

Rating Criteria for Non-Banking Finance Companies (Including Housing Finance Company and Micro Finance Institution)

Background:

Non-Banking Financial Companies (NBFCs) constitute an important segment of India's financial system, providing a wide range of credit products to retail, MSME and wholesale borrowers. NBFC lending portfolios are diversified across product categories such as vehicle finance, personal loans, gold loans, education loans, microfinance, unsecured business loans, housing finance, loans against property and infrastructure/project finance among others. Owing to their ability to serve niche and under-banked segments, NBFCs play a critical role in enhancing credit penetration across the economy.

Brickwork Ratings' (BWR) assessment of NBFCs involves a comprehensive evaluation combining quantitative metrics and qualitative factors. The analytical framework involves an in-depth assessment of the NBFC's financial strength and risk absorption capacity, as reflected in its capital structure, asset quality, liquidity buffers and earnings profile. BWR also evaluates the robustness of the business model, risk management practices, funding diversity, corporate governance standards and the entity's market position including franchise strength, scale of operations and competitive positioning within its key lending segments.

Given the systemic significance of NBFCs and their sensitivity to macroeconomic conditions, BWR's analysis incorporates a broader review of the operating environment, including trends in the overall economy, developments in the financial sector and dynamics within the specific lending segments in which the NBFC operates. The final rating outcome reflects BWR's view on the NBFC's creditworthiness based on its financial resilience, operational capabilities and external environment.

The methodology would mainly focus on evaluating the financial strength and resilience of the entity, assessed through audited financials, potential asset quality issues, capital raising plans and the entity's ability to sustain growth while maintaining liquidity and prudent risk management practices. The assessment framework comprises of the following parameters:

- Capital Adequacy
- Resource Profile
- Asset Quality
- Management Quality
- Earnings
- Liquidity
- Competitive Profile

While the above-mentioned parameters are used to assess the standalone credit profile of NBFC* similar to that for Bank/FI, the rating also considers the ownership structure of NBFCs through a notch-up model based on government support or support from a parent/group. The criteria for these can be found on the BWR website www.brickworkratings.com

Capital Adequacy

Capital adequacy reflects the financial strength of an NBFC, showing its ability to absorb losses, manage operational risks and continue business growth. It ensures that the NBFC has enough capital to withstand stress or downturns, preserving confidence in the broader financial system. A strong capital base provides flexibility to adapt to competitive and economic changes, while weak capitalization increases vulnerability to insolvency.

A higher Capital Adequacy Ratio (CAR) indicates stronger stability and resilience, while a lower CAR signals greater vulnerability to losses and potential insolvency.

The assessment of capital adequacy typically encompasses multiple dimensions to evaluate the overall financial resilience of an NBFC. The adequacy and reliability of capital are examined to gauge the company's ability to absorb operational and unexpected losses, considering both the size and composition of its capital base. The regulatory cushion or the surplus maintained over and above the minimum regulatory capital norms, is reviewed as it indicates the additional safety buffer available. The adequacy of the capital base is also assessed in relation to the NBFC's asset quality outlook, including risks arising from product mix, portfolio concentration and the inherent riskiness of assets.

Further, the capitalization policy of the management is evaluated, focusing on its approach to maintaining adequate capital through profit retention, promoter support or infusion of fresh capital from investors. The growth outlook is considered to determine the company's capacity to expand its asset base while sustaining sound capitalization levels. While higher leverage may be acceptable for stable and secured portfolios such as retail home loans or secured business loans, a more conservative stance is expected for concentrated or riskier exposures like corporate loans, builder loans, microfinance or unsecured SME loans. Finally, for NBFCs engaged in securitization or co-lending, the assessment treats off-balance sheet assets as well as on-balance sheet exposures to ensure a holistic view of capital, leverage and profitability.

