SCALE BASED REGULATION (SBR) & OTHER REGULATORY DEVELOPMENTS for NBFC-ICC

(Investment & Credit Company)

SCALE BASED REGULATION (SBR) FRAMEWORK

PURPOSE OF INTRODUCTION OF SBR

- Complexity & diversity of activities
- Increasing risk exposure due to the diversification and size
- Remove demarcation w.r.t asset size between SI & Non-SI i.e. increase threshold from 500 cr. to 1000 cr.
- Bring large sized NBFCs in line with banks and remove highly stringent norms from small size NBFCs to ensure operational flexibility

BASIS OF CLASSIFICATION OF DIFFERENT LAYERS

Asset Size

Activity

Riskiness

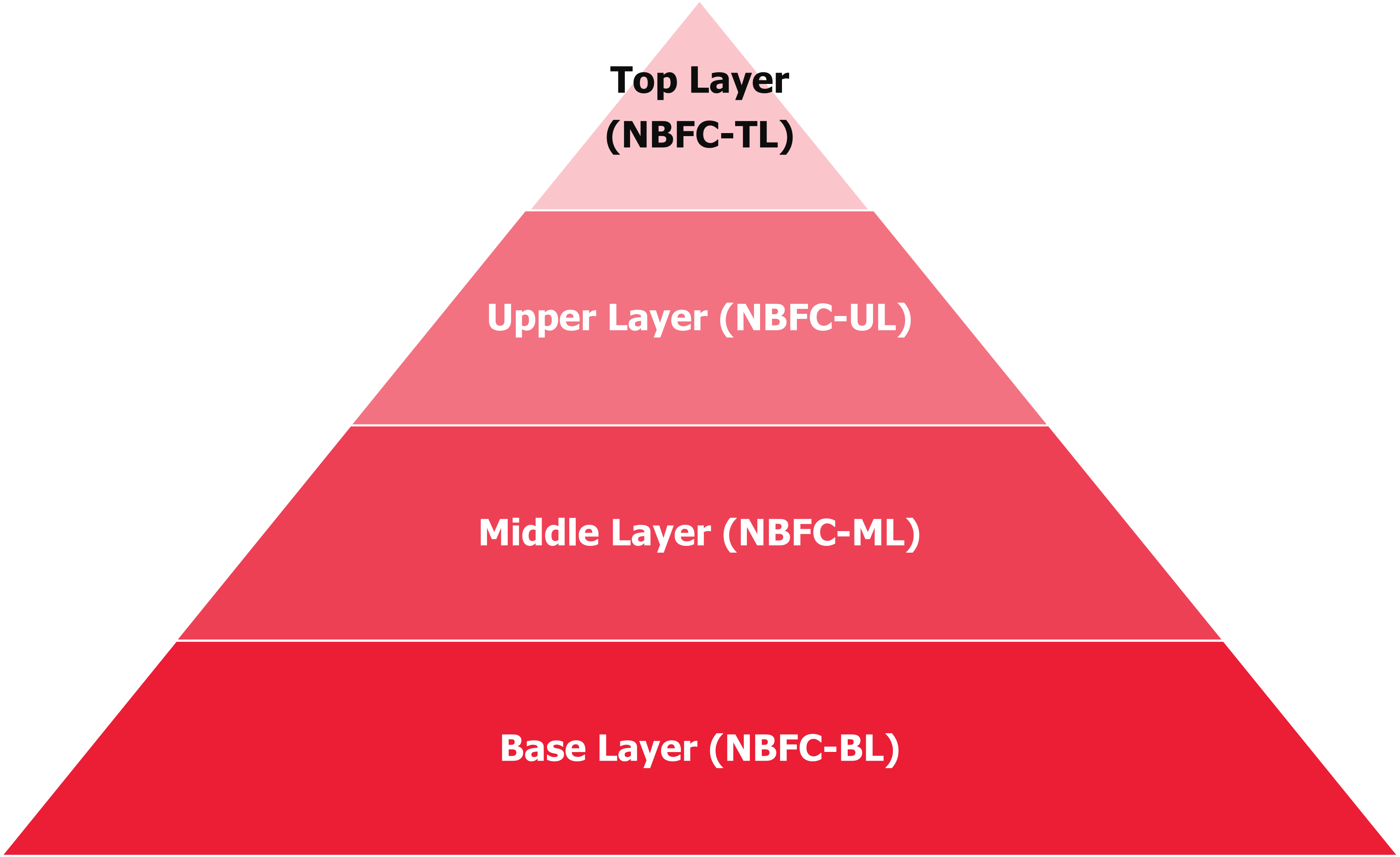
RBI Discretion

APPLICABILITY

Effective from Oct 1, 2022 unless other date specified

Regulations applicable on lower layer will automatically be applicable on higher layers unless stated otherwise

DIFFERENT LAYERS UNDER THE SBR FRAMEWORK



NBFC-BASE LAYER (NBFC-BL)

NBFCs as per size:
Non-Deposit taking NBFC of asset size < Rs. 1000 cr.

NBFCs always in this Layer
- NBFC-P2P
- NBFC-AA
- Non-Operative Financial Holding Company (NOFHC)
- NBFCs not having public funds and any customer interface

Can be in this layer or immediate next layer
Government owned NBFC

Can be in any layer
NBFC-ICC NBFC-MFI NBFC-MGC NBFC-Factor

NBFC-MIDDLE LAYER (NBFC-ML)

