

Regulatory Alert

October 26, 2021

Reserve Bank of India releases revised regulatory framework for NBFCs –Scale-Based Regulations (‘SBR’ or ‘Regulations’)

On October 22, 2021, the Reserve Bank of India (‘RBI’) released the revised regulatory framework for NBFCs –Scale-Based Regulation. A discussion paper titled ‘Revised Regulatory Framework for NBFCs- A Scale-based Approach’ was issued for public comments on January 22, 2021 which has now been formalised through this Regulation. These Regulations shall be effective from October 01, 2022 and the instructions relating to ceiling on IPO funding (discussed later) shall be effective from April 01, 2022.

With the objective of preserving financial stability and reducing systemic risks, RBI has provided a regulatory framework anchored on proportionality¹. The RBI has provided that the regulatory framework of NBFCs shall be based on a four-layered structure – Base Layer (NBFC-BL), Middle Layer (NBFC-ML), Upper Layer (NBFC-UL) and Top Layer. A snapshot of the proposed four layered SBR framework is as under:

| NBFC Layers | Covers ² | Applicability of regulations |
|-------------|---|--|
| NBFC-BL | Existing NBFC-ND below the asset size of INR 1000 Crores, all NOFHCs, NBFC-P2Ps, NBFC-AAs and NBFCs not | <ul style="list-style-type: none"> Existing regulations applicable to NBFC-ND will apply. From October 01, 2022, all references to NBFC-ND shall mean NBFC-BL. NBFC-P2P, NBFC-AA and NOFHC shall be subject to existing regulations⁴ governing them. |

¹ The principle of proportionality expounds that the degree of regulation of a financial entity should be commensurate with the perception of risk the entity poses to the financial system and its scale of operation.

² Investment and Credit Companies (NBFC-ICC), Micro Finance Institution (NBFC-MFI), NBFC-Factors and Mortgage Guarantee Companies (NBFC-MGC) could lie in any of the layers of the regulatory structure depending on the parameters of the scale based regulatory framework.

⁴ Master Directions - Non-Banking Financial Company – Peer to Peer Lending Platform (Reserve Bank) Directions, 2017; Master Direction- Non-Banking Financial Company - Account Aggregator (Reserve Bank) Directions, 2016; and Guidelines for Licensing of New Banks in the Private Sector dated February 22, 2013 and other related guidelines containing instructions on NOFHC.



| NBFC Layers | Covers ² | Applicability of regulations |
|-----------------------------------|---|--|
| | availing public funds and not having any customer interface ³ | <ul style="list-style-type: none"> NBFCs not availing public funds and not having customer interface bear a different risk profile and hence deserve a differential regulatory treatment. It has been decided that RBI will come out with separate regulations for such NBFCs in due course. Till such time, the existing regulations will continue to apply. |
| NBFC-ML | NBFC-ND-SI with asset size of INR 1000 crore or more, all NBFC-Ds, HFCs, IFCs, IDFs, SPDs and CICs ⁵ | <ul style="list-style-type: none"> Existing regulations applicable to NBFC-ND-SI, NBFC-D HFCs, IFCs, IDFs, SPDs and CICs will apply, except for certain changes (as mentioned in the table on the next page). From October 01, 2022, all references to NBFC-D and NBFC-ND-SIs shall mean NBFC-ML or NBFC-UL, as the case may be. NBFC-D, CIC, IFC and HFC will be included in the NBFC-ML or NBFC- UL, as the case may be. However, SPD & IDF will always fall under NBFC- ML. Also, regulatory revisions applicable to NBFC-BL will apply, unless otherwise stated. |
| NBFC-UL⁶ | Systemically significant NBFCs based on the parameter scores ⁵ , Top 10 NBFCs in terms of their asset size | <ul style="list-style-type: none"> Regulations applicable to NBFC-ML will apply except for certain changes (as mentioned in the table on the next page) Additional regulations applicable only to NBFC-UL shall apply. Also, regulatory revisions applicable to NBFC-BL and NBFC- ML will apply, unless otherwise stated. |
| Top Layer NBFC⁷ | NBFC-UL with extreme systemic/ supervisory risk perception would be pushed to Top Layer | <ul style="list-style-type: none"> The Top Layer is supposed to remain empty. The layer can get populated in case the RBI is of the opinion that there is a substantial increase in the potential systemic risk spill-overs from specific NBFCs in the Upper Layer. |

