EMERGING REGULATORY FRAMEWORK FOR NBFCS

[FOR BASE LAYER NBFCS]

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Regulatory Arbitrage between Banks and NBFCs

- Regulatory arbitrage has been the subject matter of policy makers' attention for long time; multilateral bodies have also been pointing the same out
- NBFCs can virtually do everything that banks can; however, without having similar regulations
- Structural arbitrage:
  - No CRR/SLR
  - No priority sector lending
  - No restriction on investments in shares of other companies
  - No Shareholding limits – not more than 10% shares in a banking co
  - FDI is freely allowed
- Prudential arbitrage
  - Licensing of banks is not all time open
  - Ownership restriction – business houses do not own banks – proposal currently under examination
  - Entry point capital requirement is much higher
  - Provisioning requirements – asset-based provisioning requirements in case of standard assets
  - Basel III has leverage

Overview of the SBR framework

- Four layers for regulatory supervision:
  - Most smaller NBFCs to be in the base layer
  - Present classification of "systemically important" NBFCs to be changed to "middle layer", with an asset threshold of Rs 1000 crores
- Do scale-based regulations override the existing regulatory framework?
  - NBFCs shall be subject to regulations as currently applicable, except for the changes under SBR
    - For NBFC-NSI & NBFC-SI (<1000crs)- Master Directions-ND-NSI and SBR Framework
    - For NBFC-SI (>1000crs)- Master Directions-ND-SI and SBR Framework

- What happens to existing functional classification?
  - Function-based classification will stay; layering into some layers is also dependent on the functional classification
    - The following will irrespective of asset size be classified as BL:
      - P2P, AA, NOFHC, NBFC with no PF and CI
    - The following will irrespective of asset size be classified as ML:
      - SPD and IDF
    - The following will be taken as at least as ML irrespective of size:
      - CIC, HFC, IFC and NBFC-D

Highlights of the SBR Framework

Entry level/ Capital requirements

- NOF requirement
- ICAAP

Corporate Governance

- Directors' relevant experience
- Risk Management Committee
- Disclosure Requirements (including corporate governance report)
- Compliance Function and CCO
- Compensation Guidelines

Prudential requirements

- NPA norms streamlining
- Sensitive sector exposures
- Concentration norms

Operational/ Business restrictions

- IPO financing
- Loans, advances and awarding of contracts to directors and senior officers
- Core Banking Solution

Evolution of Regulatory Framework for NBFCs

Regulatory Framework -1998

New regulatory Framework in Jan-1998 after newly acquired powers under RBI Act.

Provided for

1. Categorisation of NBFCs
2. Defining “Deposit”
3. Min. credit rating and NOF
4. Prohibition on loan against own shares
5. Widen scope for “auditors certificate”

Classification of Systemically Important NBFCs – Usha Thorat report 2011

Classified NBFCs with asset size => Rs. 100 cr. as “Systemically Important”

Prudential Regulations such as CAR and exposure norms made applicable

Revised Regulatory Framework - 2014

Rapid growth of NBFC sector influenced RBI to review the regulatory framework in 2014

Provided for-

1. Min NOF of Rs. 2 cr.
2. Limit for classification as systematically important increase to Rs. 500 cr. from Rs. 100 cr.
3. Harmonization of norms
4. Review of corporate governance norms

Scale Based Regulations

Discussion Paper was issued in January 2021

Align the regulatory framework for NBFCs keeping in view their changing risk profile

4 layer classification

- ✓ Threshold for systemic significance: Rs 100 crores in 2006
- ✓ A new category of CIC-SI was created in 2010
- ✓ In 2011, Usha Thorat Committee gave its report
- ✓ In 2014, the limit of systematic significance increased to Rs. 500 crores