Basic Coverage (as per size):

- All Deposit taking NBFCs irrespective of asset size
- Non- Deposit taking NBFC of asset size Rs. 1000 cr. & above

NBFCs always in this Layer

- Standalone Primary Dealers;
- Infrastructure Debt Fund

Can be in this layer or immediate next layer

- Core Investment Company
- Housing Finance Company
- Infrastructure Finance Company

Can be in any layer

NBFC-ICC NBFC-MFI NBFC-MGC NBFC-Factor

NBFC-UPPER LAYER (NBFC-UL)

- As per Scoring methodology on following NBFCs:
  - Top 50 NBFCs based on their total exposure, out of which top 10 to automatically form part of this list
  - NBFCs which are designated as NBFC-UL in the previous year
  - Added as per RBI's judgement
- Till date 16 NBFCs notified under this list

L & T Finance Limited	Mahindra & Mahindra Financial Services Limited	Tata Capital Financial Services Limited	Cholamandalam Investment and Finance Company Limited	Shriram Transport Finance Company Limited	Aditya Birla Finance Limited
Indiabulls Housing Finance Limited	Piramal Capital & Housing Finance Limited	Bajaj Housing Finance Limited	Muthoot Finance Limited	Tata Capital Financial Services Limited	LIC Housing Finance Limited
	PNB Housing Finance Limited	Shanghvi Finance Private Limited	Bajaj Finance Limited	Tata Sons Private Limited	

