VIII. ARE THE LESSONS LEARNED: REGULATORY REFORMS IN THE INDIAN NBFC SECTOR POST-GREAT INDIAN NBFC CRISIS

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ABSTRACT

The 2008 global financial crisis impacted the Indian financial system, leading to policy adjustments to ensure financial stability and reduce systemic risks. Non-banking financial companies (**"NBFCs"**) emerged as a significant source of credit in India's financial sector, but the recent Great Indian NBFC Crisis raised concerns about the effectiveness of regulatory controls and NBFC sector resilience. The Reserve Bank of India (**"RBI"**) implemented regulatory measures to restore public trust and address the crisis, including risk management principle adjustments, capital adequacy standards, and liquidity frameworks. However, uncertainty remains about the effectiveness of these measures in preventing future crises. The author aims to analyze the Great Indian NBFC Crisis, including the factors that caused it, the evolution and potential of NBFCs in India, and how to strengthen the sector post-crisis. The author will also assess if the government and regulatory authorities have learned from the crisis and evaluate the effectiveness of the measures implemented by the RBI and regulatory authorities. The study the author aims to provide valuable insights into the regulatory changes in the Indian NBFC market and the causes and difficulties faced by NBFCs in India.

I. INTRODUCTION

The Non-Banking Financial Companies (**"NBFCs"**) industry has expanded considerably in recent years, aiding in the expansion and

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advancement of the Indian economy as a whole. Small and medium-sized businesses (**"MSMEs"**), micro, Small and medium-sized businesses (**"SMEs"**), and other unbanked sectors of the economy have significantly benefited from the sector's ability to provide loans. Additionally, NBFCs are essential to financing consumer, housing, vehicle, and infrastructure initiatives.[1]

As a result of meeting the credit needs of economic sectors that traditional banks are unable to serve properly, the Indian NBFC sector has grown to be a major player in the Indian financial system. Financial organizations known as NBFCs offer banking services like loans, investments, and credit lines but need a banking license. They are governed by the Reserve Bank of India (**"RBI"**) under the Reserve Bank of India Act[2], and incorporated under the Companies Act[3].

As the requirements of the industry and the larger financial system changed over time, so did the regulatory framework for NBFCs. The RBI is the main agency in charge of overseeing and governing NBFCs to ensure their stability and soundness. Over the years, the RBI has implemented a number of regulatory measures to bolster the NBFC regulatory framework, enhance sector governance standards, and better risk management procedures.

The NBFC industry has encountered a number of difficulties recently, including the liquidity crisis and asset-liability mismatches, which resulted in

[1] Ravisha Poddar, 'What Are NBFCs And What Does It Mean To Indian Economy' (https://startup.outlookindia.com/) <https://startup.outlookindia.com/analysis/what-are-nbfcs-and-what-does-it-mean-to-indian-economy-news-7809> accessed 21 March 2023.
[2] Reserve Bank of India Act 1934, s 45(I)- s 45 (QB).
[3] Companies Act 2013, s 3.

the Great Indian NBFC Crisis in 2018–2019.[4] The crisis made it clear that regulatory changes are required to handle the sector's vulnerabilities and guarantee its stability and soundness.

As a result, this research will help in examining the NBFC crisis, and the regulatory changes made to the NBFC market after that and will also offer insightful information on what are the factors due to which the NBFC crisis has happened and what lessons are learned from that NBFC crisis.

II. THE GREAT INDIAN NBFC CRISIS

In India, the NBFCs are organizations that operate similarly to banks. They have the same authority to extend credit as banks do. They cannot, however, accept deposits from borrowers in order to make these advances.[5] Therefore, in order to finance their debts, these NBFCs borrow money from the bond market.

NBFCs handle 5% of the lending in the Indian banking sector.[6] These non-traditional banks are known as "shadow banks" because they extend credit more quickly than conventional banks do. Nevertheless, things changed dramatically in 2018, when Infrastructure Leasing and Financial Services (**"IL&FS"**) defaulted on Inter Corporate Deposits (**"ICDs"**) secured from the Small Industries Development Bank of India (**"SIDBI"**), it was clear that the company was having financial issues. The dread and panic brought on by the

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[4] ABC, 'The Great Indian NBFC Crisis' (Management Study Guide - Courses for Students, Professionals & Faculty Members.) <www.managementstudyguide.com/great-indian-nbfc-crisis.htm> accessed 21 March 2023.

