Allied Laws Bulletin

N. A. SHAH BULLETIN

February 2022

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EXECUTIVE SUMMARY

- RBI has categorised NBFCs into different layers for the application of scale based regulations. Further, it has enhanced regulatory compliances, prudential and governance guidelines for different layers of NBFCs.

- RBI has now prescribed Prompt Corrective Action (PCA) framework for NBFCs. The framework prescribes corrective actions to be taken by NBFCs placed under the PCA framework upon breach of prescribed thresholds.

- Clarifications are provided by RBI regarding certain prudential norms for NBFCs.

1. Scale Based Regulation: Revised Regulatory Framework for NBFCs (SBR Regulations)

Over the years, the NBFC sector has undergone considerable evolution in terms of size, complexity and interconnectedness within the financial sector. Since the NBFC have grown and become systematically significant and in view of their changing risk profile, there was need to align the regulatory framework for NBFCs. Earlier in January 2021, the RBI had mooted a new regulatory approach for NBFCs through its discussion paper titled 'Revised Regulatory Framework for NBFCs - A Scale-based Approach' (Discussion Paper). On 22 October 2021, the RBI issued a notification on 'Scale Based Regulation (SBR). The SBR Framework will come into effect from 1 October 2022 (except for certain compliance requirements relating to funding of initial public offerings (IPOs) which would be effective from 1 April 2022).

For ease of reference, the RBI has divided all the NBFCs into 4 layers:

Particulars	Base Layer (NBFC- BL)	Middle Layer (NBFC- ML)	Upper Layer (NBFC- UL)	Top Layer (NBFC- TL)
Scale based	Non-deposit taking NBFCs below asset size of INR 1,000 Cr. (NBFC-ND).	1) All deposit taking NBFCs (NBFC-D). 2) Non-deposit taking NBFCs with asset size of INR 1,000 Cr. and above (NBFC-ND-SI).	Those NBFCs as selected by RBI as warranting enhanced regulatory requirement. Top ten eligible NBFCs in terms of their size shall always be covered here.	Would ideally remain empty. However, may get populated if RBI is of the opinion that there is a substantial increase in the potential systemic risk from NBFCs in the Upper Layer.
Activity based	1) NBFC – Peer to peer Lending Platform (NBFC-P2P) 2) NBFC – Account Aggregator (NBFC-AA) 3) Non-Operating Financial	1) Standalone Primary Dealers (SPD) 2) Infrastructure Debt Fund (IDF) 3) Core Investment Companies (CIC) 4) Housing Finance Companies (HFC)		

	Holding Company (NOFHC) 4) NBFCs not availing public funds and not having any customer interface.	5) Infrastructure Finance Company (IFC)		
Mandatory category	NBFC P2P, NBFC-AA, NOFHC and NBFCs without public funds and customer interface.	1) NBFC-D, CIC, IFC and HFC will be included in Middle Layer or the Upper Layer (not in the Base Layer). 2) SPD and IDF will aways remain in Middle Layer.		-
	Government owned NBFCs shall be placed in the Base Layer or Middle Layer.		-	-
	Investment credit companies (NBFCs-ICC), Micro Finance Institution (NBFC-MFI), NBFC-Factors and Mortgage Guarantee Corporation (NBFC-MGC) could lie in any of the following layers.			
Applicability of Regulations	Shall be subject to current NBFC-ND Regulations. NBFC-P2P, NBFC-AA and NOHFC shall be subject to specific extant regulations.	Shall continue to follow specific regulations for NBFC-ND-SIs, NBFC-Ds, CICs, SPDs and HFCs.	Shall be subject to specific regulations applicable	-

Note:

- With effect from 1st October, 2022, all references to NBFC-ND shall mean NBFC-BL and all references to NBFC-D and NBFC-ND-SI shall mean NBFC-ML or NBFC-UL.
- Regulatory revisions applicable to lower layers of NBFCs will automatically be applicable to NBFCs residing in highest layers.

I. Regulatory changes under SBR Regulations:

a. Regulatory changes for all the layers.

- Net Owned Fund:
Regulatory minimum Net Owned Fund (NOF) shall be increased to INR 10 crores for the following NBFCs in the phased manner:

NBFCs	Current NOF	By March 31, 2025	By March 31, 2027
NBFC-ICC	INR 2 Cr.	INR 5 Cr.	INR 10 Cr.
NBFC-MFI	INR 5 Cr. (INR 2 Cr. in NE Region)	INR 7 Cr. (INR 5 Cr. in NE Region)	INR 10 Cr.
NBFC-Others	INR 5 Cr.	INR 7 Cr.	INR 10 Cr.

It is clarified that minimum NOF of NBFC-P2P, NBFC-AA, NBFCs with no public funds and no customer interface, IDF, IFC, MGCs, HFC and SPD shall remain unchanged.