Erstwhile Regulatory Framework

Based on the ability to accept deposits

Deposit taking NBFCs

Non-deposit taking NBFC

Systemically important NBFC

Those with asset size of Rs. 500 crores or above

Total assets of all NBFCs in a group must be aggregated to determine the limit

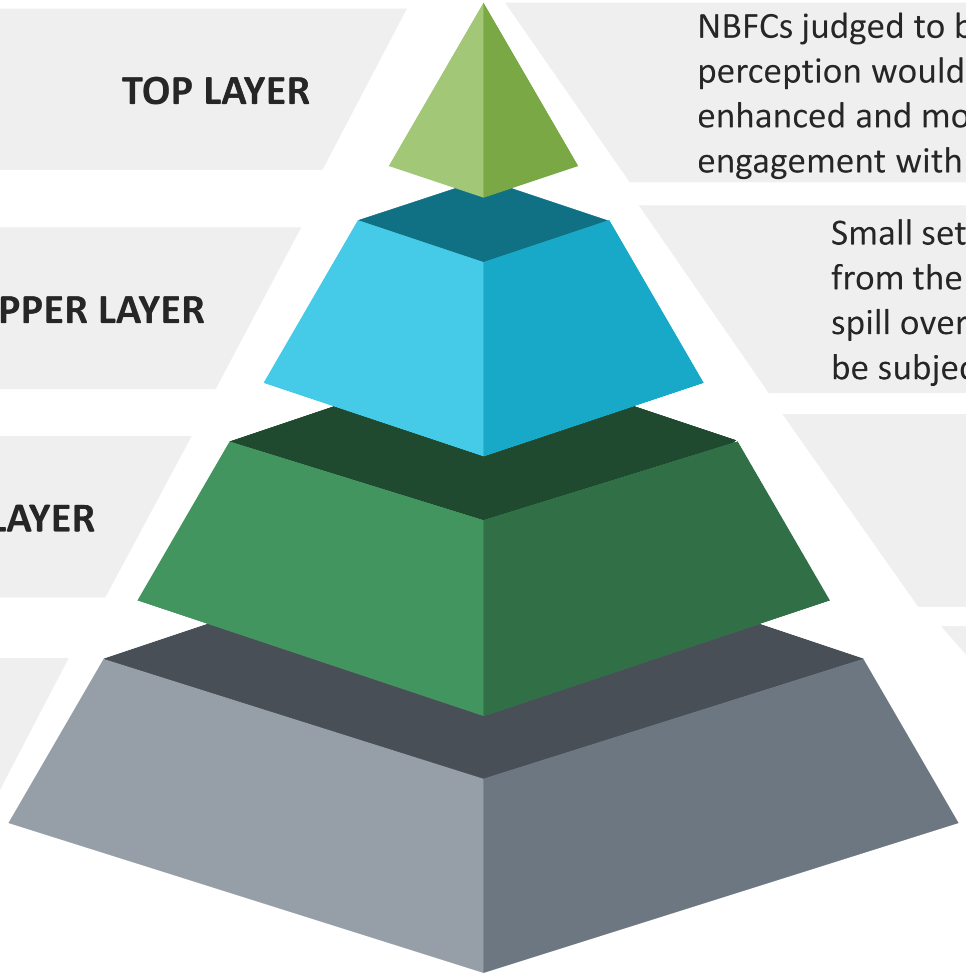
Non-Systemically important NBFC

Those with asset size of less than Rs. 500 crores

Snapshot of Applicability

	NBFC-ND-NSI	NBFC-ND-SI
Corp. Gov. Norms	Not Applicable	Applicable
Capital Adequacy	Not Applicable	Applicable
Leverage Ratio	Applicable (with PF)	Not Applicable
Provisioning norms	Applicable (with PF)	Applicable
Asset Classification	Applicable (with PF)	Applicable
Concentration Norms	Not Applicable	Applicable (with PF)
KYC Norms	Applicable (with CI)	Applicable (with CI)
CIC Reporting	Applicable (with CI)	Applicable (with CI)
Fair Practice Code	Applicable (with CI)	Applicable (with CI)
Statutory Auditor Cert.	Applicable	Applicable
Prior Approval for transfer of control/mangt.	Applicable	Applicable
Liquidity Risk Management	Applicable (with PF, CI and >100cr)	Applicable (with PF and CI)
Legal Entity Identifier for Borrowers	Applicable	Applicable
Outsourcing Guidelines	Applicable	Applicable
Digital Lending Guidelines	Applicable	Applicable

