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IS POLICY NEED OF THE HOUR FOR ASSET LIABILITY MANAGEMENT – NBFC-HFCS?

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ABSTRACT Non-banking finance companies (NBFCs) form an integral part of the Indian financial system. In India, NBFC sector has undergone a notable transformation over the past few years and has shown consistent on year-on-year growth .They play a critical role in the core development of infrastructure, transport, employment generation, wealth creation opportunities and financial support for economically weaker sections. This paper was shaped by the research question "Is policy need of the hour for Asset liability management-NBFC-HFCs"NBFC Housing Finance companies only. Imprudent liability management can put NBFCs' earnings and reputation at great risk. The basic objective of Asset Liability Management system is to assess risks and suggest measures to manage them in order to implement strategic tools for NBFCs. Long term assets funded by short term borrowings is not a desirable situation for NBFC's. The analysis from this study will help government departments, regulators, market participants and research scholars to gain a better understanding of the role of NBFCs in promoting financial inclusion in the country.

KEYWORDS : Asset Liability Management, Commercial Paper, NBFCs-HFCs, Risk, Banks

Introduction

The Housing Finance Company is yet another form of non-banking financial company which is engaged in the principal business of financing of acquisition or construction of houses that includes the development of plots of lands for the construction of new houses. These companies have grown strongly, especially in the last three to four years. The share of NBFCs and HFCs in the total credit system has been steadily rising from 15.2 per cent in 2014-15 to 19.2 per cent in 2017-18. This growth was partly due to the slowdown in lending by commercial banks especially Public sector banks and partly due to the model of these entities, built a quicker response times and last-mile connectivity.

Statement of the problem

The combination of reduced bank lending and easy availability of low-cost funds in the wake of continued credit demand in the economy contributed to the NBFC-HFC growth story in recent years. NBFC-HFCs growth as per RBIs record is 25% in the last 3 years. In 2018 a series of events impacted the growth story. The interest rates started toughened due to rate hike in both repo and bank interest rates, macro-economic factors like crude crossed $85 per barrel in October 2018 and the rupee depreciated rapidly, further aggravating the liquidity situation. There was a significant concern on what would happen to commercial paper (short term debt) outstanding to NBFCs, a lot of which would mature in Nov 2018. An asset-liability mismatch –specifically, having long-term assets funded by short-term borrowings like commercial paper is not a desirable situation for an NBFC-HFCs. So the study focuses on Asset liability management of NBFC-HFCs.

Object of the study

To know the asset liability management of NBFC-HFCs

Limitations of the study

The study area is limited to NBFC-HFCs only.

Review of Literature

MilindGadkariet et al. (2010)[1] found that profitability is expected to be lower than historical levels due to conservative ALM management, higher provisioning and avoidance of high yielding unsecured loan segments. However, profits are at the same time expected to be much more stable and less susceptible to liquidity related pressures going forward.

V. Sornaganesh (2016)[2]NBFCs invest in mandatory (SLR) and Non-Mandatory (Non-SLR) based investments as seen in their balance sheets every year since 2013 for Asset liability management

ASSET LIABILITY MANAGEMENT (ALM)

The core function of NBFCs is accepting deposits as a liability and converting them into assets in the form of loans, etc. NBFCs have been providing large loans on the basis of small deposits collected from the people. Indian financial markets are going through a period of liberalization over the last few years with growing integration of domestic market with the external market. With growing needs for credit and for the expansion of financial markets, NBFCs have started entering into the market to fill the credit gap of both the corporate sector and the retail segment. The operations of NBFCs have become very complex and are associated with different risks. They require strategic management expertise to manage these risks.

After April 1, 2003, NBFCs are operating in a fairly deregulated environment and are able to fix the rate of interest on different deposit schemes subject to ceiling of maximum rate of interest and maximum period of deposits. The return from the investments of NBFCs in government securities are directly related to market risk. NBFCs are now facing acute competition with each other and managements of NBFCs are trying to maintain a good balance between the assets and liabilities for profitability and long-tern viability. Careless liquidity management of NBFCs can put their earnings and goodwill at great risk. The hard competition can create pressure on them for structured and comprehensive liquidity management on a permanent basis.