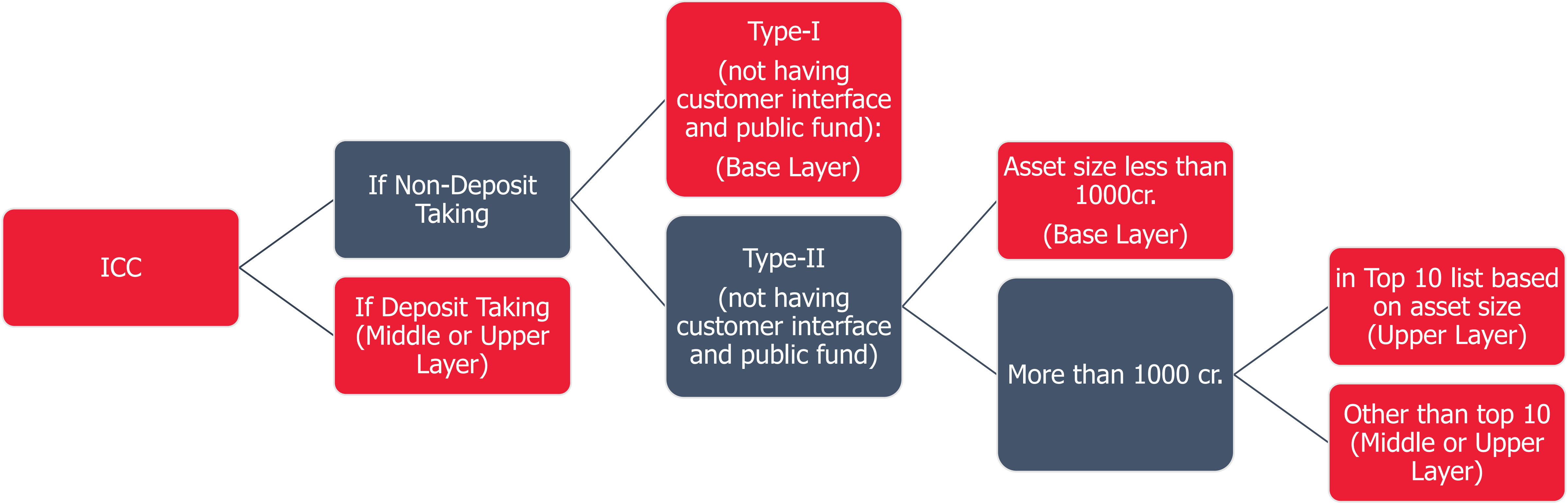
NBFC- TOP LAYER (NBFC-TL)

- NBFCs from Upper Layer to move to this layer where RBI is of the opinion that there is substantial risk from specific UL NBFCs
- Otherwise this layer will remain empty

WHICH NBFC FALLS IN WHICH LAYER

ENTITY DESCRIPTION	LAYER
Investment & Credit Company (NBFC-ICC)	Base Layer/ Middle Layer/ Upper Layer
Micro Finance Institution (NBFC-MFI)	Base Layer/ Middle Layer/ Upper Layer
Factor (NBFC- Factor)	Base Layer/ Middle Layer/ Upper Layer
Mortgage Guarantee Company (NBFC-MGC)	Base Layer/ Middle Layer/ Upper Layer
NBFC- P2P Platform (NBFC-P2P)	Base Layer
NBFC – Account Aggregator (NBFC-AA)	Base Layer
Non – Operative Financial Holding Company (NOHFC)	Base Layer
NBFCs not having public funds and any customer interface	Base Layer
Government Owned NBFC	Base Layer / Middle Layer
Standalone Primary Dealers (SPD)	Middle Layer
Infrastructure Debt Fund (NBFC- IDF)	Middle Layer
Core Investment Company (NBFC- CIC)	Middle Layer/ Upper Layer
Housing Finance Company (HFC)	Middle Layer/ Upper Layer
Infrastructure Finance Company (NBFC-IFC)	Middle Layer/ Upper Layer

Which Investment & Credit Company (ICC) falls in which Layer



SBR – CHANGES & IMPACT ON NBFC-ICC

NET OWNED FUNDS – for all layers

No change for NBFC-ICC not having any customer interface and access to public funds

	Current	By 31st March, 2025	By 31st March, 2027
NBFC- ICC	Rs. 2 cr.	Rs. 5 cr.	Rs. 10 cr.