Overview of Scalar Approach



TOP LAYER	NBFCs judged to be extreme in supervisory risk perception would be pushed to Top there will be enhanced and more intensive supervisory engagement with these NBFCs	Supervisory Discretion
UPPER LAYER	Small set of NBFCs which are significant from the point of view of systemic risk spill overs and are therefore required to be subjected to tighter regulations	Bank like regulations
MIDDLE LAYER	Shall consist of all non-deposit taking NBFCs having asset size > Rs. 1000 cr. and all deposit taking NBFCs	Arbitrages plugged
BASE LEVEL	Consist of NBFCs having asset size < Rs. 1000 cr.	Equivalent to current NBFC-ND-NSI

Scalar Approach: Filtering Process (1/2)

Size

Scale of Significance

Activity

Upper Layer

- Top 10 NBFCs to be included
- Top 50 NBFCs by asset size to go following filters
  - Size – 35%
  - Interconnectedness – 25%
  - Complexity – 10%
  - Supervisory Inputs – 30%

Middle Layer

- CICs
- HFCs
- IFCs

Always NBFC-ML

- IDFs
- Standalone Primary Dealers

Base Layer

- Type-I NBFCs
- Peer to Peer
- Account Aggregators
- NOFHC
- Asset Size upto Rs. 1000 cr

Scalar Approach: Filtering process (2/2)

Two-Phase parametric Analysis for UL

- **Quantitative Factors**
  - Weight – 70%
- **Qualitative Factors/ Supervisory Inputs**
  - Weight – 30%

Quantitative Measures

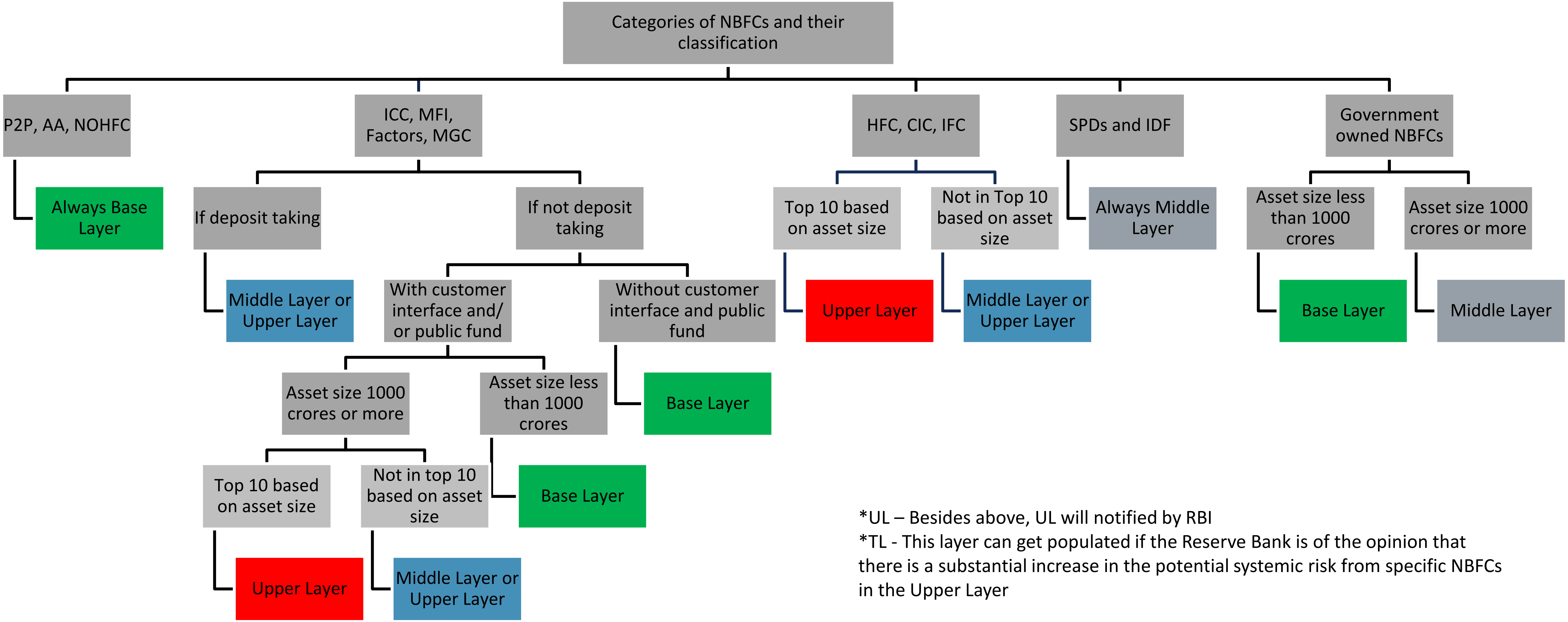
- Size & Leverage
- Inter-connectedness
- Complexity