[5] James Chen, 'Nonbank Financial Institutions: What They Are and How They Work' (Investopedia, 31 May 2009) <www.investopedia.com/terms/n/nbfcs.asp> accessed 16 April 2023.

[6] Krishna Kant, 'NBFCs' Share in India's Lending Pie Fell to 5-Year Low of 19.8% in H1FY23' (Business standard, 13 December 2022).

delayed payment of Commercial Papers (**“CPs”**) rocked the economy. The default was primarily caused by the Asset Liability Management (**“ALM”**) mismatch. Although ALM mismatch is common in the financial sector, it nevertheless constitutes a major threat to the company and must be handled with care. Long-term liabilities like CPs and Non-Convertible Debentures (**”NCDs”**) may be used to support loans carried out in sectors like infrastructure and housing. These investments provide more cost-effective funding and are reviving interest in some investment groupings, such as mutual funds. However, they mature in a very short amount of time—between three and six months—while NBFCs are expected to repay loans over the following twenty years. NBFCs routinely issue new sets of CPs together with additional borrowing to meet short-term obligations. They were able to "roll over" money in this way without any issues up to the point where lenders started to withdraw from the succeeding batch of CPs, which dried up liquidity. The company's assets and obligations are out of balance because it cannot make money.[7]

Here “The Great Indian NBFC Crisis” affected the NBFCs’ sectors and sub-sectors like Asset Management Companies (**“AMCs”**) and Housing Finance Companies (**“HFCs”**) very negatively and made them particularly susceptible. The effects were so severe that credit disbursal amounts decreased by 17% from October to December 2018 compared to the prior year as a result. The NBFCs were collapsing and closing down at a faster pace than expected.[8]

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[7] ABC, ‘NBFC Crisis | Study Into the Causes & Solutions | NBFC License India |’ (NBFC Registration) <https://nbfclicenseindia.com/blog/nbfc-crisis/> accessed 22 March 2023.
[8] ‘How the IL&FS crisis ravaged India's NBFC sector - A Timeline - ET BFSI’ (ETBFSI.com) <https://bfsi.economictimes.indiatimes.com/news/nbfc/how-the-ilfs-crisis-ravaged-indias-nbfc-sector-a-timeline/90541212> accessed 22 March 2023.

The outlook for NBFCs was no longer positive in the market. Instead, their stock prices were plummeting. A blue-chip NBFC company, Dewan Housing Finance Corporation Ltd. (“**DHFL”**), unexpectedly experienced a 60% daily stock price decline.[9] The same thing happened with IL&FS, which is reputed to be a leader in this industry. The following are some ways that the stock’s fall contributed to the market crash:

- Asset Quality Issues: Many NBFCs are HFCs that lend to developers or homebuyers, heavily investing in the housing sector. However, the Indian housing sector has collapsed, with companies such as Amrapali, Supertech, and Unitech failing, leading to questions about NBFCs’ asset quality. This, along with increased scrutiny of assets and liabilities, is driving these companies towards insolvency.
- Timing Mismatch: Indian NBFCs have been borrowing short-term and lending long-term, resulting in an asset-liability timing mismatch. However, they were able to pay their debts when due until IL&FS mismanaged its funds, exposing its faulty business model.[10] As a result, investors were scared away, and NBFCs couldn’t issue new debt to roll over old debt, causing further problems.
- Mutual Funds: The NBFCs depended on debt mutual funds for funds, but due to their market crash, investors reduced their investments, causing a decline in the supply of funds. This has worsened the problems of the NBFCs.

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[9] Rahul Oberio, ‘NBFC Bubble Burst: Stocks Fall Up to 80% From 52-Week Highs’ (The Economic Times) <https://economictimes.indiatimes.com/markets/stocks/news/nbfc-bubble-burst-stocks-fall-up-to-80-from-52-week-highs/articleshow/65946303.cms> accessed 23 March 2023.