A non-deposit taking NBFC is classified as NBFC-ND when the asset size of such NBFC is below INR 500 crore. However, the revised regulatory framework has increased the said threshold to INR 1000 crore. Thus, NBFC-ND with an asset size of INR 1000 crore or more is regarded as NBFC-ND-SI.

³ Non-systemically important non deposit taking NBFCs ('NBFC-ND'), NBFC- Account Aggregator ('NBFC-AA'), Non- Operative Financial Holding Company ('NOFHC'), NBFC Peer-to-Peer Lending Platform ('NBFC-P2P')

⁵ Non-Banking Financial Company – Systematically Important Non-Deposit taking Company ('NBFC-ND-SI'), Deposit taking Non-Banking Financial Company ('NBFC-D'), Housing Financial Companies ('HFCs'), Infrastructure Finance Companies ('IFC'), Infrastructure Debt Fund ('IDF'), Standalone Primary Dealers ('SPD') and Core- Investment Companies('CIC')

⁶ For identification of entities to be categorised as NBFC-UL, a parametric analysis will be carried out, comprising quantitative and qualitative parameters/ supervisory judgment. The quantitative parameters will have weightage of 70% whereas qualitative parameters/ supervisory inputs will have weightage of 30%. Scoring methodology for identification of an NBFC as NBFC-UL shall be based on the set of NBFCs fulfilling the following criteria: a) Top 50 NBFCs (excluding the top 10 NBFCs based on asset size, which automatically fall in the Upper Layer) based on their total exposure including credit equivalent of off-balance sheet exposure; b) NBFCs designated as NBFC-UL in the previous year; and c) NBFCs added to the sample by supervisors using their supervisory judgment. The computation of scores of all NBFCs in the above set shall be performed annually based on their position as on March 31 every year. On identification of an NBFC for classification into the UL from the lower levels, it shall be required to adhere to the Transition path given under Section III of the SBR.

⁷ NBFCs falling in the Top layer of Regulatory structure shall, inter alia, be subject to higher capital charge. Such higher requirements shall be specifically communicated to the NBFCs at the time of its classification in the Top Layer. There will be enhanced and intensive supervisory engagement with these NBFCs.



The four layered Scale-Based Regulatory framework (key points) has been summarized below.

| S.no. | Parameters | NBFC-BL | NBFC-ML | NBFC-UL |
|--|---|--|--|---|
| Capital Regulation | | | | |
| 1. | Net Owned Fund ('NOF') ⁸ | <ul style="list-style-type: none"> NBFC P2P, NBFC-AA, NBFC with no public funds and no customer interface- INR 2 crores⁹; NBFC- ND- INR 2 crores⁸ NOFHC- INR 2 crores⁸ | <ul style="list-style-type: none"> NBFC- ND- SI- INR 2 crores⁸ NBFC- D- INR 2 crores⁸ NBFC IDF & IFC- INR 300 crores⁸; NBFC HFC- INR 20 crores⁸; NBFC SPD which undertake only core activities- INR 150 crores⁸; NBFC SPD which undertake core and non-core activities- INR 250 crores⁸; | Same as NBFC-ML |
| 2. | Common Equity Tier 1 ¹⁰ ('CET 1') capital | Not stipulated | Not stipulated | 9% ¹¹ |
| 3. | Leverage Ratio | Presently, a leverage ratio of 7 is required | Not stipulated | A suitable ceiling for leverage will be prescribed for these entities ¹⁰ |
| 4. | Internal Capital Adequacy Adequacy Assessment Process ('ICAAP') | Not stipulated | Requirement of having a Board approved policy on ICAAP. The internal assessment shall be on similar lines as ICAAP prescribed for commercial Banks under Pillar 2 | Same as NBFC-ML |
| Asset classification and provisioning | | | | |
| 5. | Standard Asset provisioning | Presently, a standard asset provisioning of 0.25% is required | Presently, a standard asset provisioning of 0.40% is required | Differential provisioning towards different class of standard assets. ¹⁰ |