Reason for introduction & Impact

- More capital infusion required;
- Increase free reserves/ profit;
- Reduce Investment in Group Companies

Common Equity Tier I Capital – Upper Layer & above

CET1 to be at least 9% of risk weighted assets

Existing Regulations

CAPITAL TO BE ATLEAST 15% OF RISK WEIGHTED ASSETS
of which Tier I capital to be minimum 10% and Tier II cannot exceed Tier I

Tier I includes owned funds which comprises of equity, preference convertible to equity
Which means CET1 is closely similar to Owned Funds i.e. Tier I

Reason for introduction & Impact

- To bring them in line with Banks ie. as per Basel III requirements;
- Total capital of 15% comprise of
  - CET1 of 9%
  - Additional 1% tier I
  - Balance 5% Tier II

Internal Capital Adequacy Assessment (ICAAP) – Middle Layer & Above

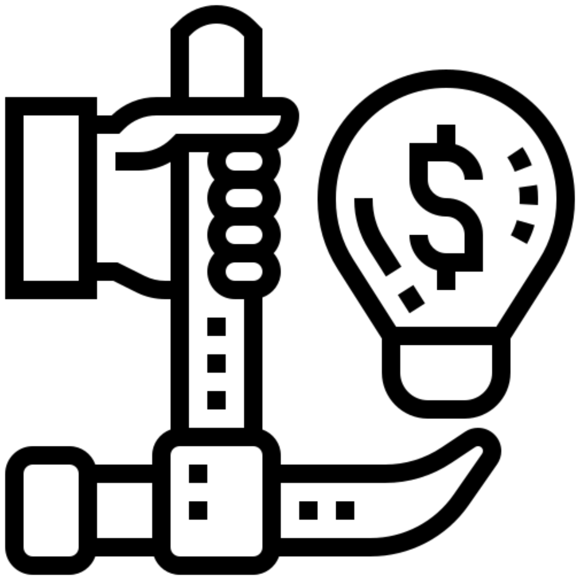
Capital Assessment to factor in different kind of risks

Background

- Concept introduced for NBFCs for the first time;
- Entities to identify and quantity different risks faced by them and accordingly determine the quantum of capital required to cover such risks;
- Existing CAR does not take into account various kind of risks associated with different types of activities and NBFCs , hence ICAAP would be additional aid for the same;
- Assessment to be as per ICAAP framework and further approved by Board and shared with RBI as basis for determining the capital

Leverage: Upper Layer

In addition to CRAR
Will be defined separately by RBI subsequently



Current leverage ratio is 7

Asset Classification: All Layers

NPA Norm	Timeline
> 150 days overdue	by March 31, 2024
> 120 days overdue	by March 31, 2025
> 90 days overdue	by March 31, 2026

Asset Classification: All Layers

Currently an account is classified as NPA by NBFC-NSI after 180 days of overdue

- With SBR, 90 days norm will have to be followed by all categories of NBFCs.
- To bring all NBFCs on the same footing and not allow NBFC-NSI to take advantage of extended period.
- NBFCs to not take advantage of extended period and reduced provision, thereby exposing themselves to higher long term risk;
- Short TAT for bucket shifting would lead to quicker identification and subsequent write off from the books.

Exposure Norms: Middle Layer & Upper Layer

Sensitive Sector Exposure

- Exposure to Capital Market and Commercial Real Estate to be considered as Sensitive Sector- Board approved limits to be set;
- Sub-limit within the commercial real estate exposure ceiling shall be fixed internally for financing land acquisition
- Sub-limits within overall SSE limits can be freely determined by the Board

Exposure Norms: Middle Layer & Upper Layer

Periodic vulnerability assessment of various sectors and their likely impact can be used to determine such limits

Internal Exposure

- In addition to Sensitive Sector Exposure , Internal limits for exposure to other important sectors should be determined by Board;
- Internal Limit for exposure to other NBFCs should also be fixed

Concentration & Exposure Limits: Middle Layer & Above

	SBR	EARLIER	
	LENDING & INVESTMENT COMBINED LIMIT	LENDING	INVESTMENT
Single Borrower/ Party	25% of Tier I capital	15% of owned funds	15% of owned funds
Single group of borrowers/ parties	40% of Tier I capital	25% of owned funds	25% of owned funds

Concentration & Exposure Limits: Middle Layer & Above

Impact

- ✍ Tier I is less than Owned funds and consolidated limits as opposed to separate individual limits
- ✍ Less exposure compared to earlier
- ✍ Motive is to reduce the overall exposure and risk