Capital adequacy ratios is analyzed w.r.t the regulatory requirements, however BWR may look into the other parameters like ability to raise capital in future, risk appetite vs. internal generation of capital while rating an entity. Some of the ratios that are considered while analyzing capital are

- Gearing Ratio (x) = Total Debt / Tangible Net worth
- Adjusted Gearing (x) = (Managed asset- Adjusted Net worth)/ Adjusted Net worth

where, Managed asset refers to the total on balance sheet and off-balance sheet assets including the off-book securitization and co-lending assets;

Adjusted Net worth represents the net worth after incorporating the impact of first loss default guarantee obligations arising from co-lending arrangements.

- Capital Adequacy Ratio (CAR%) = (Total capital/ Risk-Weighted Assets) × 100
- Net Worth/NNPA (x) = Net Worth/ Net Non-Performing Assets

Resource Profile

The resource profile indicates the quality, diversity, stability and cost of NBFC's funding sources.

BWR evaluates the resource profile of an NBFC through a comprehensive analysis of various parameters that reflect its funding strength, stability and market access. The funding mix is reviewed to understand the composition of borrowings including bank loans and market instruments.

BWR assesses the diversity of funding base. A diversified funding base is viewed favourably as it reduces dependence on any single source or lender. The stability and diversity of funding sources are assessed by examining the depth of the NBFC's relationships with banks and financial institutions, as well as its access to a broad investor base in debt capital markets. The ability to mobilise funds even during stressed market conditions is considered a key indicator of financial resilience.

Further, the maturity profile of liabilities is analyzed to ensure that the tenure of borrowings is appropriately aligned with the maturity of assets, thereby minimising rollover risks and supporting sound asset–liability management practices.

The cost of funds is a critical aspect as lower borrowing costs generally indicate stronger creditworthiness, established reputation and wider funding access. The availability of backup lines, including unutilised bank limits, refinance facilities or other emergency funding arrangements is evaluated to determine the NBFC's preparedness to meet unforeseen liquidity pressures. The NBFC's market access and reputation are also assessed based on investor and lender confidence, track record of timely repayments and overall credibility in financial markets. Collectively, these factors provide an integrated view of the NBFC's resource adequacy, funding flexibility and resilience under varying economic and market conditions.

In reference to the above, BWR considers the following ratio for evaluating the resource profile of NBFCs:

- $\text{Cost of Funds} = \text{Total Interest Expense} / \text{Average Borrowings}$

where, Total Interest Expense refers to the interest paid on bank borrowings, non-convertible debentures, commercial papers, term loans, securitisation payouts, refinance etc.

Asset Quality

Asset quality is a key determinant of an NBFC's financial health, risk exposure and ability to withstand economic stress. BWR assesses the asset quality of an NBFC through a detailed evaluation of multiple factors that collectively indicate the soundness and sustainability of its loan portfolio. The portfolio quality and risk appetite are examined to understand the overall credit profile, underwriting standards and adherence to prudent lending norms, which reflect the entity's approach to risk-taking and long-term sustainability. The sectoral exposure and concentration are analyzed to identify the extent of dependence on specific industries or borrower segments, as higher concentration increases vulnerability to sectoral or cyclical downturns. The track record over time is also reviewed, focusing on the historical performance of assets, credit discipline and portfolio stability as key indicators of consistent credit management.

The assessment gives particular emphasis to NPA indicators, with Gross Non-Performing Assets (GNPA), Net Non-Performing Assets (NNPA) and trend of NPA (GNPA and NNPA) in industry and peers serving as primary measures of asset quality. While a high GNPA ratio suggests deterioration in the loan book, a high NNPA may point to insufficient provisioning. In order to understand the underlying asset quality trend over time and ensure that rapid growth does not dilute reported asset quality metrics, BWR also conducts 1-year lagged GNPA and static pool analysis while evaluating the asset quality.

Asset quality of NBFCs is also examined through its provisioning adequacy, write-offs, recovery rates and overall effectiveness in managing stressed exposures. Given the growing importance of off-balance sheet activities in the sector, BWR also evaluates the off-balance sheet portfolio, encompassing securitisation and co-lending arrangements. This ensures a comprehensive view of the NBFC, capturing both on-book and off-book exposures to form a holistic assessment of asset quality.

The vintage and track record of operations are reviewed to assess stability and credibility. An NBFC with a longer operational history and consistent performance is generally viewed more favourably, as it demonstrates resilience, sound governance and the ability to navigate cyclical downturns effectively.

