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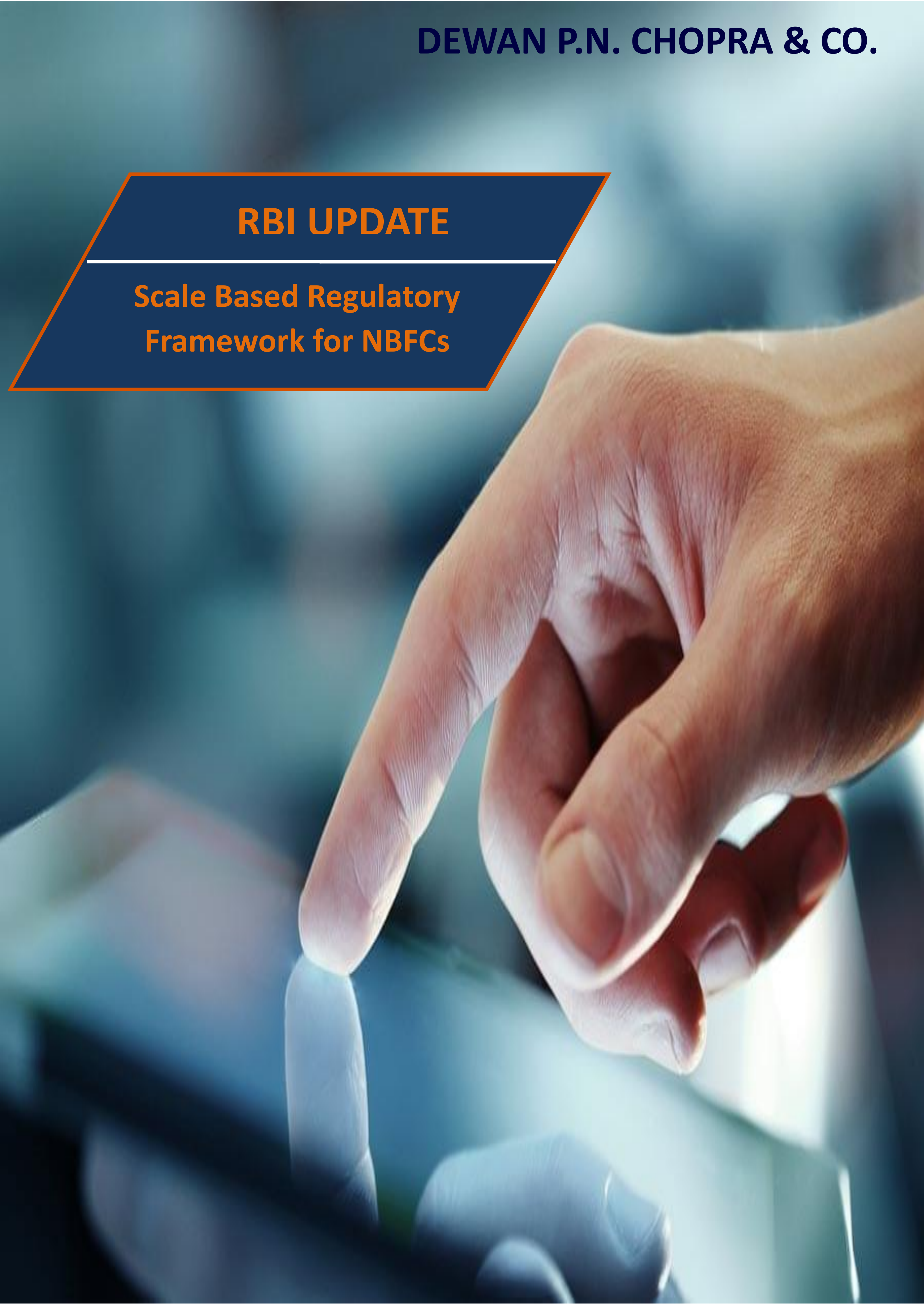
RBI UPDATE

Scale Based Regulatory Framework for NBFCs



SCALE BASED REGULATORY FRAMEWORK FOR NBFCs [Applicable from 1st Oct 2022]

Reserve Bank of India vide Notification dated 22.10.2021 announced its new scale-based regulations for the non-banking finance companies. The new guidelines will be applicable from 1st October 2022.

The regulatory structure will comprise NBFCs into four layers based on their size, activity, and perceived risk. These layers include:

Base Layer: This includes NBFCs with an asset size below INR 1,000 crore. It will also include peer-to-peer lending platforms, account aggregators, non-operative financial holding companies and NBFCs not accessing public funds nor having any public interface.

