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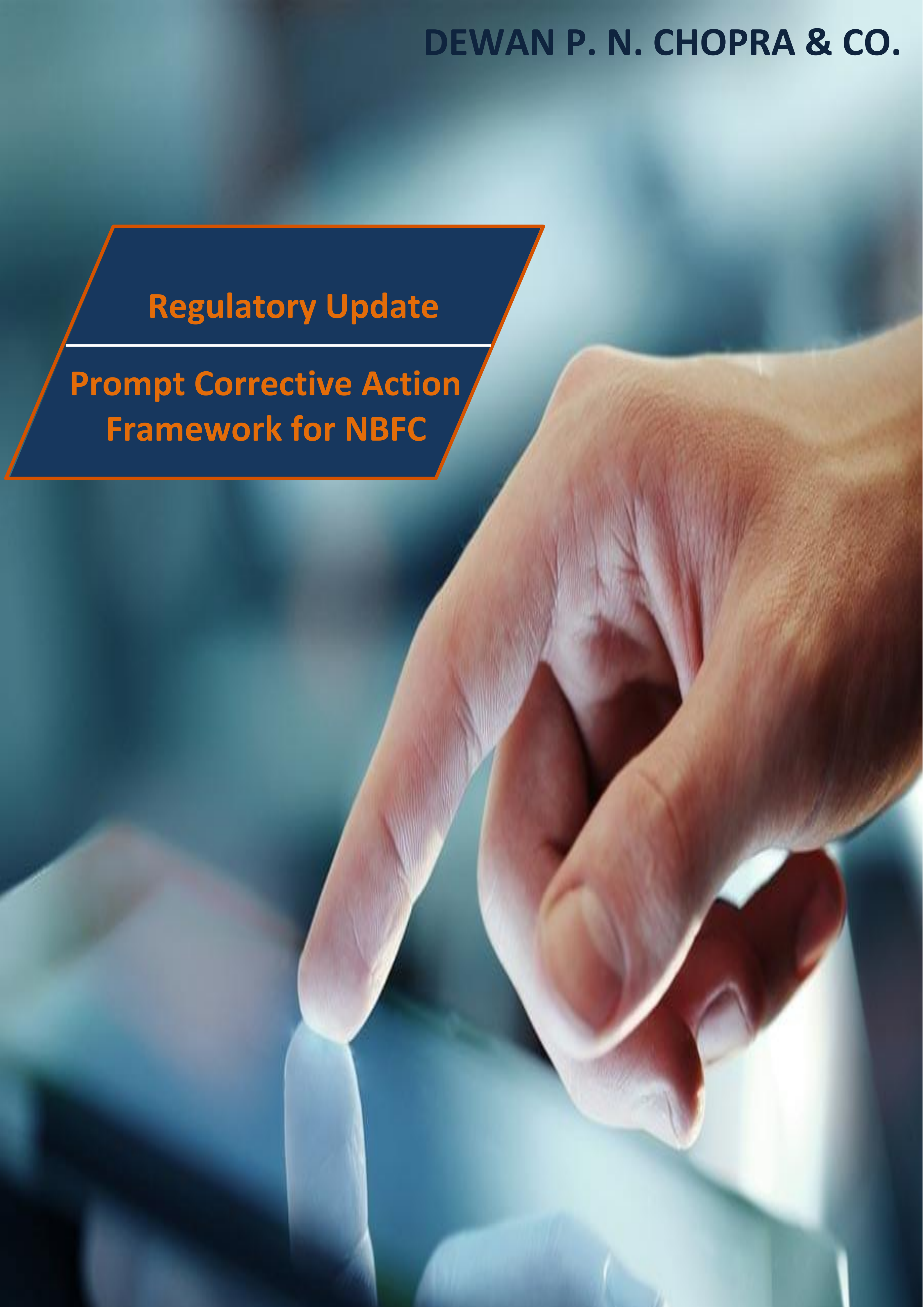
Regulatory Update

Prompt Corrective Action Framework for NBFC



Prompt Corrective Action Framework for NBFC's

RBI vide Circular **RBI/2021-22/13DoS.CO.PPG.SEC.7/11.01.005/2021-22, dated 14th December, 2021** has issued guidelines for a prompt corrective action framework for non-bank finance companies. The PCA Framework for NBFCs comes into effect from October 1, 2022, based on the financial position of NBFCs on or after March 31, 2022.

In view of growing size and substantial inter-connectedness with other parts of the financial system, RBI has decided to put in place PCA framework for NBFC's to further strengthen the supervisory tools applicable to NBFCs.

