



IMF Report on India's Financial System

Source: TH

Why in News?

The [International Monetary Fund \(IMF\)](#), in its report titled "*India Financial System Stability Assessment*", has flagged concerns about the stress in [Non-Banking Financial Companies \(NBFCs\)](#) and its potential risks to India's financial system.

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INTERNATIONAL MONETARY FUND

- Estd. - 1944 (UN Bretton Woods Conference following Great Depression 1930s)
- Headquarters - Washington, DC, USA
- Functions -
 - » Global financial assistance
 - » Facilitate international trade
 - » Financing for developing countries
 - » Promotion of exchange rate stability
- Member States - 190 (India a founding member)

India's FM is the ex-officio Governor on the Board of Governors of IMF

- Special Drawing Rights (SDR) -
 - » IMF's intl. reserve asset to supplement the official reserves of its member countries (not a currency)

Currencies in SDR Basket - \$, €, £, ¥ (Yen) and CN¥ (Renminbi)
- IMF Quotas -
 - » Reflects a member country's relative position in world economy (India – 2.75%)
 - » Denominated in SDRs
- Flagship Publications -
 - » World Economic Outlook
 - » Global Financial Stability Report
 - » Fiscal Monitor
 - » External Sector Report

What are the Key Highlights of the IMF Report on India Financial System?

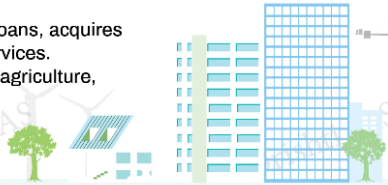
- **NBFC Stress and Systemic Risk:** 63% of power sector loans in **FY 2024** were from the three largest **Infrastructure Financing NBFCs**, up from 55% in **2019-20**.
 - 56% of NBFC lending is financed by **market instruments** (mutual funds, and corporate bond markets), with the remaining from bank borrowings.
 - **State-owned NBFCs like [Indian Renewable Energy Development Agency \(IREDA\)](#)** are at **higher risk** due to their exposure to the power sector which face delays, and financial stress. Without expected revenues, NBFCs **asset-liability mismatches that hinder repayments**.
 - NBFCs can't accept demand deposits, lack deposit insurance, and have no direct [Reserve Bank of India \(RBI\)](#) liquidity access, making them vulnerable to financial stress.
- **Stagflation Risk and Impact on PSBs:** The report warns that **geopolitical risks and miscalculated monetary policies by major central banks** could lead to **rising interest rates and slow economic growth**, affecting both NBFCs and banks.
 - IMF stress tests indicate that [Public Sector Banks \(PSBs\)](#) may struggle to maintain the 9% [Capital Adequacy Ratio \(CAR\)](#) if stagflation (slow growth + high inflation) occurs.

- **RBI mandates** 12% CAR for PSBs and 9% for scheduled commercial banks.
- **Financial Inclusion Growth:** Nearly **80% of Indian adults** have financial accounts, supported by an extensive banking network and digital infrastructure like **[Unified Payments Interface \(UPI\)](#)**.
 - The rapid rise of **retail investors in equities** has transformed India into one of the **world's largest equity options** trading markets.
- **Financial System Assets:** India's **financial system assets** (including banks, NBFCs, insurance companies, mutual funds, and pension funds) amount to nearly 190% of GDP, with banks holding 60% of total financial assets.
- **Recommendations For Financial Stability:** Instead of **paying dividends to the government**, PSBs should **retain earnings** to bolster their capital reserves and support economic recovery in case of downturns.
 - Improve **data sharing on NBFC credit and exposure** to assess risks better.
 - IMF recommends **state-owned NBFCs should have the same regulatory burden** as **private sector NBFCs** to create a level playing field.
 - IMF recommends **prioritizing financial stability** over aggressive lending for economic development.



Non-Banking Financial Companies (NBFCs)

A Non-Banking Financial Company (NBFC) provides loans, acquires financial securities, and offers leasing & insurance services. However, it excludes companies primarily engaged in agriculture, industrial activities, trading, or real estate.