[10] ABC, ‘NBFC Crisis | Study Into the Causes & Solutions | NBFC License India |’ (NBFC Registration) <https://nbfclicenseindia.com/blog/nbfc-crisis/> accessed 22 March 2023.

Both immediately and over time, the IL&FS crisis had a major effect on India's financial situation. Here are some of the main effects:

- Liquidity crunch: Due to the fact that numerous other NBFCs and mutual funds had invested in the company's debt documents, the default by IL&FS and its subsidiaries caused a liquidity shortage in the Indian financial market. Investor trust suffered as a result, and a large number of investors withdrew money from mutual funds and NBFCs, worsening the liquidity crisis.
- Slowdown in economic growth: India's economy grew more slowly as a result of the liquidity crisis and the uncertainty it brought about because many sectors and industries that depended on financing from NBFCs and other financial institutions had trouble acquiring capital.[11]
- Regulatory overhaul: As a result of the crisis, the RBI and other regulatory bodies overhauled the financial system's regulatory framework in order to avoid future crises. Additionally, the RBI improved NBFC oversight and surveillance.[12]
- Investor confidence: Investor trust in the Indian financial system was damaged by the crisis, and many investors became warier in making investments in NBFCs and other financial organizations. This has caused investors to switch to safer investments like government bonds,

[11] Mathew Joseph, 'Global Financial Crisis: How Was India Impacted?', Inwent-Die Conference on Global Financial Governance – Challenges and Regional Responses (Deutsches Institut für Entwicklungspolitik 2009) <www.idos-research.de/fileadmin/_migrated/content_uploads/Global_Financial_Crisis_and_Impact_on_India_Berlin030909.pdf> accessed 16 April 2023.

[12] Reserve Bank of India, Financial Stability Report (Including Trend and Progress of Banking in India 2019-20) (ACME Packs & Prints (I) Pvt. Ltd.) <www.sbfnetwork.org/wp-content/assets/policy-library/910_India_Report_on_Trend_and_Progress_of_Banking_in_India_2019-2020_RBI.PDF> accessed 16 April 2023.

which has adversely affected the financial sector’s development prospects in the private sector.

- Impact on corporate governance: The disaster revealed significant flaws in IL&FS and its subsidiaries’ corporate governance and risk management procedures. Companies are now under pressure to improve their governance practices to prevent similar disasters as a result of increased scrutiny of corporate governance practices across the Indian corporate sector.

III. LESSONS LEARNED FROM THE NBFC CRISIS

The IL&FS crisis, which occurred in India in August 2018, had a significant impact on the country’s NBFC sector.[13] The company heavily relied on short-term debt to fund long-term infrastructure projects, resulting in an asset-liability mismatch when projects were stalled, and fresh funds did not flow in. The company suffered from mismanagement, poor governance, high leverage, and poor returns on investments. The Government of India, being a major stakeholder, intervened to prevent the company from collapsing, with LIC and SBI providing the necessary liquidity.[14] The new Board at IL&FS identified certain lessons from the NBFC crisis and acted according to that:

- Need for better regulation: The NBFC crisis in India has brought attention to the need for stringent and effective oversight of the non-

[13] Riya Regmi and Poornima Kukreti, ‘The Impact of Government Intervention on the NBFC Crisis’ (Social Science Research Network) <https://deliverypdf.ssrn.com/delivery.php?ID=777119081090115113125007119064077029117046025068004010066118104028006102104102113119029035055009008044005105101118121016015127106071060023014122071107069108095084028031052051113064117110026107021099066082097114102067127019010071068080075001090084020094&EXT=pdf&INDEX=TRUE>.

[14] Claudia Buch and B Gerard Dages, ‘Structural changes in banking after the crisis’, Committee on the Global Financial System (Bank for International Settlements).

banking financial sector. Despite the RBI's efforts to address the issue, more extensive regulation is needed to prevent regulatory loopholes.[15] The crisis has also highlighted the importance of varied funding sources, such as a thriving securitization market, in order to supply NBFCs with long-term financing. Because the upheaval caused by the crisis has had an impact on banks and mutual funds that have invested in insolvent financial enterprises, effective regulation is even more crucial.[16] In order to keep the NBFI market stable and viable, more transparency, competition, and financial literacy among investors and borrowers are also necessary.

