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The RBI notifies Master Direction on Scale-Based Regulation of NBFCs

Introduction

On October 19, 2023, the Reserve Bank of India ("**RBI**") has issued 'Master Direction – Reserve Bank of India (Non-Banking Financial Company – Scale Based Regulation) Directions 2023' ("**SBR Master Direction**"). The SBR Master Direction comes into immediate effect and replaces the erstwhile framework of non-banking finance companies ("**NBFCs**"), *viz.* Master Direction – NBFC – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016 and Master Direction – NBFC – Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016 (collectively, "**Previous Framework**"). The SBR Master Direction aims to harmonize the Previous Framework with the scale-based regulation of NBFCs, published by the RBI on October 22, 2021 ("**SBR Framework**").

Under the SBR Master Direction, the earlier classification of NBFCs based on asset size (i.e., systemically important and non-systemically important NBFCs) is brought to an end, while the classification of NBFCs based on: (a) acceptance of public deposits (i.e., deposit-taking and non-deposit taking); and (b) specialisation (factoring business, housing finance, microfinance, account aggregation, etc.) continues to be in force. Further, as classified by the RBI under the SBR Framework, the SBR Master Direction also continues to classify NBFCs into 4 (four) layers, namely, the Base Layer, the Middle Layer, the Upper Layer and the Top Layer. (Please click here for further information on classification of NBFCs into 4 (four) layers).

Key Highlights and Regulatory Changes

General Regulations

1. **Multiple NBFCs in a Group:** Under the SBR Master Direction, if there are multiple NBFCs belonging to the same group or if they are promoted by common set of promoters, then the total asset size of the NBFCs in the group will be considered to determine whether the NBFCs of the same group will fall under the middle layer. If the consolidated asset size of the NBFCs in the group is either INR 1,000 crore (Indian Rupees one thousand crore) or more, then each NBFC (i.e., NBFC – investment and credit company ("**NBFC-ICC**"), NBFC- micro finance institution ("**NBFC-MFI**"), NBFC factor and mortgage guarantee companies ("**NBFC-Factor**")) in the same group will be classified in the Middle Layer and regulations applicable to the Middle Layer NBFCs will apply to such NBFCs in the group (irrespective of their individual asset size). However, this methodology will not be followed for classifications of NBFCs falling under the Upper Layer.

2. **Asset classification:** The SBR Master Direction has revised the asset classification norms for NBFCs. The SBR Master Direction also provides for a transition path (applicable only to those NBFCs which are currently not required to follow the 90 (ninety) days' NPA norm under the SBR Master Direction). All such NBFCs will be required to classify the accounts as a non-performing asset if their overdue period is more than 150 (one hundred and fifty) days. However, post March 31, 2024, the period for declaring such accounts as non-performing accounts will be reduced to 120 (one hundred and twenty) days and from March 31, 2025, it will be reduced to 90 (ninety) days. Further, Middle Layer NBFCs are also required to make provisions even for their standard assets at 0.40% of the outstanding standard loans. This provisioning is not permitted to be counted for arriving at net NPAs in relation to such Middle Layer NBFCs.
3. **Experienced director on the board of directors**: The board of directors of any NBFC must include at least 1 (one) director with relevant experience in a bank / NBFC.
4. **NBFCs not availing public funds and having no customer interface:** NBFCs which do not access public funds and have no customer interface are classified as Base Layer NBFCs under the SBR Framework. In addition to this, the SBR Master Direction has also exempted all such NBFCs from the prudential regulations and regulatory restrictions and limits identified for the Base Layer under Chapters IV and V of the SBR Master Direction.
5. **Minimum net owned fund**: Net owned fund requirement for NBFC-ICC, NBFC-MFI and NBFC-Factors is increased to INR 10,00,00,000 (Indian Rupees ten crore) (to be increased in stages).
6. **Reporting to CRILC:** All deposit taking NBFCs, non-deposit taking NBFCs with an asset size of INR 500,00,00,000 (Indian Rupees five hundred crore) and above and NBFC Factor (collectively, "**Notified NBFCs**") are required to identify 'non-cooperative borrowers' (as provided under the SBR Master Direction) in line with the SBR Master Direction and report classification of such borrowers to Central Repository of Information on Large Credits ("**CRILC**"). Further, the Notified NBFCs are also required to report all relevant credit information such as the aggregate fund based and non-fund-based exposure of INR 5,00,00,000 (Indian Rupees five crore) and above with them and the special mention account status of the borrower with CRILC, in accordance with the requirements under the SBR Master Direction.

Applicability to Middle Layer NBFC / Upper Layer NBFC

1. **Asset size of INR 1,000,00,00,000 (Indian Rupees one thousand crore) and above:** As per the SBR Master Direction, once an NBFC attains the asset size threshold of INR 1,000,00,00,000 (Indian Rupees one thousand crore), such NBFC will be subject to regulatory requirements applicable to the Middle Layer NBFCs, irrespective of not having such assets as on the date of last balance sheet. Once an NBFC is classified as a Middle Layer NBFC, even if its asset size falls below INR 1,000,00,00,000 (Indian Rupees one thousand crore) because of market fluctuations, even then such NBFCs will be required to adhere to the norms applicable to Middle Layer NBFCs.
2. **Exposure norms:** Middle Layer NBFC would be required to link the exposure limits with Tier I capital. The Upper Layer NBFC will have to additionally follow the direction on large exposure framework (similar to banks). Both NBFCs would be required to have board approved internal limits for sensitive sectors.
3. **Corporate governance**: Several corporate governance measures have been prescribed for Middle Layer and Upper Layer NBFCs such as additional disclosures in financial statements, restrictions on independent directors and key managerial personnel, introduction of core financial services solutions, etc.

Applicability to Upper Layer NBFC

1. **Listing obligation**: The SBR Master Direction re-affirms the position provided under the SBR Framework in relation to listing of the Upper Layer NBFCs. As per the SBR Master Direction also, the Upper Layer NBFCs are required to be listed on the stock exchange within 3 (three) years of them being classified as an Upper Layer NBFC.

2. **Capital and prudential norms**: Common equity tier 1 capital is prescribed by the RBI. Leverage requirement will also be prescribed by the RBI. Standard asset provisioning (similar to banks) will be applicable to these NBFCs.

The SBR Master Direction is available here.

JSA Viewpoint

The introduction of the SBR Master Direction represents a significant stride towards establishing a comprehensive and harmonized regulatory framework for NBFCs in India. This master direction has effectively addressed and resolved the uncertainties that persisted during the interim period when both the Previous Framework as well as the SBR Framework were in force.

Considering the systemic importance, the SBR Master Direction has enhanced the corporate governance in Middle Layer and Upper Layer NBFCs. As expected, the regulations for Upper Layer NBFCs are at par with banks on many fronts.

A new layer-based classification and its accompanying regulatory framework have been implemented by the SBR Master Direction. While this master direction introduces a few new regulations, it primarily consolidates the existing regulations. RBI guidelines specific to certain NBFCs such as housing finance companies, standalone primary dealers, mortgage guarantee companies, peer to peer lending platform, core investment companies continue to apply over and above the SBR Master Direction, unless stated otherwise. It would have been better if RBI had superseded all existing regulations and issued a comprehensive guideline. These would have taken away any ambiguity in NBFC regulations.

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