Large Exposure Framework: Upper Layer

Large exposure framework

Upper layer NBFCs to folllow the folllowing instead of Concentration & Exposure norms	
Single Counterparty	• 20% • Additional 5% with board approval • Additional 5% in case of exposure towards infrastructure loan/investment
Group of Connected Counterparties	• 25% • Additional 10% if exposure towards infrastructure/loan
	% of eligible capital base i.e. Tier I capital

Ceiling on IPO funding: All Layers

Effective from 01st April, 2023

- Ceiling of **Rs. 1 cr.** Per borrower for financing subscription to IPO. (More conservative limits can be fixed);
- No Such limits specified earlier.

Standard Asset Provisioning Norms - Upper Layer

Current regulations	
For Non-SI	0.25%
For SI	0.40%

Since sensitive sectors have been identified by RBI, which involve higher risk, accordingly, their provisioning should be high to provide more cushion in case the loan turning bad /NPA

Standard Asset Provisioning Norms - Upper Layer

Different asset size for different type pf assets	
Asset Category	Rate of Provision on Standard Asset
Individual Housing Loan and Loans to Small and Micro enterprises (SMEs)	0.25%
Advances to Commercial Real Estate -Residential Housing (CRE - RH) Sector	0.75%
Advances to Commercial Real Estate (CRE) Sector (other than CRE-RH)	1.00%
All loans and advances except stated above and including loans to Medium Enterprises	0.40%

Loans to directors, Senior Officers & Relatives of directors

Layer	Requirement	Layer
BASE LAYER	Board approved policy and limits to be in place	**MIDDLE & UPPER LAYER**
BASE LAYER	Policy to grant loans to directors, senior officers and **Relatives** of directors and to entities where directors or their relatives have major shareholding	**MIDDLE & UPPER LAYER**
BASE LAYER	Policy to include a threshold beyond which loans to abovementioned persons shall be reported to the Board.	**MIDDLE & UPPER LAYER**
BASE LAYER	Aggregate amount of such loans and advances sanctioned to be disclosed in Annual Financial Statement as per prescribed template	**MIDDLE & UPPER LAYER**
	Loans & Advances > 5 cr. to directors or their relatives or associated firm or company must be sanctioned by Board/ Committee of Directors	**MIDDLE & UPPER LAYER**
	Loans and advances to Senior officers shall be reported to the Board.	**MIDDLE & UPPER LAYER**
	Declaration to be obtained from borrower containing relationship with director/relative	**MIDDLE & UPPER LAYER**
	No senior officer or any Committee comprising of them to sanction any credit facility to its own relative	**MIDDLE & UPPER LAYER**
	Loan exposure to real estate sector to ensure thar borrowers have adequate permission	**MIDDLE & UPPER LAYER**

Governance matters: Board related

Experience of the board	• At least 1 director to have relevant past experience of working in a bank/ NBFC	All Layers
Limit on directorship of KMP	• KMP to not hold any directorship in any other NBFC-ML or NBFC-UL except in it subsidiary - timeline of 2 yrs. • No restriction on KMP of NBFC-BL ie. KMP of NBFC-BL can be director in as many other Base Layer NBFCs	Middle Layer & above
Limit on directorship of independent director	• Not to be on the board of more than 3 middle and upper layer NBFCs at a time • Can be independnet director in as many BL NBFCs as possible • Timeline of 2 years is provided w.e.f. Oct 1, 2022	Middle Layer & above

Governance matters: Board related

Removal of independent directors	• Removal/resignation of independent directors before completion of normal tenure to be reported to RBI	Middle Layer & above
Chief Compliance Officer	• Independent compliance function and a strong risk management framework • Appointment of chief compliance officer (CCO) along with board approved policy defining responsibility	Middle Layer & above
Qualification of board members	• Board composition to have mix of educational qualification and experience. • Should also have specific expertise based on the type of business	Upper Layer