- Importance of Risk Management: In order to handle increased lending volumes and a wider range of portfolios, NBFCs must strengthen their internal risk-management procedures, as the crisis has made abundantly evident. As a result of the crisis, it has been urged and advised that the NBFC industry operate with due diligence and regularly evaluate firm growth. Risk management is crucial for NBFCs to exist since it has an impact on their capacity to draw in funding from primary markets in the short term and list on the stock exchange. The RBI has also made attempts to tighten risk management in the NBFC sector by pooling considerable funds in the NBFC and banking sectors in order to mitigate the impact of the crisis through open market operations.[17]

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[15] Reserve Bank of India, 'Re-Designing Regulatory Framework for NBFCS' Regulating Non-Banking <www.rbi.org.in/scripts/FS_Speeches.aspx?Id=928&fn=14> accessed 16 April 2023.

[16] Agustín Carstens, 'Non-Bank Financial Sector: Systemic Regulation Needed' (Bank For International Settlements 2021) <www.bis.org/publ/qtrpdf/r_qt2112_foreword.htm> accessed 16 April 2023.

[17] K Srinivasa Rao, 'Strengthening Risk-Management Capabilities in the Financial Sector' (Ideas For India, 21 June 2021) <www.ideasforindia.in/topics/money-finance/strengthening-risk-management-capabilities-in-the-financial-sector.html> accessed 16 April 2023.

- Need for better transparency and disclosure: The NBFC crisis has highlighted how important it is to perform careful due diligence on how the NBFC sector functions and routinely monitor business growth. The necessity for mutual funds and credit rating agencies to be more open and honest when evaluating risky assets has also been brought to light by the financial crisis.[18] In an effort to mitigate the consequences of the crisis through open market activity, the RBI has increased transparency in the NBFC industry by pooling sizable quantities of money from the banking and NBFC sectors. Therefore, improving openness and transparency is essential to prevent future issues of this nature.[19]
- Need for better liquidity management: The NBFC crisis in India has improved our understanding of the need for better liquidity management in the non-banking financial sector. The crisis has brought to light how important it is to perform careful due diligence on how the NBFC industry functions and constantly track business growth. The crisis has also forced the NBFC sector realise the necessity for improved risk-management capabilities in order to handle increasing volumes of loans and more diverse portfolios.[20]
- Role of credit rating agencies: The role of credit rating agencies in the non-banking financial industry has received more attention as a result

[18] Debashis Basu, 'How Not to Waste the NBFC Crisis' (Indian Express, 10 June 2019) <www.business-standard.com/article/opinion/how-not-to-waste-the-nbfc-crisis-119061000006_1.html> accessed 16 April 2023.
[19] FE Bauru, 'Lessons From NBFC Crisis: Securitization Market Essential for Sustainable Funding' (Financial Express, 16 October 2018) <www.financialexpress.com/money/lessons-from-nbfc-crisis-securitisation-market-essential-for-sustainable-funding/1350330/> accessed 16 April 2023.
[20] K Srinivasa Rao, 'Strengthening Risk-Management Capabilities in the Financial Sector' (Ideas For India, 21 June 2021) <www.ideasforindia.in/topics/money-finance/strengthening-risk-management-capabilities-in-the-financial-sector.html> accessed 16 April 2023.

of the NBFC crisis. The necessity for tougher regulations limiting credit rating companies' capacity to provide high ratings to risky ventures has been made clear by the financial crisis. Banks and mutual funds that had lent money to troubled finance companies saw the effects of the crisis in addition to the NBFC sector. The problem has also drawn attention to the importance of carrying out exhaustive examinations into how the NBFC industry functions and of routinely monitoring business expansion.

