs that build credible ESG frameworks including green portfolio definitions, impact measurement, DPDP-compliant data governance, and transparent governance structures will access a progressively larger pool of institutional capital at more favourable pricing. The ESG premium, modest today, is likely to widen as these demand-side dynamics mature.



08. CONCLUSION



The central thesis of this report is that India's NBFC sector is mid-transition, not mid-cycle. A mid-cycle reading would suggest that current stresses rising stressed assets, NIM compression, MFI enforcement actions are temporary fluctuations within a broadly stable structural arrangement, to be resolved by the passage of time or the next phase of the credit cycle. The evidence argues otherwise. The governance architecture of the sector is being permanently redrawn, and the institutions that will define the sector's next chapter are those that successfully navigate this redrawn landscape rather than those that wait for a return to prior conditions.

The duality running through the sector's current condition is real and cannot be resolved through selective emphasis on either dimension. The growth credentials are genuine: a combined balance sheet that expanded from ₹48.39 lakh crore in advances in FY25 to ₹65.51 lakh crore in total assets by September 2025, with NBFC credit continuing to grow at approximately 17% year-on-year in H1 FY26; an 84.3% share of sub-₹50,000 personal loans; and a demonstrated capacity to reach rural and informal economy borrowers that the formal banking system does not efficiently serve. The GNPA ratio for the broader sector improved to 2.9% by end-March 2025, even as the stressed assets ratio — which captures early-stage delinquencies — peaked at 5.9% in the same period before beginning to moderate. These are not marginal contributions. They are structurally significant to the functioning of India's credit architecture, to the government's financial inclusion programme, and to the financing of infrastructure and MSME investment. Equally genuine are the risks: stressed assets rising sharply, MFI over-indebtedness episodes exposing structural underwriting failures, co-lending technology gaps creating implementation uncertainty, and funding cost pressures compressing margins across the sector.

The granting of SRO status to FIDC in October 2025 is the symbolic close of the shadow-banking era for the NBFC sector. The defining characteristic of shadow banking performing credit intermediation functions outside the institutional accountability architecture applicable to banks no longer accurately describes the NBFC regulatory environment. The sector now operates under Scale-Based Regulation with progressively bank-equivalent standards, a self-regulatory organisation with conduct oversight and grievance redressal functions, consolidated Master Directions that create a unified compliance framework, and active supervisory enforcement that has demonstrated willingness to impose direct operational constraints on non-compliant entities. The governance architecture is, for the first time, genuinely institutional.





The Co-Lending Arrangements Directions 2025 represent the structural bridge to the next phase. By enabling all regulated entities to co-originate credit across all loan categories with flexible risk-sharing arrangements and technology-enabled transparency, the framework creates the conditions for the NBFC sector to scale in a capital-efficient, governance-consistent manner. An NBFC that leverages co-lending effectively deploying its distribution network and underwriting expertise to originate credit that is funded in partnership with bank capital is not simply a credit intermediary. It is an infrastructure for credit delivery, a structurally differentiated role that is both commercially viable and systemically valuable.

The forward view, without prescription, is one of conditional optimism. The NBFC sector will grow. The question is whether it grows in a manner that is sustainable, inclusive, and appropriately governed, or whether the combination of competitive pressure, compliance challenges, and asset quality stress generates a more disruptive transition. The pace of digital adoption of Account Aggregator, AI-driven underwriting, and OCEN-embedded finance will determine how quickly the sector can improve underwriting precision and reduce the structural vulnerabilities that have historically created credit cycles. The resolution of MFI stress, and the effectiveness of the new NBFC-MFI Directions in preventing recurrence, will determine whether financial inclusion continues to expand on a durable basis. And the viability of the co-lending model at scale operationally and commercially will determine whether the sector's balance sheet evolution creates a more resilient NBFC ecosystem or a more fragmented one.

At approximately 25% of the Scheduled Commercial Bank credit and growing, the NBFC sector is not peripheral to India's credit architecture. It is load-bearing. The institutions, regulators, and investors that recognise this and that invest accordingly in governance quality, technology capability, and risk discipline will shape a sector that is genuinely capable of supporting India's credit needs through the next decade of growth.



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