Governance matters: Committee & other matters

Risk management committee at Board or Executive level	• Committee to be responsible for evaluating overall risks and to report to the board. • Committee to report to the Board	All Layers
Board committees	Role of different committees to be specified along with calendar of reviews	Middle Layer & above
Compensation guidelines	• Board approved policy to be put in place including the following: • Constitution of remuneration committee • Principles of compensation including guaranteed bonus • Claw back provisions	Middle Layer & above

Governance matters: Committee & other matters

Whistle blower mechanism	Policy for directors and employees to report genuine concerns	Middle Layer & above
Corporate governance of subsidiaries	Board to ensure the same in subsidiaries of the NBFC	Middle Layer & above
Core banking solution	NBFCs with 10 and more branches are mandated to adopt core banking solution. A glide path of 3 years with effect from October 1, 2022 is being provided	Middle Layer & above
Mandatory Listing	Listing within 3 years of being identified as NBFC-UL	Upper Layer

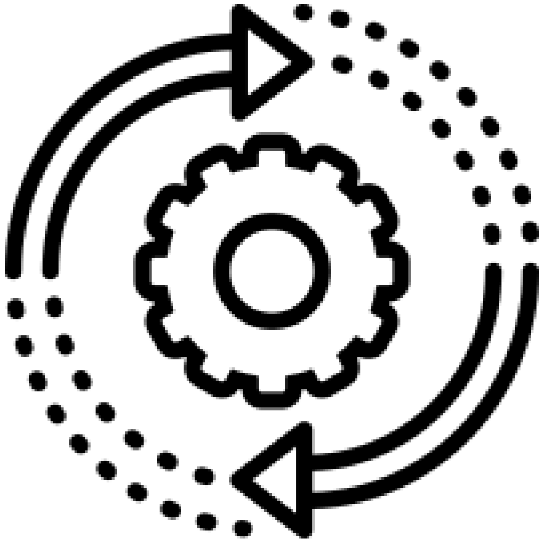
Disclosure in notes to accounts: Additional disclosures from 31/03/2023

Base, Middle & Upper Layers	Exposure to Real Estate Sector
	Exposure to Capital Market
	Sectoral exposure
	Intra Group Exposures
	Unhedged foreign currency exposure
	Related Party Disclosure
	Disclosure of Complaints from customer and Ombudsman office and grounds of complaints

Disclosure in notes to accounts: Additional disclosures from 31/03/2023

Middle & Upper Layers	CGR report to contain Composition and category of directors, shareholders
	Disclosure on modified opinion, if any, expressed by auditors, its impact on various financial items and management views on the audit
	Items of income and expenditure of exceptional nature
	Breaches in terms of covenants in respect of loans availed by the NBFC or debt securities issued by the NBFC including incidence/s of default
	Divergence in asset classification and provisioning norms
	Composition of the Board and its Committees
	Summarized ToR of each committee
	Details of compliance with requirements of Companies At, 2013
	Penalties imposed by RBI or any statutory authority
	Instances of breach of covenant of loan availed or debt securities issued
	Resolutions passed at General Body Meetings
Upper Layer	Roadmap for disclosure requirements of Listed Company under SEBI LODR

Transition to Upper Layer



- Within 3 months, NBFC should put a Board approved policy for adoption of the enhanced guidelines
- Board to ensure that additional stipulations are met within 24 months from the date of advice
- Once categorized, it will be subject to the guidelines for at least 5 years, i.e. it will move out of the framework if it does not meet the criteria for 5 consecutive years
- NBFCs which are about to reach the UL threshold will be intimated by RBI beforehand to enable them to readjust their operations, in case they do not want to graduate to UL