IV. REGULATORY RESPONSE TO THE NONBANKING FINANCIAL COMPANY CRISIS

Although the NBFC crisis has not yet been fully resolved, the RBI and the government have taken major steps to contain it, which has led to a recovery in the market.[21] The RBI's initial actions included pooling funds through Open Market Operations (**"OMO"**) in the banking and NBFC sectors to lessen the effect, carefully monitoring significant NBFCs based on size and business volume, and creating a committee to review liquidity management frameworks. Additionally, the government offered assistance by declaring a six-month partial guarantee against high-quality pool buyouts to ensure the industry had enough liquidity.[22]

In order to fund lending in the financial system, the RBI also bought government debt paper worth Rs. 3 lakh crore from the market. NBFCs sought out alternative sources like external commercial borrowings, public bond issuances, and asset sales because the cost of borrowing from risk-averse

[21] Nupur Anand Swati Bhat, 'RBI Moves Unlikely to Ease Pain for India's Struggling Shadow Banks' (U.S., 7 August 2019) <www.reuters.com/article/us-india-nbfc-liquidity-analysis/rbi-moves-unlikely-to-ease-pain-for-indias-struggling-shadow-banks-idUSKCN1UX1N1> accessed 16 April 2023.
[22] 'NBFC Regulation' (2018) LXXIV(11) RBI Bulletin, 1.

banks remained expensive for them. Despite the fact that this improved balance sheets and refinanced obligations, the liquidity problem remained.

In order to address this, the RBI loosened some regulations and limited the amount of loans that banks could extend to NBFCs. For a few months, the maximum limit was briefly raised from 10% to 15%, injecting almost $10 billion of liquidity into cash-strapped NBFCs. They were able to roll over their debts and collect short-term cash as a result Additionally, the RBI revoked the licences of several NBFCs after finding that they were breaking rules.[23]

The government and RBI took various actions to address the situation after realizing the gravity of the challenge facing NBFCs and HFCs in the wake of the IL&FS crisis and the wider economic impact of this episode.[24] The administration took the following measures:

- the initiation of a program worth $1 trillion aimed at providing guarantees to all NBFC lending that met the program's criteria, protecting them from first loss; and
- the introduction of an alternative investment fund worth $250 billion, with a government contribution of $100 billion, to complete housing development projects that were at a standstill. This was aimed at helping financially struggling developers to complete their projects, which would benefit HFCs that had

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[23] Abhijit Bhave, 'The NBFC Crisis and the Solution' (Wealth Management Course, Certification, AAFM Reviews, Real Estate Short Course) <www.aafmindia.co.in/Blog/the-nbfc-crisis-and-the-solution> accessed 16 April 2023.
[24] Subarta Panda, 'After IL&FS Crisis, Covid-19 Makes NBFCs Struggle Despite RBI Actions' (Business News, Finance News, India News, BSE/NSE News, Stock Markets News, Sensex NIFTY, Union Budget 2023) <www.business-standard.com/article/finance/after-il-fs-crisis-covid-19-makes-nbfcs-struggle-despite-rbi-actions-120061201803_1.html> accessed 25 March 2023.

- provided home loans to individuals who were purchasing homes in those projects.[25]

The RBI made the following actions to increase the amount of bank lending to NBFCs[26]:

- The risk weights assigned by banks for financing to NBFCs were reduced and made equivalent to those assigned for other businesses;
- the single-borrower exposure limitations of NBFCs were increased from 15% to 20% of Tier I capital to allow for more expansion; and
- banks were allowed to lend to registered NBFCs (excluding microfinance institutions) for on-lending to agriculture (limited to term loans only) up to $1 million, to micro and small businesses up to $2 million, and to housing up to $2 million per borrower (previously limited to $1 million), subject to certain conditions.