⁸ Irrespective of the layer under which the NBFC would classify, following minimum NOF shall be maintained by following NBFCs: **NBFC-ICC**- Increased from INR 2 crores to INR 5 crores by March 31, 2025 and to INR 10 crores by March 31, 2027; **NBFC- MFI**- Increased from INR 5 crores to INR 7 crores by March 31, 2025 and to INR 10 crores by March 31, 2027; **NBFC Factors**- Same as NBFC- MFI and **NBFC MGC**- INR 100 crores;

⁹ This has remained unchanged.

¹⁰ Currently, CET requirement is only applicable to banks.

¹¹ Detailed guidelines in this regard will be issued shortly.



| S.no. | Parameters | NBFC-BL | NBFC-ML | NBFC-UL |
|--|--|--|---|--|
| 6. | NPA Classification | A glide path is provided to the NBFCs under NBFC-BL to adhere to the 90 days NPA as under: <ul style="list-style-type: none"> >150 days overdue- by March 31, 2024; >120 days overdue- by March 31, 2025; >90 days overdue- by March 31, 2026; | NPA norm of 90 days overdue will now be followed | NPA norm of 90 days overdue will now be followed |
| Concentration Norms | | | | |
| 7. | Concentration limits to be computed as a % of | Owned funds | Tier 1 capital | Tier 1 capital |
| 8. | Credit Concentration Norms and Applicability of Large Exposure Framework ('LEF') | Extant guidelines as applicable for NBFC-NDs | Merger of lending and investment limits into a single exposure limit- 25% for Single Borrower and 40% for Single Group Borrowers | Same as NBFC-ML until LEF is put in place. |
| Governance and Disclosure Norms | | | | |
| 9. | Compensation Guidelines – Constitution of Nomination and Remuneration Committee | Not stipulated | A Board approved compensation policy shall be put in place which shall at minimum include - a) constitution of a Remuneration Committee, b) principles for fixed/ variable pay structures, and c) malus/ claw back requirements | Same as NBFC-ML |
| 10. | Risk Management Committee ('RMC') | Constitute a RMC either at the Board or executive level. RMC shall be responsible for evaluating the overall risks faced by the NBFC including liquidity risk and will report to the Board | Same as NBFC-BL | Same as NBFC-ML |



| S.no. | Parameters | NBFC-BL | NBFC-ML | NBFC-UL |
|-------|---|---|---|---|
| 11. | Key Managerial Personnel ('KMP')- Whole Time employee in the nature of CEO, CFO, CS and WTD | As per Companies Act, 2013 | <p>Except for directorship in a subsidiary, KMP shall not hold any office in any other NBFC-ML or NBFC-UL</p> <p>Further, a timeline of 2 years is provided w.e.f. October 01, 2022 to ensure compliance with these norms. Also, the KMP can assume directorship in NBFC-BL</p> | Same as NBFC-ML |
| 12. | Independent Director ('ID') | As per Companies Act, 2013 | <p>An ID shall not be on Board of more than 3 NBFCs (NBFC-ML or NBFC-UL) at the same time</p> <p>Further, a timeline of 2 years is provided w.e.f. October 01, 2022 to ensure compliance with these norms. Also, there shall be no restriction on directorship on the Board of NBFC-BLs, subject to applicable provisions of Companies Act, 2013</p> | Same as NBFC-ML. Additionally, NBFC-UL is required to report to the supervisors in case any ID is removed / resigns before completion of his tenure |
| 13. | Disclosures | Expanded to include type of exposure, related party transactions, loan to Directors / Senior Officers and customer complaints ¹⁰ | <p>Same as NBFC-BL</p> <p>Further, it shall also comply with the additional disclosure requirements given under para 3.2.3(f) of the Regulations</p> | Same as NBFC-ML |
| 14. | Other governance matters | Not stipulated | <p>The Board shall delineate the role of various committees (Audit Committee, Nomination and Remuneration Committee, Risk Management Committee or any other Committee);</p> <p>NBFCs shall formulate a whistle blower mechanism for Directors and employees; The Board shall ensure good corporate governance practices in the subsidiaries of NBFC</p> | Same as NBFC-ML |