Middle Layer: It consists of all deposit-taking and non-deposit taking NBFCs with an asset size of INR 1,000 crore and above, standalone primary dealers, infrastructure debt fund NBFCs, core investment companies, housing finance companies and infrastructure finance companies.

Upper Layer: This shall comprise of NBFCs which are specifically identified by the Reserve Bank as warranting enhanced regulatory requirement based on a set of parameters and scoring methodology. The top 10 eligible NBFCs in terms of their asset size shall always reside in the upper layer, irrespective of any other factor.

Top Layer: This layer will remain empty and NBFCs in the upper layer may be moved to the top layer if the potential systemic risk from specific companies rises, according to the RBI's assessment.

Categorization of NBFCs carrying out specific activity

As the regulatory structure envisages scale based as well as activity-based regulation, the following prescriptions shall apply in respect of the NBFCs

a) NBFC-P2P, NBFC-AA, NOFHC and NBFCs without public funds and customer interface will always remain in the Base Layer of the regulatory structure.

b) NBFC-D, CIC, IFC and HFC will be included in Middle Layer or the Upper Layer (and not in the Base layer), as the case may be. SPD and IDF-NBFC will always remain in the Middle Layer.

c) The remaining NBFCs, viz., 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.

d) Government owned NBFCs shall be placed in the Base Layer or Middle Layer, as the case may be. They will not be placed in the Upper Layer till further notice

Regulatory Changes under SBR for all the layers in regulatory structure

a) **Net Owned Funds** - Regulatory Minimum Net Owned Fund (NOF) for NBFC-Investment and Credit Companies (ICC), NBFC Micro Finance Institution (MFI) and NBFC-Factors would be increased to INR 10 crore. The RBI has set a three-year glide path for the existing NBFCs to achieve the net-owned funds (NOF) of INR 10 crore.

   However, for NBFC-P2P, NBFC-AA, and NBFCs with no public funds and no customer interface, the NOF will continue to be INR 2 crore.

b) **NPA Classification** - The RBI has revised existing norms for classifying loans as non-performing assets (NPAs). Now, the overdue of more than 90 days will be termed NPAs for all categories of NBFCs. The central bank has provided a three-year transit period to NBFCs in the base layer to adhere to the revision.

   All NBFCs irrespective of their size will now also have to move to a 90-day NPA recognition cycle which is similar to banks.

c) **Experience of the Board -** Atleast one of the directors shall have relevant experience of having worked in bank/NBFC.

d) **Ceiling on IPO Funding** - Ceiling of INR 1 crore per borrower for financing subscription of IPOs has also been imposed on NBFCs after concerns were raised about increased exposure of some of the smaller NBFCs in these IPOs. NBFC can fix more conservative limits

In order to enhance the quality of regulatory capital, NBFC Upper layer would maintain Common Equity Tier 1 capital of at least 9 per cent of Risk Weighted Assets while they will be required to hold differential provisioning towards different classes of standard assets.

In addition to the CRAR, NBFC Upper layer will also be subjected to leverage requirement to ensure that their growth is supported by adequate capital, among other factors. A suitable ceiling for leverage will be prescribed subsequently for these entities as and when necessary.

Further, the central bank has outlined large exposure limit for all counterparties and groups of connected counterparties and for the capital market and commercial real estate.

To strengthen corporate governance, it has suggested inclusion of independent directors on the board, among other requirements.

The revised regulatory framework being issued will ensure that strong and resilient financial system will be established in view of considerable evolution in terms of size, complexity, and interconnectedness within the financial sector and issue an integrated regulatory framework for NBFCs under SBR providing a holistic view of the SBR structure.

For detailed guidance on this aspect, please refer the below link:
https://rbi.org.in/Scripts/NotificationUser.aspx/searchnew/NotificationUser.aspx?Id=12179

Disclaimer

The information contained herein is in summary form of Scale Based Regulation (SBR): A Revised Regulatory Framework for NBFCs issued by Reserve Bank of India vide RBI/2021-22/112 DOR.CRE.REC.No.60/03.10.001/2021-22 dated Oct 22, 2021 and is based on information available in public domain. While the information is believed to be accurate to the best of our knowledge, we do not make any representations or warranties, express or implied, as to the accuracy or completeness of this information. Reader should conduct and rely upon their own examination and analysis and are advised to seek their own professional advice. This note is not an offer, invitation, advice or solicitation of any kind. We accept no responsibility for any errors it may contain, whether caused by negligence or otherwise or for any loss, howsoever caused or sustained, by the person who relies upon it.