In addition to these direct actions, a number of indirect ones were also made to increase NBFCs' liquidity. Among these indirect metrics[27] are:

- between October 2018 and March 2019, OMOs were executed to inject approximately 3.5 trillion worth of liquidity into the financial system;
- the maximum quantity of securities that can fulfill both the statutory liquidity ratio and the liquidity coverage ratio, or the Facility to Avail Liquidity for Liquidity Coverage Ratio (**"FALLCR"**), was increased,

[25] Reserve Bank of India, Report on Trend and Progress of Banking in India 2018-19 (RBI 2019).
[26] Nupur Anand Swati Bhat, 'RBI Moves Unlikely to Ease Pain for India's Struggling Shadow Banks' (U.S., 7 August 2019) <www.reuters.com/article/us-india-nbfc-liquidity-analysis/rbi-moves-unlikely-to-ease-pain-for-indias-struggling-shadow-banks-idUSKCN1UX1N1> accessed 16 April 2023.
[27] Rajeswari Sengupta, Lei Lei Song and Harsh Vardhan, 'A Study of Nonbanking Financial Companies in India' (ASIAN DEVELOPMENT BANK 2021).

enabling banks to hold fewer securities in reserves and offer more loans;

- to encourage NBFCs to securitize their loan portfolios, modifications to the securitization regulations, such as reducing the minimum holding time requirement, need to be implemented; and
- transferring control over HFC regulation from the National Housing Bank (**"NHB"**) to the RBI in order to coordinate regulatory supervision among banks, NBFCs, and HFCs.

The majority of these actions aimed to make NBFCs' short-term liquidity circumstances better. The imposition of liquidity-related rules (such as those related to asset liability management, or asset-liability mismatch) on NBFCs and the transfer of regulation of HFCs from the NHB to the RBI were two additional structural, long-term measures.[28] In order to improve NBFC regulation, the RBI must implement additional long-term steps, such as a stricter supervisory regime for NBFCs and HFCs.

V. FUTURE OF NBFC

The recent incidents in the NBFC industry, along with the resulting credit squeeze, have raised several questions about the NBFC's business strategy and future prospects. What are the possible benefits of enabling these specialized financial organizations to operate despite their lack of funding, as opposed to forcing banks to serve the same areas, must be considered? Banks have a higher cost of funding because they have direct access to public funds, and it is possible that some banks will enter into sectors that were previously only served by NBFCs.[29]

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[28] ibid.
[29] ibid.

If banks are unable to serve all consumer categories, determining the best non-bank funding strategy becomes critical. And access to home savings appears to be the most sustainable form of funding in an economy with an underdeveloped and illiquid bond market.[30] In such a setting, it is critical to devise strategies to assist non-banking financial enterprises in growing, even if banks provide the majority of their funding. This suggests that the RBI, the regulator, must re-calibrate regulatory monitoring based on the lessons learned from the current crisis.

Annual inspections and regulatory actions, similar to the asset quality review conducted for commercial banks during the NPA crisis of 2015-16[31], must be conducted on systematically important NBFCs.[32] Such NBFCs should be identified, and those with significant interconnections that may be too big to fail must be regulated individually and differently. While transforming these highly interconnected NBFCs into commercial banks or reducing their network externalities may improve the stability of the financial system, they may also be more efficient than other NBFCs in diverting funds to places where banks do not lend. As a result, there must be a balance between regulation and economic efficiency.

Additionally, a framework must be developed to assist NBFCs in managing periodic liquidity shocks. Contrary to the banks, which have access to RBI repo operations, NBFCs do not have a reliable source of short-term financing.[33] Furthermore, most NBFCs do not own high-quality debt

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[30] Claudia Buch and B Gerard Dages, 'Structural changes in banking after the crisis', Committee on the Global Financial System (Bank for international settlements).
[31] 'NBFC Regulation' (2018) LXXIV(11) RBI Bulletin, 1.
[32] Master Direction – Non-Banking Financial Company – Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2020 (RBI 2020).
[33] Financial Sector Regulation for Growth, Equity and Stability (BIS Papers, Bank for International Settlements 2019).

instruments that can be used as collateral and a coordinated effort may be required to develop an institutionalized process for supplying liquidity in order to respond to a systemic liquidity shock.