Qualitative Measures

- Nature and type of liabilities
- Group Structure
- Segment penetration

- Upper layer entities to be identified by RBI based on a scoring methodology –
  - will require compliance with the Large Exposure Framework,
  - Minimum CET I requirement as well as well leverage restrictions,
  - Differential provisioning requirements for standard assets
  - Internal limits on exposure to ‘important sectors’ to be laid down
  - NBFC-UL shall be mandatorily listed within 3 years of identification

Classification Based on Categories and Scale of NBFCs

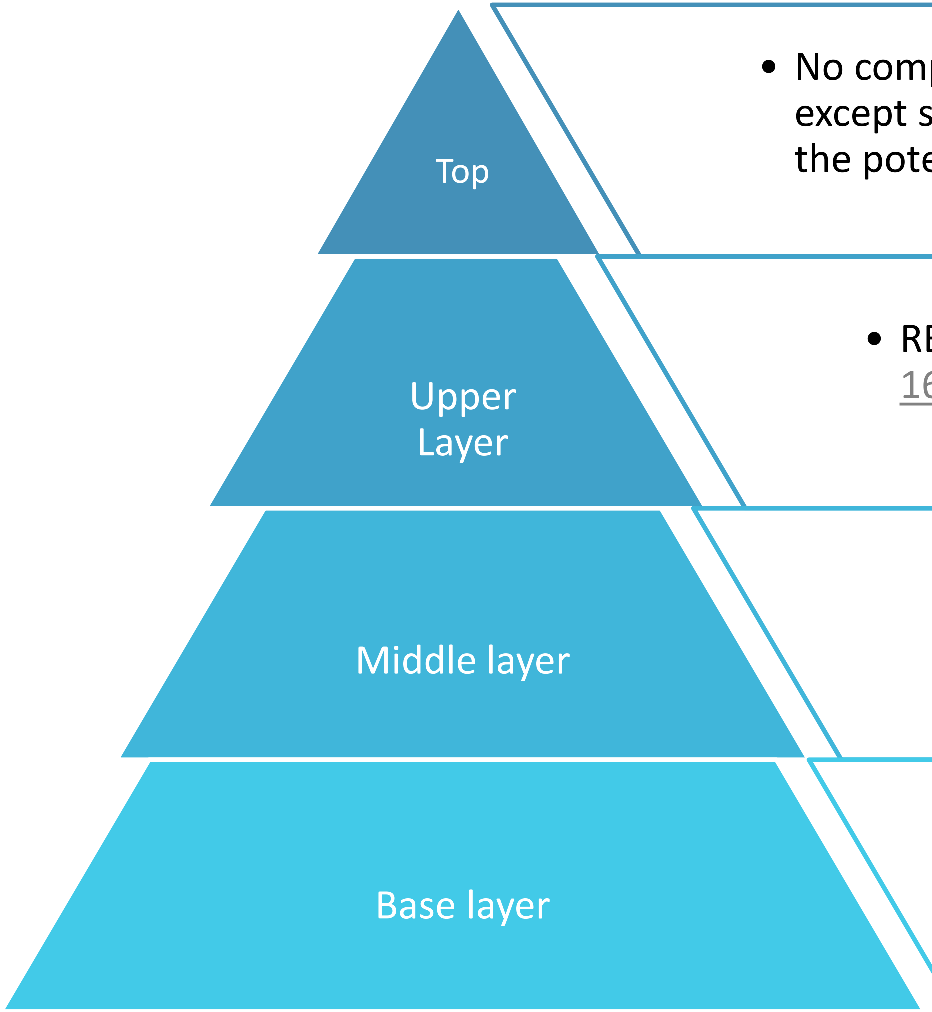


*UL – Besides above, UL will notified by RBI

*TL - 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

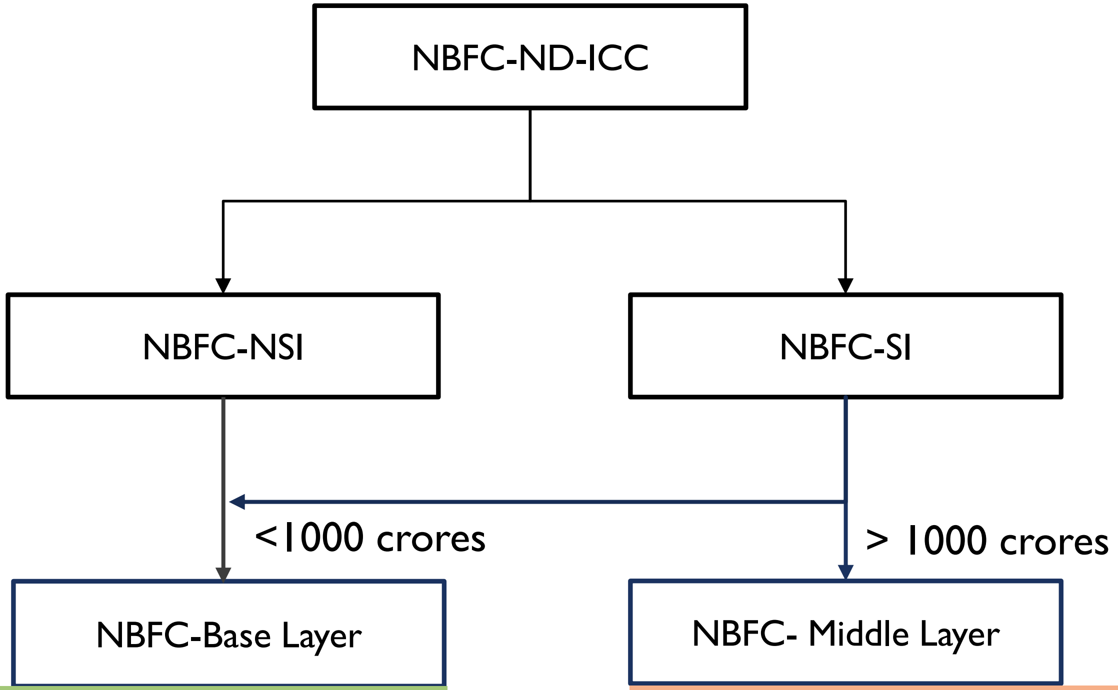
Scalar view by number

Type of NBFC (As on December 31, 2022)	Number (9471)
NBFCs-D	42
NBFC-ND-SI	420
NBFC-ND-NSI	8981
NBFC-ICC	9265
NBFC-MFIs	100
NBFC- Factors	8
NBFC-IDF	3
NBFC - P2P	25
Account Aggregator	6
NOFHC	3
CICs	55
NBFC - IFCs	8
HFC-D	15
HFC-ND	81