- NPA Classification:
In line with the NPA Classification norms for the banks, the overdue period in case of NBFCs shall be adhered to 90 days in the following phased manner.

NBFCs	Timeline
> 150 days overdue	By March 31, 2024
> 120 days overdue	By March 31, 2025
> 90 days overdue	By March 31, 2026

- Experience of the Board:
Considering the need for professional experience in managing the affairs of NBFCs, at least on the directors shall have relevant experience of having worked in a bank/NBFC.

- Ceiling on IPO Funding:
There shall be a ceiling of INR 1 Cr. per borrower for financing subscription to Initial Public Offer (IPO). NBFCs may fix more conservative limits.

b. Regulatory changes for different layers.

- **Capital Guidelines:**

  - Internal Capital Adequacy Assessment Process (ICAAP):
    NBFC-ML and NBFC-UL are required to undertake a thorough internal capital assessment by internally determining a methodology as per the Board approved Policy considering various risks associated with their business. The ICAAP will be on similar lines prescribed for banks.

  - Additional regulatory changes:
    In order to improve the quality of regulatory capital, the RBI has directed NBFC-UL to maintain common equity tier 1 capital of at least 9% of its risk weighted assets. Such NBFCs will also be required to comply with leverage ceilings and differential standard asset provisioning requirements to be prescribed by the RBI in due course.

- **Prudential Guidelines:**

  - Credit concentration norms:
    RBI has prescribed a single credit concentration limit (as against separate limits for lending and investments) for NBFC-ML and NBFC-UL. Such limit must now be determined with reference to the tier 1 capital of the NBFC (as against owned funds). Such NBFCs must ensure that their exposure to a single party and a single borrower group does not exceed 25% and 40% of their tier 1 capital respectively.

  - Limits for sensitive sector exposures:
    RBI has prescribed that exposure of NBFC-ML and NBFC-UL to capital market and commercial real estate would be considered as sensitive sector exposures, requiring such NBFCs (other than HFCs) to set internal limits as per Board approved policy for such exposures. Such NBFCs are also required to separately fix sub-limits (within the overall limits for real estate exposure) for financing land acquisition. The RBI has also prescribed a limit of INR 1 Cr. per borrower for financing subscription to IPOs.

  - Large exposure framework:
    It is also proposed by RBI to notify a separate large exposure framework for NBFC-UL. This will consider large exposures of such NBFCs to all counterparties (as well as business groups of connected counterparties).

The RBI will detail out the definition of large exposure, the relevant exposure limits, and the related reporting requirements in due course.

- Restrictions on Loans and advances:
  NBFC-ML and NBFC-UL shall be subject to following restrictions:
  - Granting loans and advances to directors, their relatives and to entities where directors or their relatives have major shareholding.
  - Granting loans and advances to Senior Officer of the NBFCs.
  - NBFCs must ensure that borrowers have obtained prior permission from government and all statutory authorities, as required for the relevant real estate project. While NBFCs may sanction loans pending compliance of this requirement, they can undertake disbursement of such loans only after the borrower has obtained requisite approvals from the relevant authorities.

- **Governance Guidelines:**

- Risk management committee:
  All NBFC-BL must constitute a risk management committee for evaluating various risks, including liquidity risk and must submit its report to the Board of NBFC.

- Grant of loans to employees and their relatives:
  All NBFC-BL must have a Board approved policy for grant of loans to directors, senior officers, relatives of directors and entities where such directors or their relatives have major shareholding.

- Disclosure requirements:
  - The RBI will notify minimum disclosures to be made by all NBFC-BL in their financial statements, including on matters such as related party transactions, loans to directors and senior officers, types of exposure, customer complaints, etc.
  - Further, NBFC-ML and NBFC-UL with effect from 31 March 2023 shall make additional disclosures in their annual financial statements in respect of a corporate governance report, views of the management on audit qualifications, exceptional items of income and expenditure, details of breaches under financing documents, divergence of asset classification and provisioning norms, etc.

- Restrictions on Key managerial personnel (KMPs) holding other offices:
  KMPs of NBFC-ML and NBFC-UL must not hold any office in any other NBFCs in such layers (except being director in subsidiaries of the NBFCs they are employed with). Such NBFCs have been provided with time until 30 September 2024 to comply with this requirement.

- Independent directors (ID):
  An individual shall not be ID of more than three NBFC-ML and NBFC-UL. Such NBFCs have until 30 September 2024 to ensure compliance. Further, any removal or resignation (prior to original tenure) of ID of NBFC-UL must be promptly reported to the RBI.

- Chief compliance officer (CCO):
  All NBFC-ML and NBFC-UL must mandatorily appoint a CCO who would be in charge of an independent compliance function. Such NBFCs must adopt a Board approved policy on the roles and responsibilities of CCO.

- Adoption of core banking solution (CBS):
  All NBFC-ML and NBFC-UL having at least ten branches must form part of the CBS platform of RBI. A glide path for 3 years with effect from 1 October 2022 is provided.