A wide set of funding sources are required for the NBFC model's long-term survival. Banks and domestic debt capital markets are now the only sources of liabilities for NBFCs. To establish a sustainable and dependable funding model, NBFCs must have access to a larger pool of debt capital, both domestically and internationally. It may be necessary to revise regulations governing NBFCs' external commercial borrowing. Asset-backed securitization, for example, might help NBFCs gain access to large pools of debt capital, such as pension funds. Additionally, alternative investment vehicles with a higher risk tolerance can be encouraged to create funds for NBFC debt securities investments.[34] The 2018 financial crisis revealed critical lessons for different financial system players, including auditors, securities market regulators, mutual funds, credit rating agencies (**"CRAs"**), and banks.[35] The IL&FS default caused widespread shock due to the high ratings assigned to defaulted instruments, highlighting the need for stronger oversight of supportive institutions such as CRAs by the Securities and Exchange Board of India (**"SEBI"**) in the future. To establish an NBFC model, all participants must have a comprehensive understanding of the risks involved. NBFCs are critical in under or unserved consumer sectors, but their unique characteristics necessitate distinct regulatory oversight than that of commercial banks.[36] The

[34] Vijaya Kittu Manda, 'Lessons from the IL&FS Financial Crisis' (GITAM University April 2019).
[35] Jaime Caruana, 'Financial reform and the role of regulators: Evolving markets, evolving risks, evolving regulation' (BIS Speech, Bank for International Settlements 2015).
[36] Subhomoy Bhattacharjee, 'IL&FS default: Did rating agencies' failure to connect dots lead to crisis?' (Business News, Finance News, India News, BSE/NSE News, Stock Markets News, Sensex NIFTY, Union Budget 2023) <www.business-

designation of NBFCs as larger, systemically significant organizations, as opposed to others, is required to focus regulatory and supervisory attention on the former and establish a balance between financial and operational flexibility and the reduction of systemic risk. The 2018 crisis may result in a system reorganization, with specialist and competent NBFCs remaining and dominating the market while stronger, more distinct NBFCs exit.

Non-banking financial institutions (**"NBFIs"**), particularly NBFCs, have a significant role to play in developing countries like India, where obtaining bank funding is a challenge for a significant proportion of the population and enterprises.[37] The emergence of NBFCs in India and the 2018 crisis provide valuable lessons for other developing nations. To avoid a recurrence of the 2018 crisis, capital sources must exercise greater caution and discrimination when funding NBFCs. Furthermore, the long-term viability of the NBFC model necessitates a diverse funding source structure, including access to a broader range of domestic and international debt capital and techniques such as asset-backed securitization.[38]

VI. CONCLUSION

The Great Indian NBFC crisis of 2018 had a significant impact on the NBFC sector in India, leading to liquidity tightening, difficulty in fresh lending, and impacting company profits. The crisis has taught several lessons to the Indian government and regulators, including the importance of governance, capital adequacy, liquidity, and continuous clean-up of the NBFC sector. Although the NBFC crisis has not yet been fully resolved, the RBI and

standard.com/article/companies/il-fs-default-did-rating-agencies-failure-to-connect-dots-lead-to-crisis-118092800364_1.html> accessed 25 March 2023.

[37] Claudia Buch and B Gerard Dages, 'Structural changes in banking after the crisis', Committee on the Global Financial System (Bank for International Settlements).

[38] 'NBFC Regulation' (2018) LXXIV(11) RBI Bulletin, 1.

the government have taken major steps to contain it, which has led to a recovery in the market. The RBI's initial actions included pooling funds through OMO in the banking and NBFC sectors to lessen the effect, carefully monitoring significant NBFCs based on size and business volume, and creating a committee to review liquidity management frameworks. Additionally, the government offered assistance by declaring a six-month partial guarantee against high-quality pool buyouts to ensure the industry had enough liquidity. The RBI also loosened some regulations and limited the amount of loans that banks could extend to NBFCs, leading to an injection of almost $10 billion of liquidity into cash-strapped NBFCs. The government and RBI made several other direct and indirect actions to increase NBFCs' liquidity, such as reducing banks' risk weights for financing to NBFCs and expanding NBFCs' single-borrower exposure restrictions. These actions, along with several other measures, helped in containing the NBFC crisis and restoring confidence in the sector. However, continuous monitoring and clean-up of the sector are necessary to avoid similar crises in the future. The lessons learned from the NBFC crisis will help the Indian government and regulators to create a more robust financial sector, with better governance, capital adequacy, and liquidity management, thereby increasing the trust of investors in the sector.