The managements of NBCSs have to formulate their business decisions on a dynamic and integrated risk management system because they encounter several risks which they have face in their normal course of business operations. These risks are stated below:

Liquidity risk
Credit risk
Interest rate risk
Operation price risk
Commodity price risk

Therefore, it is very important for NBFCs to introduce an effective risk management system that can efficiently manage the risks relating particularly to the interest rate and the liquidity.

According to RBI guidelines, NBFCs are required to manage their risks in a sophisticated way by adopting more comprehensive Asset-Liability Management (ALM) System. Comprehensive and dynamic framework is necessary for measuring, monitoring and managing the liquidity and interest risk of major operators in the financial system. It relates to the assessment of various types of risks and altering the portfolio of asset-liability in a dynamic way in order to manage risks. Liquidity risk management and interest rate risk management are two important limbs of the ALM system. The basic objective of ALM system is to assess risks inherent thereon and suggest measures to manage them in order to implement strategic

tools for NBFCs.

From 1.4.2013, the RBI has prohibited the NBFCs from accepting deposits less than 1 year. So there is no question of asset-liability mismatches below the 1 year period.

Analysis and Interpretation

Balance Sheet

This balance sheet contains the information of 84 housing finance companies. A sharp increase in loans and advancesof HFCs—propelled by the recent initiatives of the Government of India to boost affordable housing—was instrumental in driving the growth of their consolidated balance sheet. On the asset side, loans and advances constituted more than four-fifth of their balance sheet while more than two-third of their loan portfolio comprised housing loans in 2017-18. On the liabilities side, deposits and borrowings together accounted for almost four-fifth of the total liabilities of HFCs, with borrowings being the dominant source of funds. Borrowings, including debentures and CPs, increased at 27.7 per cent in 2017-18

Table 1BALANCE SHEET OF NBFC-HFCs

PARTICULARS	31-Mar-16	31-Mar-17	31-Mar-18
Share Cap	79	93	305
R&S	736	932	1247
Public Deposits	935	1121	1219
Deb	2589	3364	4100
Bank Borrowings	1723	1727	2310
Borrowings from Fis	135	216	279
ICDs	22	20	40
CP	481	682	975
Borrowings from Govt	0	0	0
Subordinated Debts	133	163	202
Other Borrowings	78	186	211
Current Liabilities	184	245	318
Provisions	97	83	126
others*	139	171	184
TL/A	7332	9003	11516
Loans and Advances	6053	7286	9354
HP and Lease Assets	0.01	0.02	0.04
Investments	316	551	739
Cash and Bank Balances	188	227	196
Others**	775	938	1228

Sources: RBI trend and progress of banking 2018

Profit and Loss account Performance

Both income and expenditure of HFCs decelerated in 2017-18 as compared to2016-17. While expenditure decelerated partly reflecting lower spending on interest payments, income growth was marred by lower fund-based income. Accordingly, net profits of HFCs grew at a lower rate. While there was a marginal decline in RoAs of HFCs in 2017-18 vis-à-visin 2016-17 as profitability declined, the cost to income ratioof HFCs remained fairly stable in 2017-18 as compared to 2016-17.