In addition to the above, BWR considers the following ratios for evaluating the asset quality of NBFCs:

- $\text{GNPA}\% = \text{Gross NPAs} / \text{Gross Advances} \times 100$

- $\text{NNPA}\% = \text{Net NPAs} / \text{Net Advances} \times 100$

where, Net NPAs = Gross NPAs – Provision on assets

Management Quality

The quality of management is a critical factor in determining the long-term performance, sustainability and governance standards of an NBFC. BWR assesses the management quality of an NBFC that reflects the competence, integrity and effectiveness of the organization's leadership. The promoter background and track record are examined to gauge the promoters' experience, credibility and integrity, along with their past achievements in establishing and scaling financial institutions. This provides insight into the foundation of the NBFC's governance culture and strategic direction. The leadership competence of the senior management team is also evaluated, focusing on their ability to articulate a clear long-term vision, sustain growth, adapt to evolving market conditions and diversify into new business areas. The management's capability to attract, develop and retain skilled professionals is viewed as a key indicator of organizational strength.

The quality of corporate governance practices forms a critical component of the assessment. BWR examines the independence and effectiveness of the board, the robustness of governance committees, transparency in operations and the manner in which related-party transactions are handled. Adequacy of disclosures, adherence to best governance standards and alignment with regulatory expectations are also reviewed. The NBFC's market reputation and fund-raising ability are analyzed in conjunction with management credibility, as strong leadership often translates into better access to funding from banks and capital markets, enhancing financial flexibility.

Further, the prudence in capital deployment and risk appetite is assessed to determine whether management decisions reflect sound judgment, avoiding excessive leverage, aggressive expansion or high-risk exposures. The presence and effectiveness of a risk management framework are evaluated through the existence of formal risk assessment systems and stress-testing practices designed to mitigate business and financial vulnerabilities. The quality of accounting and regulatory compliance is also reviewed, focusing on the transparency, consistency and conservatism of accounting practices, along with a demonstrated track record of compliance with regulatory bodies such as the RBI and SEBI. Finally, the management's focus on technology adoption and responsiveness to competition is examined. Investments in digital infrastructure, data security and technology-driven processes, along with the ability to adapt to competitive dynamics and execute growth strategies effectively, reflect the NBFC's overall adaptability and forward-looking management approach.

Earnings

Earnings quality in NBFCs refers to consistent, reliable and risk-adjusted profitability of the entity. It indicates the NBFC's ability to meet debt obligations, while also reflecting how effectively it manages its operations and funding costs. High-quality earnings are critical for maintaining investor confidence and attracting debt and equity, especially during periods of financial stress. The quality of earnings is influenced by the composition of income, cost efficiency, asset quality and capital requirements. Key parameters and metrics are used to assess earnings quality, considering both historical performance and forward-looking sustainability.

BWR evaluates the earnings quality and variability in earnings of an NBFC through a detailed analysis of the stability and composition of its income streams and profitability metrics. The composition of income is reviewed to understand the relative contribution of fund-based income such as interest from loans and advances and fee-based income, including processing fees, advisory charges and servicing income from securitised assets. A well-balanced mix of these income sources is viewed favourably, as it reduces earnings volatility and supports consistent profitability. The analysis of profitability trends and margins focuses on historical performance indicators such as net interest margins, operating margins and growth in earnings. Stable or improving margins over time indicate stronger earnings quality and effective management of operations.

The assessment also includes an evaluation of cost efficiency, typically measured through the cost-to-income ratio, which reflects how effectively the NBFC manages operating expenses relative to its income. Lower ratios are indicative of higher operational efficiency. Credit costs and provisioning are analyzed to determine their effect on overall profitability and sustainability. While higher credit costs can temporarily depress profits, they often reflect prudent risk management practices that strengthen long-term financial stability. Income from securitisation gains, such as upfront premiums, excess interest spreads and servicing fees is also reviewed to assess its recurrence and sustainability, ensuring that reported profits are not unduly influenced by one-time gains.

