N. A. SHAH ADVISORY SERVICES LLP

BULLETIN

ALLIED LAWS BULLETIN – MAY 2022

EXECUTIVE SUMMARY

- RBI has introduced new guidelines under the Revised Scale Based Regulations.
- RBI has provided a timeline for certain borrowers to obtain LEI code.

GUIDELINES UNDER THE REVISED SCALE BASED REGULATIONS

- RBI had introduced Scale based regulations under which NBFCs were categorised into 4 buckets namely, Top Layer (NBFC-TL), Upper Layer (NBFC-UL), Middle Layer (NBFC-ML) and Base Layer (NBFC-BL) (*See* **Definitions**). RBI had provided that detailed circulars covering various aspects such as corporate governance, capital requirements etc will be issued in the future.

- Pursuant to the above, RBI has come out with detailed guidelines. Key aspects are as under:

    - <u>Compliance function and Chief Compliance Officer (CCO)</u>

        - With an effort to enhance corporate governance, RBI has directed NBFC UL and NBFC ML to formulate Compliance function as well as to appoint a CCO.
        - These NBFCs must form a policy on Compliance function by 1st April 2023 and should appoint CCO by 1st October 2023.
        - As per the regulations, the tenure of the CCO shall be a minimum fixed period of 3 years. Further, prior intimation to RBI will be required for appointment/premature termination etc. of CCO.

    - <u>Disclosure requirements in the notes to financial statements</u>

        - RBI has specified the formats for additional disclosures in the notes to accounts of Financial Statements of all NBFCs which shall be applicable for annual financial statements for the year ending 31st March 2023.

    - <u>Guidelines on compensation of KMP and senior management in NBFCs</u>

        - These guidelines will be applicable to all NBFCs except NBFC-BL and Government owned NBFCs. These will be effective from 1st April 2023.
        - The guidelines provide for appointment of Nomination and Remuneration committee to oversee the framing, review and implementation of compensation policy.
        - RBI has also laid out the elements forming part of Fixed, and Variable pay of KMPs and Senior management.

- <u>Regulatory restriction on loans and advances by NBFC ML and NBFC UL</u>

  - Under the revised guideline, RBI has specified conditions, subject to which loans and advances shall granted by NBFCs. These guidelines shall be effective from 1st October 2022.
  - Granting of loans aggregating to INR 5 crores and above to directors and interested persons shall require sanction by the Board/committee of Board of the company.
  - For loans to real estate sector, NBFCs shall ensure that the borrowers have obtained prior permission from statutory authorities for the project, wherever required.

- <u>Capital Requirements for NBFC-UL</u>

  - Earlier under the Scale based regulations, RBI had specified that NBFC-UL shall maintain Common Equity Tier I Capital of at least 9% of Risk Weighted Assets.
  - RBI has now provided the list of elements which would form part of Common Equity Tier 1 capital while calculating the above mentioned ratio.
  - The above circular is applicable to all NBFC-UL except CICs.

- <u>Large Exposure Framework for NBFC-UL</u>

  - RBI has specified the limits (based on Eligible capital base) up to which the NBFC-ULs can have exposures in the single counterparty or a group of connected counterparties. Summary of the limits is produced below:

	NBFC-UL (Other than Infrastructure Finance Companies ('IFC'))*	NBFC-UL (IFC)*
Single Counterparty	▪ 20% allowed. ▪ Additional 5% allowed with Board Approval. ▪ Additional 5% allowed if exposure is towards Infrastructure loans or investment. (However, Single counterparty limit shall not exceed 25% in any case)	▪ 25% allowed. ▪ Additional 5% allowed with Board Approval.

Group of Connected Counterparties	▪ 25% allowed. ▪ Additional 5% allowed if exposure is towards Infrastructure loans or investment.	▪ 35% allowed.

** as percentage of Eligible Capital Base of NBFC*.

LEI FOR BORROWERS

- RBI has provided that non-individual borrowers enjoying aggregate exposure of INR 5 crores and above from Banks and Financial Institutions (Including NBFCs) shall be required to obtain LEI as per the below mentioned timeline:

Total Exposure	LEI to be obtained on or before
Above INR 25 crores	April 30, 2023
INR 10 crores to INR 25 crores	April 30, 2024
INR 5 crores to INR 10 crores	April 30, 2025

Definitions

Base Layer - The Base Layer shall comprise of (a) non-deposit taking NBFCs below the asset size of ₹1000 crore and (b) NBFCs undertaking the following activities- (i) NBFC-Peer to Peer Lending Platform (NBFC-P2P), (ii) NBFC-Account Aggregator (NBFC-AA), (iii) Non-Operative Financial Holding Company (NOFHC) and (iv) NBFCs not availing public funds and not having any customer interface.

Middle Layer - The Middle Layer shall consist of (a) all deposit taking NBFCs (NBFC-Ds), irrespective of asset size, (b) non-deposit taking NBFCs with asset size of ₹1000 crore and above and (c) NBFCs undertaking the following activities (i) Standalone Primary Dealers (SPDs), (ii) Infrastructure Debt Fund - Non-Banking Financial Companies (IDF-NBFCs), (iii) Core Investment Companies (CICs), (iv) Housing Finance Companies (HFCs) and (v) Infrastructure Finance Companies (NBFC-IFCs).

Upper Layer - The Upper Layer shall comprise of those 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 ten eligible NBFCs in terms of their asset size shall always reside in the upper layer, irrespective of any other factor.

Top Layer - The Top Layer will ideally remain empty. This layer can get populated if the Reserve Bank is of the opinion that there is a substantial increase in the potential systemic risk from specific NBFCs in the Upper Layer. Such NBFCs shall move to the Top Layer from the Upper Layer.

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B 21-25 & B41-45, Paragon Centre,
Pandurang Budhkar Marg, Mumbai – 400013
Tel: 91-022-4073 3014
E-mail Id: info@nashahadvisors.com