PCA framework will be applicable to

- all deposit-taking NBFCs,
- middle, upper and top-layer NBFCs, under the new scale-based regulations.
  [Including Investment and Credit Companies, Core Investment Companies (CICs), Infrastructure Debt Funds, Infrastructure Finance Companies, Micro Finance Institutions and Factors]

NBFCs not accepting or not intending to accept public funds, government companies, primary dealers and housing finance companies will be exempt from the framework.

RISK THRESHOLD

For NBFCs to be put under prompt corrective action, indicators to be tracked would be:

a.) Capital to Risk Weighted Assets Ratio (CRAR), Tier I Capital Ratio and Net NPA Ratio (NNPA)**[For NBFCs-D and NBFCs-ND]**

Indicator	Risk Threshold-1	Risk Threshold-2	Risk Threshold-3
CRAR	Upto 300 bps below the regulatory minimum CRAR [currently, CRAR <15% but ≥ *12%]*	More than 300 bps but upto 600 bps below regulatory minimum CRAR [currently, CRAR <12% but ≥ *9%]*	More than 600 bps below regulatory minimum CRAR [currently, CRAR <9%]
Tier I Capital Ratio	Upto 200 bps below the regulatory minimum Tier I Capital Ratio [currently, Tier I Capital Ratio <10% but ≥ *8%]*	More than 200 bps but upto 400 bps below the regulatory minimum Tier I Capital Ratio [currently, Tier I Capital Ratio <8% but ≥ *6%]*	More than 400 bps below the regulatory minimum Tier I Capital Ratio [currently, Tier I Capital Ratio <6%
NNPA Ratio (including NPIs)	>6% but ≤ 9%	>9% but ≤12%	>12%

b.) Ratio of adjusted net worth to aggregate risk weighted assets, leverage ratio and net NPA ratio **[Core investment companies]**

Indicator	Risk Threshold-1	Risk Threshold-2	Risk Threshold-3
Adjusted Net Worth / Aggregate Risk Weighted Assets	Upto 600 bps below the regulatory minimum ANW/RWA [currently, ANW/RWA <30% but ≥24%]	More than 600 bps but upto 1200bps below regulatory minimum ANW/RWA [currently,	More than 1200 bps below regulatory minimum ANW/RWA [currently,

		ANW/RWA <24% but ≥18%]	ANW/RWA <18%]
Leverage Ratio	≥2.5 times but < 3 times	≥3 times but < 3.5 times	≥3.5 times
NNPA Ratio (including NPIs)	>6% but ≤ 9%	>9% but ≤12%	>12%

Restrictions on NBFC breaching thresholds [Corrective Actions]

NBFCs breaching the first risk threshold will be put under restrictions on

- **dividend distribution**,
- promoters or shareholders will be required to **bring additional equity** to reduce leverage.
- **Restriction on issue of guarantees** or taking on other contingent liabilities on behalf of group companies (only for CICs)

In the event of breaching the second risk threshold, the RBI will put restriction on

- **branch expansion**, apart from the restrictions under threshold one.

In case the NBFC has breached the third risk threshold, the RBI will put appropriate restrictions on

- **capital expenditure**,
- restrictions on **variable costs**, apart from the restrictions mentioned above.

Apart from these restrictions, the RBI may take further common actions including special supervisory action, strategy, capital and governance related actions.

The PCA framework does not preclude the Reserve Bank from taking any other action as it deems fit at any time in addition to the corrective actions prescribed in the framework

Exit from PCA and Withdrawal of Restrictions under PCA

Once a NBFC is placed under PCA, taking the NBFC out of PCA Framework and/or withdrawal of restrictions imposed under the PCA Framework will be considered:

a) if no breaches in risk thresholds in any of the parameters are observed as per four continuous quarterly financial statements, one of which should be Annual Audited Financial Statement (subject to assessment by RBI); and

b) based on Supervisory comfort of the RBI, including an assessment on sustainability of profitability of the NBFC

For details, please refer Circular dated 14th December 2021:
https://rbidocs.rbi.org.in/rdocs/Notification/PDFs/139PCANBFCSC3389782516C440DAF56D30473BF005B.PDF

DISCLAIMER:

The information contained herein is in summary form based on interpretation of Notification No. **RBI/2021-22/139 DoS.CO.PPG.SEC.7/11.01.005/2021-22, dated 14th December, 2021** *issued by RBI. 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. Readers should conduct and rely upon their own examination and analysis and are advised to seek their own professional advice. This document 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.*