Synopsis of all changes under the SBR

RELATED TO	REGULATIONS	BASE	MIDDLE	UPPER	TIMELINE
Capital	Net Owned Funds	✓	✓	✓	Phased manner till Mar 31,2027
	Ceiling on IPO funding	✓	✓	✓	Apr 1, 2022
	Internal Capital Adequacy Assessment Process	X	✓	✓	Oct 1, 2022
	Common Tier I equity	X	X	✓	Oct 1, 2022
	Leverage	X	X	✓	When prescribed
Asset Classification & Provisioning	NPA classification	✓	✓	✓	Phased manner till Mar 31, 2026
	Differential standard asset provisioning	X	X	✓	Oct 1, 2022
Exposure & Concentration	Sensitive Sector Exposure	X	✓	✓	Oct 1, 2022
	Credit/ Investment Concentration	X	✓	✓	Oct 1, 2022
	Large Exposure framework	X	X	✓	Oct 1, 2022
	Internal Exposure Limits	X	X	✓	Oct 1, 2022

Synopsis of all changes under the SBR

	REGULATION	BASE	MIDDLE	UPPER	IMPLEMENTATION DEADLINE
Board & DIRECTORS RELATED	Experience of the Board	✓	✓	✓	Oct 1, 2022
	Limit on Directorship of KMP	X	✓	✓	Oct 1, 2024
	Limit on directorship of Independent Director	X	✓	✓	Oct 1, 2024
	Qualification of Board member	X	X	✓	Oct 1, 2022
	Removal of Independent Director	X	X	✓	Oct 1, 2022
	Appointment of Chief Compliance Officer	X	✓	✓	Oct 1, 2022
	Disclosures	✓	✓	✓	Oct 1, 2022
	Loans and Advances to directors and senior officers and their relatives	✓	✓	✓	Oct 1, 2022
COMMITTEE & OTHER CONCERNS	Mandatory Listing	X	X	✓	Within 3 yrs. from identification as NBFC-UL
	Board Committees	X	✓	✓	Oct 1, 2022
	Risk Management Committee	✓	✓	✓	Oct 1, 2022
	Compensation guidelines	X	✓	✓	Apr 1, 2023
	Whistle blower mechanism	X	✓	✓	Oct 1, 2022
	Corporate governance of subsidiaries	X	✓	✓	Oct 1, 2022
	Core banking solution	X	✓	✓	Oct 1, 2025

OTHER RECENT DEVELOPMENTS

Prompt Corrective Action

Additional discipline tool for NBFCs to enable supervisory intervention at appropriate time

Prompt corrective action (PCA) framework

APPLICABLE ON	APPLICABLE FROM
All NBFCs except: i. NBFCs in BASE LAYER ii. NBFCs not accepting or intending to accept public funds	October 1, 2022 based on Financial position on or after March 31, 2022

ENTRY	EXIT
NBFC will be placed under the framework based on • Audited Annual Financial Results or • Supervisory assessment made by RBI	**Exit from the framework or withdrawal of restrictions will be considered** • If no breach in risk threshold in any parameter observed as per four continuous quarterly financial statements , one of which should be Annual Audited Financial Statement • Based on supervisory comfort of the RBI, including assessment on sustainability of profitability of the NBFC

Prompt corrective action (PCA) framework

Indicator Risk	Risk Threshold-1	Risk Threshold-2	Risk Threshold-3
CRAR	<15% but ≥12%]	<12% but ≥9%]	<9%
TIER-I CAPITAL RATIO	<10% but ≥8%	<8% but ≥6%	<6%
NNPA RATIO	>6% but ≤ 9%	>9% but ≤12%	>12%

Prompt corrective action (PCA) framework

Reason for introduction & impact

- Increased monitoring of required thresholds by NBFCs even having significantly small size of portfolio
- Increased comfort level of investors and stakeholders