BWR further examines earnings stability and persistence by evaluating the consistency of profits across business cycles and benchmarking performance against peers. Adjustments are made for extraordinary items, accounting changes or non-recurring income to derive the NBFC's true earning capacity. The ability of earnings to augment capital is another key factor, as internally generated profits contribute to reserve build-up and support future loan growth, providing a cushion against potential losses. Finally, a peer comparison and forward-looking assessment are conducted to contextualize performance within the industry, evaluate efficiency and resilience, as well as project the NBFC's future profitability based on its historical trends and strategic direction.

In addition to the above, BWR considers the following ratios for evaluating the earnings quality of NBFCs:

- Return on Managed Assets (ROMA%) = $\text{PAT} / (\text{Total Assets} + \text{Off-book Portfolio}) \times 100$

where, Total Assets refer to the assets appearing on the balance sheet;

Off-book Portfolio refers to the off-book securitisation and co-lending assets

- Return on Equity (ROE%) = $\text{Net Income} / \text{Shareholders Equity} \times 100$

- Net Interest Margin (NIM%) = $\text{Net Interest Income (NII)} / (\text{Average Interest Earning Assets}) \times 100$

where, NII=Interest Earned–Interest Paid,

Average Interest Earning Assets are loans and advances to borrowers that generate interest (usually average of opening and closing balance)

- Provision Coverage Ratio (PCR%) = $(\text{Loan Loss Provisions} / \text{Non-Performing Loans}) \times 100$

Liquidity

Liquidity management in NBFCs refers to how effectively they manage cash flows to ensure timely repayment of short-term obligations (borrowings and interest), while also supporting day-to-day operations, even during financial stress. It involves maintaining adequate liquid assets (like cash and marketable securities) and having assured access to funding when required. The Asset–Liability Management (ALM) framework plays a key role in enforcing risk discipline, since NBFCs are exposed to various risks such as credit, interest rate, equity/commodity price, liquidity and operational risks. Liquidity challenges for NBFCs often arise due to higher borrowing costs, asset–liability mismatches, repricing risks, the illiquid nature of certain assets and reluctance of lenders/investors to extend funding.

BWR assesses the liquidity risk of an NBFC by evaluating its ability to meet both short-term and long-term financial obligations. The asset–liability maturity structure is analyzed to determine the alignment between expected cash inflows such as loan repayments and investment maturities and outflows including debt servicing, interest payments and operating expenses across various time buckets. A well-matched maturity profile indicates prudent liquidity management and reduces rollover risk. The availability of unutilised bank limits is also reviewed, as undrawn credit lines serve as immediate liquidity buffers that can be utilised during periods of cash flow pressure.

The collection efficiency of the NBFC is a key factor in assessing liquidity, since the regularity and predictability of borrower repayments directly influence cash flow stability. The liquidity of investments is evaluated to gauge the company’s ability to liquidate or sell investments before maturity to meet urgent funding requirements without incurring significant losses. The strength of lender relationships is also considered important, as well-established ties with banks and other financial institutions can facilitate quicker access to funding or rollovers during stressed market conditions.

Finally, the degree of funding diversification is assessed to identify concentration risks. NBFCs with a diversified funding base across multiple sources—such as banks, debentures, commercial papers and refinance institutions are considered better positioned to withstand liquidity shocks and maintain stability under varying market conditions.

In addition to the above, BWR considers the following ratios for evaluating the liquidity of NBFCs:

- Liquidity Coverage Ratio (LCR%) = $\text{HQLA} / \text{Net Cash Flow over 30-day period} \times 100$

where, HQLA are unencumbered assets that can be converted into cash or used as collateral, with little or no loss of value under stressed conditions.

- Liquid Assets Ratio (%) = $\text{Liquid Assets} / \text{Total Assets} \times 100$

Competitive Profile

Competitive profile reflects the relative standing or competitive strength of the NBFC in the financial services industry compared to its peers. A strong market profile indicates that the NBFC is more likely to generate stable revenues, withstand competition, access capital at lower costs and navigate stress situations better.

The size and scale of operations are key considerations. Larger NBFCs generally benefit from stronger funding access, greater bargaining power with lenders and broader customer outreach.