- Other Governance Matters:
  All NBFC-ML and NBFC-UL must comply with the following:
  - To delineate the roles of various committees and lay down a procedure of reviews.
  - Adopt a whistle-blower mechanism to report genuine concerns and mishandling within the organization.
  - To ensure good corporate governance practices in subsidiaries.

- Compensation policy:
  For minimizing excessive risks taken due to misaligned compensation packages by NBFCs to its senior management, all NBFC-ML and NBFC-UL must adopt a compensation policy, constitute a remuneration committee, set out the principles for fixed / variable pay and claw-back provisions.

- Mandatory listing requirement:
  All NBFC-UL must be mandatorily listed within 3 years from its identification as an NBFC-UL. Such NBFCs must also be subject to

additional disclosure requirements (akin to those applicable to a listed company) prior to the actual listing of its securities on the stock exchange.

- Qualification of Board Members:
  All NBFC-UL shall ensure mix of educational qualification and experience with the Board Members. Specific expertise will be preferred based on type of NBFC.

c. Regulatory changes for Top Layer:

All NBFC-TL shall be subject to higher capital charge which will be specifically communicated to NBFC on its classification**.**

II. Transition Path for NBFC-UL:

An NBFC-UL shall on classification adhere to the following:

a) Within 3 months the NBFC shall have a Board approved policy and a roadmap for adoption of enhanced regulatory framework.
b) Within 24 months the NBFC shall comply with all the stipulations prescribed.
c) Such roadmap shall be submitted to the RBI.
d) It shall be subject to enhanced regulatory framework for 5 years from classification unless it does not satisfy the criteria for 5 consecutive years.
e) However, such NBFC may move out of the catoegory on account of voluntary strategic move to readjust their operations.
f) NBFCs which are close to criteria of NBFC-UL shall be intimated to enable them to adjust their operations to continue functioning in NBFC-ML.

Note:

- All the guidelines shall be effective from 1st October 2022 except for change in ceiling of IPO funding which shall be effective from 1st April 2022.

2. Prompt Corrective Action Framework for NBFCs

Earlier, RBI had prescribed Prompt Corrective Action (PCA) for Scheduled Commercial Banks. The objective of the PCA framework is to enable supervisory intervention and require the supervised entity to initiate and implement remedial measures in a timely manner, so as to restore its financial health.

Now, as the NBFCs have been growing in size and have substantial interconnectedness with other segments of the financial system, RBI has now introduced a PCA framework for NBFCs.

Key points of the framework are mentioned below:

I. Coverage

- All deposit taking NBFCs
- Non-Deposit taking NBFCs with asset size of INR 1,000 crore and above
- Core Investment Companies (CIC), Infrastructure Debt Funds, Infrastructure Finance Companies and Micro Finance Institutions

II. Out of Coverage:

- NBFCs not accepting/not intending to accept public funds, Government companies, Primary Dealers and Housing Finance companies.

III. Basis for selection of NBFC

- In addition to RBI's discretion an NBFC shall be placed under PCA framework in the event of breach of risk threshold based on audited annual financial results and/or the supervisory assessment made by RBI.
- The risk thresholds have been defined based on the category of the entity to be capital risk adequacy ratio, NNPA ratio, and Tier I Capital Ratio for covered NBFCs and Adjusted Net Worth to risk weighted assets, Leverage ratio and NNPA ratio for CICs.

IV. Exit from PCA and withdrawal of Restrictions under PCA

- Exit of an NBFC out of PCA shall be considered:

a) If no breaches in risk thresholds in any four continuous quarterly financial statements including one annual audited financial statement; and
b) Based on Supervisory comfort of the RBI.

V. Corrective Actions

- Based on the category of risk threshold under which the NBFC falls based on breach of the threshold, mandatory corrective actions shall be undertaken as follows:

Particulars	Mandatory Corrective Actions
Risk Threshold 1	o Restriction on dividend distribution/remittance of profits; o Promoters/shareholders to infuse equity and reduction in leverage; o Restriction on issue of guarantees (only for CICs)
Risk Threshold 2	In addition to mandatory actions of Threshold 1, o Restriction on branch expansion
Risk Threshold 3	In addition to mandatory actions of Threshold 1 & 2, o Appropriate restrictions on capital expenditure o Restrictions/reduction in variable operating costs

- RBI has also prescribed set of discretionary actions which can be undertaken by the NBFC upon breach of Risk Thresholds.

3. Clarifications regarding prudential norms on Asset classification and provisioning pertaining to advances.

- The definition of 'out of order' is applicable to all loan products being offered as an overdraft facility, including personal loans and/ or loans which entail interest repayments as the only credits.
- Loan accounts classified as NPAs may be upgraded as 'standard' asset only if entire arrears of interest and principal are paid by borrower. NBFCs to put in place necessary systems to implement this provision till 30th September 2022.

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