Table 2PROFIT AND LOSS ACCOUNT OF NBFC-HFCs

Particulars	2016	2017	2018
Total Income	769.86	900.30	1036.44
Fund Income	755.20	882.29	1013.41
Fee Income	14.66	18.01	23.03
Total Expenditure	549.90	666.22	760.06
Financial expenditure	498.58	576.19	656.41
Operating expenditure	51.32	81.03	115.16
Tax Provision	65.99	72.02	80.61

Sources: RBI trend and progress of banking 2018

Table 3

	FINANCIAL RATIOS	2016	2017	2018
1	Commercial paper to cash balance (in times)	2.56	3.00	4.97
2	Loans and advances to Total assets	82.56	80.93	81.23
3	Financial expenditure as a % of total expenses	90.67	86.49	86.36
4	Interest as a % of total borrowings	8.18	7.70	7.03
5	Fund Income as a % of Loans &Advances	12.48	12.11	10.83
6	Net Interest Margin	4.30	4.41	3.80
7	Cost to Income Ratio(Total exp/Total Income)	71.6	73.6	73.6
8	Return on Assets (ROA)/PAT/TA	2	2.1	2

1. Commercial Paper to Cash Balance (in times)

As per the table 1 short term borrowing that is commercial paper is significantly increased from 2016 to 2018. Whereas on the cash balance as a portion of total assets is significantly smaller portion then how these firm settle the due regarding commercial paper (within one year) so I consider this ratio whether these firm is able to settle the short term borrowings. As per the above table 3 commercial paper to cash balance ratio in times is increased consistently and they are very struggle to settle their short term debts.

2. Loans and Advances to Total assets

Loans and Advances as a percent of total assets ratio is in and around 81% every year for the last three years which shows liquidity position is very low. Because 81% of funds are employed for housing loan which is a long term period, for short term they are not having enough funds. Their balance sheet shows that they are not having enough long term funds they raised in their liability side according to their business volume growth. The reason for this phenomenal growth is partly due to slow down in lending by banks because of Prompt Corrective Action (PCA) adopted by RBI, particularly; public sector banks (PSBs) and partly due to the model of these entities, built on quicker response times and last mile connectivity.

3. Financial expenditure as a percentage of total expenses

This ratio is used to measure the finance cost (interest paid and other financial obligations) as a percentage of total expenditure which shows the cost of raising finance is reduced significantly for the last 3 years because of lower cost of debt, this is favourable for these companies during this period of study.

4. Interest as a percentage of Total borrowings

This ratio is used to measure the cost of debt that is interest as a percentage of borrowings. This is favourable for these firms during this period of study because of lower cost of debt raised.

5. Fund income as a percentage of Loans and advances

This ratio is used to measure the income generated from loans and advances is enough. This ratio is significantly in the initial year and reduced in the second and third year because of cost increase for raising finance for the last two years significantly due to macro-economic conditions.

6. Net Interest Margin

This ratio is used to measure the difference between interest paid by the company and interest income earned by the company that is spread. This ratio is enough in the beginning and reduced in the last year because of cost of raising finance due to macro-economic conditions.

7. Cost to Income ratio

This ratio is used to measure the cost of expenses as a percentage of income. This shows that they have to maintain in and around 72%, this is also significant one.

8. Return on Assets

This ratio is used to measure the return on assets earned by these

companies which is also significant.

Suggestion

- An asset-liability mismatch-specifically, having long term assets funded by short term borrowings like CPs-is not a desirable situation for an NBFC.
- Credit is the life blood of an economy, and given the issues that banks are facing, alternative source of credit augment economic growth. In the absence of a vibrant bond market, medium-to long-term funding for such entities can come from other pools of capital, namely banks, mutual funds, insurance and pension.

Conclusion

In this financial situation, there is a challenging liquidity problem in the mid of August to December RBI takes a bold decision to ease liquidity. The RBI undertook significant open-market operations from sep 18 to Dec 18 to inject liquidity in the system, while SBI announced a significant corpus to buy assets from NBFCs and HFCs. The NHB offered to increase its refinancing to HFCs. In end-November, the RBI eased the loan securitisation norms for NBFCs. NBFC-HFCs need to focus on a more robust asset-liability management framework and diversify their borrowing mix. They become complement to banks in the system and provide credit to parts of the economy that banks cannot or do not. The regulator also need to think about overall systemic risk and what could be done to fund the larger NBFCs and HFCs over time as they become larger than midsize banks and need access to funds.

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