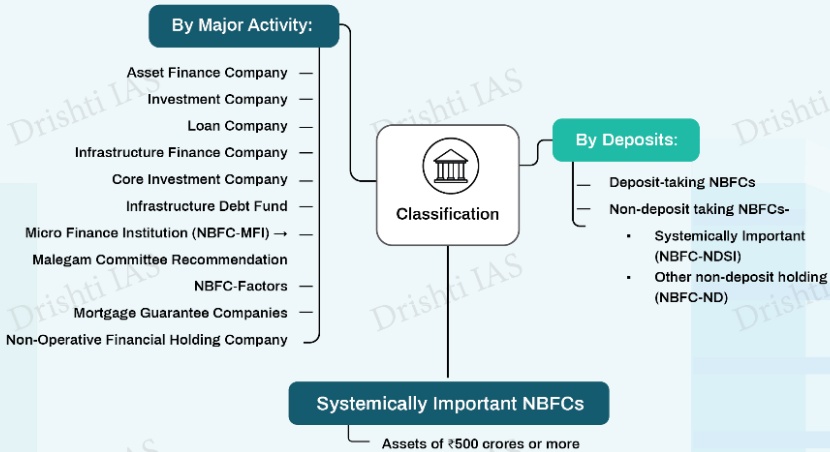


About:

- Do not have a banking license; not part of the payment system; cannot issue cheques
- Can accept public deposits for 12-60 months (no demand deposits)
- Registration → Companies Act, 1956
- Insurance by Deposit Insurance & Credit Guarantee Corporation → not available for NBFC depositors
- NBFCs require an investment-grade credit rating
- Key Services Offered- Personal loans, Home loans, Vehicle Financing, Gold Loans, Microfinance, Infrastructure Financing, Insurance Services, Investment Management



Classification:



Regulation:

Type of Institution	Regulatory Authority
NBFCs registered with RBI	RBI
Housing Finance Institutions	National Housing Bank
Merchant Banking Companies, Venture Capital Fund Companies, Stock Broking, Collective Investment Schemes (CIS)	SEBI
Nidhi Companies, Mutual Benefit Companies	Ministry of Corporate Affairs (MCA)
Chit Fund Companies	State Government
Insurance Companies	IRDAI
Non-Banking Non-Financial Companies	Statute- Companies Act 1956 Regulator- Ministry of Corporate Affairs Enforcement Agency- State Governments

Benefits of NBFCs:

- Financial Inclusion
- Innovative Products
- Liquidity
- Support for MSMEs

Challenges of NBFCs:

- Funding Constraints
- Asset Quality & Credit Risk
- Regulatory Compliance
- Corporate Governance



Drishti Mains Question:

How does the high exposure of NBFCs to power and infrastructure sectors pose financial risks? Suggest regulatory measures to mitigate these risks.

UPSC Civil Services Examination, Previous Year Question (PYQ)

Prelims

Q1. "Rapid Financing Instrument" and "Rapid Credit Facility" are related to the provisions of lending by which one of the following? (2022)

- (a) Asian Development Bank
- (b) International Monetary Fund
- (c) United Nations Environment Programme Finance Initiative
- (d) World Bank

Ans: (b)

Q2. "Gold Tranche" (Reserve Tranche) refers to (2020)

- (a) a loan system of the World Bank
- (b) one of the operations of a Central Bank
- (c) a credit system granted by WTO to its members
- (d) a credit system granted by IMF to its members

Ans: (d)

Q3. 'Global Financial Stability Report' is prepared by the (2016)

- (a) European Central Bank
- (b) International Monetary Fund
- (c) International Bank for Reconstruction and Development
- (d) Organization for Economic Cooperation and Development

Ans: (b)

Mains

Q. The World Bank and the IMF, collectively known as the Bretton Woods Institutions, are the two inter-governmental pillars supporting the structure of the world's economic and financial order. Superficially, the World Bank and the IMF exhibit many common characteristics, yet their role, functions and mandate are distinctly different. Elucidate. **(2013)**