Prompt corrective action (PCA) framework

	Mandatory Actions	Discretionary Actions
Risk Threshold-1	• Restriction on dividend distribution/remittance of profits; • Promoters/shareholders to infuse equity and reduction in leverage; • Restriction on issue of guarantees or taking on other contingent liabilities on behalf of group companies (only for CICs)	Special Supervisory Actions • Strategy related • Governance related • Capital related • Credit risk related • Market risk related • HR related • Profitability related • Operations/Business related • Any other
Risk Threshold-2	In addition to mandatory actions of Threshold 1, • Restriction on branch expansion	
Risk Threshold-3	In addition to mandatory actions of Threshold 1 & 2, • Appropriate restrictions on capital expenditure, other than for technological upgradation within Board approved limits • Restrictions/reduction in variable operating costs	

Digital Lending Norms

Guidelines on 'Digital Lending' issued on 02nd September, 2022 however, time give till 30th November, 2022 to NBFCs and other regulated entities to ensure loans sanctioned since the date of the circular.

Digital Lending Norms

- Terms viz 'Digital Lending Apps/Platforms, Digital Lending etc. have been specifically **defined**;
- Loan servicing , repayment etc. should be executed by the borrower **directly in REs bank account** without any pass through/ pool account of third party including accounts of LSPs and their DLAs
- **No fee or any charges etc.** are charged by LSPs to the borrower directly
- **Grievance redressal officer** of the RE to deal with complaints against their respective DLAs

Digital Lending Norms

- **Privacy policy** for access and collection of personal information of borrowers should be in in place and made publicly accessible by DLAs and LSPs of the entity

- Extension of structured digital lending products by REs and/or LSPs engaged by REs over a merchant platform involving short term, unsecured/ secured credits or deferred payments, need to be **reported to CICs**

- W.r.t. responsibilities of DSA/DMA/Recovery Agents following additional restricting activities have been highlighted:

  - Sending inappropriate messages either on mobile or through social media
  - Persistently calling borrowers or calling before 8 a.m. and after 7 p.m. for recovery of overdue loans, making false and misleading representations

Digital Lending Norms

Impact

- Specific definition of terms viz. Digital Lending Apps, Digital Lending etc. reduces the scope of bypassing the laws by entities not wishing to come under the ambit of these guidelines
- LSPs cannot charge any fee directly from borrowers would reduce the incentive available to such Lenders to enter into such arrangements/business deals
- As industry still awaits clarity on FLDG limits as per recommendation of working committee of RBI, existing & new tie ups are under uncertainty. Although NBFCs have optional avenues of entering into co-lending arrangement to reduce risks, future of digital lending tie ups is yet to be ascertained.

Microfinance Loans

CHANGE
Provisions as per Master Direction - Reserve Bank of India (Regulatory Framework for Microfinance Loans) Directions, 2022 applicable to NBFCs to the extent the loans provided by them classify as a 'microfinance loan'
A collateral free loan given to a household having annual household income upto Rs. 3,00,000 shall be considered as a 'microfinance loan'
Following necessary directions to be followed in case an NBFC provides microfinance loans: - Board approved policy for assessment of household income must be put in place - Board approved policy to be in place regarding limit on outflows on account of repayment of monthly loan obligation - Board approved policy regarding pricing of microfinance loans - Penalty for delayed payment of microfinance loans shall be applied only on the overdue amount and not on the entire loan
No cap on interest rate charged for microfinance loans

Microfinance Loans

Impact

- Removal of interest rate cap will provide level playing field to all lenders of microfinance loans.
- Standardization of criteria for ‘microfinance loans’ will enable common monitoring and eligibility criteria for all borrowers and lending institutions providing such loans

Securitization norms

CHANGE
Loans with residual maturity of less than 365 days cannot be securitized. Exceptions: • Loans with tenor upto 24 months extended to individuals for agricultural activities where both interest and principal are due only on maturity • Trade receivables with tenor upto 12 months discounted/ purchased by lenders from their borrowers.

Impact

- Small ticket size loans with maturity period of few days like BNPL etc. will not get covered

Corporate Professionals

THANK YOU

Ankit Singhi

Head- Corporate Affairs & Compliance, Corporate Professionals