| S.no. | Parameters | NBFC-BL | NBFC-ML | NBFC-UL |
|-------|---|---|---|---|
| 15. | Appointment of Chief Compliance Officer ('CCO') | Not stipulated | <p>It is necessary to have an independent corporate compliance function and a strong compliance risk management programme. Therefore, a functionally independent CCO should be appointed, who should be sufficiently senior in the organization hierarchy</p> <p>NBFC shall put in place Board approved policy laying down the roles and responsibilities of the CCO with an objective of promoting better compliance culture</p> | Same as NBFC-ML |
| 16. | Listing requirements | Not mandatory | Not mandatory | Such NBFCs shall be subject to mandatory listed within 3 years of identification as NBFC-UL. Disclosure requirements shall be put in place on same lines as are applicable to listed companies even before the actual listing |
| 17. | Expertise for Board Members | Considering the need for professional experience in managing the affairs of the NBFCs at least one of the directors shall have experience in retail lending in a bank/ NBFC | Same as NBFC-BL | Same as NBFC-ML. Additionally, it shall ensure that specific expertise of Board members depending on the type of NBFC exists before their appointment |
| 18. | Sensitive Sector Exposures ('SSE') | Not stipulated | <p>NBFCs shall fix Board approved internal limits for SSE separately for capital market exposure and commercial real estate sector</p> <p>Further, a sub-limit within the commercial real estate exposure ceiling should be fixed internally for financing land acquisition</p> | Same as NBFC-ML. Apart from that Board of NBFC-UL shall also determine internal exposure limits on other important sectors to which credit is extended. Further, it shall put in place an internal Board approved limit for exposure to the NBFC sector |



| S.no. | Parameters | NBFC-BL | NBFC-ML | NBFC-UL |
|-------|---|---|--|-----------------|
| 19. | Regulatory Restriction on loans | Not stipulated | While appraising loan proposals involving real estate, NBFC shall ensure that the borrowers have obtained prior permission of government / local governments / other statutory authority for the project | Same as NBFC-ML |
| 20. | Loans to Directors | NBFC-BL shall have a Board approved policy on grant of loans to directors, senior officers and relatives of directors and to entities where directors or their relatives have major shareholding ⁹ | Restriction on granting loans and advances: <ul style="list-style-type: none"> to directors and their relatives or to entities where directors or their relatives have major shareholding; to senior officers of NBFC; | Same as NBFC-ML |
| 21. | IPO financing | There shall be ceiling of INR 1 crore per borrower for financing subscription to IPO | Same as NBFC- BL | Same as NBFC-ML |
| 22. | Core Banking Solution ('CBS') for NBFCs | Not mandatory | NBFCs with 10 and more branches shall mandatorily be required to adopt CBS | Same as NBFC-ML |

Dhruva Comments

The RBI vide the regulatory framework seeks to segregate the larger entities and subject them to a stricter set of 'bank-like' rules. This is aimed at ensuring financial stability and responsibility while making sure that smaller NBFCs continue to enjoy light-touch regulations and grow with ease. While NBFC-UL would be subject to bank-like regulations, this may aid such NBFCs in easier transition (if, desired) into a private bank (subject to RBI's acceptance of the report of the internal working group to review Extant Ownership Guidelines and Corporate Structure for Indian Private Sector Banks) in future. Relaxation in the asset size for non-deposit taking NBFCs to INR 1000 crores is a welcome move as it may facilitate greater access to funds for borrowers.



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