Further, diversification across products, customer segments and geographic regions is analyzed to determine the NBFC's resilience against cyclical or regional risks. A well-diversified franchise mitigates overdependence on any single asset class or market segment, thereby enhancing business stability. The NBFC's competitive advantages such as strong distribution networks and superior customer service are evaluated to understand its ability to carve out a niche in competitive markets.

Environmental, Social and Governance:

In addition to the risks mentioned above, BWR recognizes that Environmental, Social, and Corporate Governance (ESG) factors increasingly influence the operations, resilience and long-term sustainability of NBFCs. Accordingly, while evaluating the credit profile of an NBFC, BWR also examines its ESG profile based on the availability of relevant data. It may be noted that the impact of the ESG profile of the NBFC, both in terms of its strengths and weaknesses, are incorporated in the various management risk related parameters while assessing the credit risk associated with the NBFC.

Group or Parent Support: In cases where the NBFC is part of a larger group, the willingness and ability of the parent or affiliate companies to provide financial, operational or strategic support is examined. The strength of such linkages enhances overall management credibility. Refer to support criteria on BWR website.

Specialized NBFCs that BWR rates:

- Housing Finance Companies (HFCs) and
- Microfinance Institutions (MFIs)

The above-mentioned entities are specialized categories of Non-Banking Financial Companies (NBFCs) that play a vital role in promoting financial inclusion and supporting underserved segments of the economy.

BWR evaluates Housing Finance Companies (HFCs) and Microfinance Institutions (MFIs) using broadly the same parameters applied for other NBFCs. The evaluation framework considers key aspects such as capital adequacy, resource profile, asset quality, management quality, earnings, liquidity, market position, regulatory compliance, financial performance and risk management practices. While

the core assessment principles remain consistent, the analysis also takes into account sector-specific characteristics, operating models and the unique risk profiles associated with HFCs and MFIs to ensure a balanced and comprehensive evaluation of their creditworthiness.

- **Housing Finance Company (HFC):**

A Housing Finance Company (HFC) is a non-banking financial company (NBFC) primarily engaged in providing finance for housing purposes. Similar to NBFCs these companies are regulated by the Reserve Bank of India (RBI).

Products and Services offered by HFCs:

HFCs promote home ownership and support housing development by offering loans for purchasing, constructing or renovating residential properties. Other than home loan, HFCs include loan against property (LAP), lease rental discounting (LRD), project loans to builders and developers, insurance and allied services (home loan insurance, property insurance).

- **Micro Finance Institution:**

Micro Finance Institution (NBFC-MFI) is a non-deposit taking NBFC that provides small, collateral-free loans and other basic financial services (like savings, insurance and remittances) to low-income individuals or households who typically lack access to traditional banking services. Microfinance Institutions are required to allocate at least 75% of their total assets towards microfinance loans.

Services offered by Microfinance Institutions:

Microfinance Institutions (MFIs) primarily serve economically weaker sections of society, including self-employed individuals, small entrepreneurs and low-income households. The loans offered are typically small in size ranging from a few thousand to a few lakh rupees depending on the borrower's income level and repayment capacity. These are collateral-free loans, extended on the basis of the borrower's income stability, credit discipline or group guarantees, without any lien on the borrower's deposit account to preserve their collateral-free nature. The primary purpose of such loans is to support income-generating activities like small businesses, agriculture, handicrafts or service-related ventures. Repayments are generally made in small, regular installments and MFIs follow a board-approved policy that allows flexibility in repayment schedules to suit the borrower's convenience and financial capacity.

Conclusion:

BWR evaluates each of the above parameters by assessing the impact of identified risks and key attributes, to determine the overall credit quality of an NBFC. The rating methodology involves a comprehensive analysis of various risk factors, including regulatory landscape, industry positioning, financial strength, operational effectiveness and business fundamentals to arrive at a holistic and well-informed assessment of the entity's credit profile.

* All NBFC analysis ratios will remain similar for Housing Finance Company (HFC) and Micro Finance Institution (MFI)

This is the first criterion document, so no prior version or reference link exists.

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