- No company to be there; except substantial increase in the potential systemic risk
- RBI has released list of 16 NBFCs
- May have about 270-300 cos
- May have about 9000+ cos

Transition for NBFC-NSI and NBFC-SI



Existing Guidelines-

NBFC-ND-NSI Master Directions

Additional Guidelines-

SBR Framework for NBFC-BL

Existing Guidelines-

NBFC-ND-SI Master Directions

Additional Guidelines-

SBR Framework for NBFC-ML

NBFC-SI falling in Base Layer- will they follow the SI Master Directions or NSI Master Directions?

Multiple NBFCs in the group

Type of NBFC	Asset size on standalone basis	Classification on a standalone basis	Classification due to aggregation
NBFC-ICC	350 crs	NBFC-BL as the individual asset size is < 1000 crs	NBFC-ML as consolidated group asset size is > 1000 crs
NBFC-MFI	150 crs	NBFC-BL as the individual asset size is < 1000 crs	NBFC-ML as consolidated group asset size is > 1000 crs
HFC	250 crs	NBFC-ML as all HFCs will fall under middle layer unless classified as NBFC-UL	
NBFC-IFC	450 crs	NBFC-ML as NBFC-IFC shall always fall under the middle layer, irrespective of aggregation	
NBFC-P2P	100 crs	NBFC-BL as NBFC-P2P shall always fall under the base layer, irrespective of aggregation	
NBFC-without PF and CI	100 crs	NBFC-BL as such NBFCs shall always fall under the base layer, irrespective of aggregation	
Total Asset Size	1400 crs		

Group NBFCs may have any of the following:

- Subsidiaries and Holding Companies as per applicable accounting standards
- Joint ventures as per applicable accounting standards
- Associate Companies as per applicable accounting standards
- Promoters- Promotee as per SEBI Takeover Regulations for listed companies
- Entities that are related parties as per applicable accounting standards
- Entities having a common brand name
- Entities holding more than 20% of the equity capital of the investee company

Timelines for applicability of specific guidelines on BL and ML

April 1, 2022

Limit on IPO Financing

October 1, 2022

ICAAP
Director's relevant experience
Risk Management Committee
Concentration norms

Sensitive Sector Exposure
Loans, advances and awarding of contracts to directors and senior officers

March 31, 2023

Disclosure Requirements including CG Report (Annual Financial Statements for FY ending **March 31, 2023**)

April 1, 2023

Compensation Guidelines

Reporting on implementation of CFSS

October 1, 2023

Compliance Function

March 1, 2024

NPA transitioning (**Beginning date** of NPA transitioning. To align with **more than 90 DPD by March 31, 2026**)

March 31, 2025

NOF Requirement (**Beginning date.** To reach Rs10 crores By March 31, 2027)

September 30, 2025

Core Financial Services Solution
NBFC-ML with >=10 FUs

REGULATORY CHANGES UNDER SBR

Important Terminologies

MINUS

Investments in other NBFCs

Investments and loans in group companies

To the extent it exceeds 10% of Owned Funds

Tier I/ Net Owned Funds

Equity Shares

CCPS convertible within 5 years

Reserves & Surplus

PDI, to the extent of 15%

Public Funds

- Public Deposits
- Inter corporate deposits
- Bank Finance
- Commercial Papers
- Debentures (other than CCDs)

"customer interface" means interaction between the NBFC and its customers while carrying on its business.

Regulatory Provisions

List of Regulatory Provisions	NBFC-NSI: Without customer interface and public funds	NBFC-NSI: With customer interface or public funds	NBFC-SI: Asset size between 500-1000 crores	NBFC-SI: Asset size 1000 crores and above	NBFC-SI: Top 10 or identified as such	HFC: Not in Top 10	HFC: Top 10 or identified as such
Supervisory category	**BL**	**BL**	**BL**	**ML**	**UL**	**ML**	**UL**
NOF	No change, that is, Rs 2 crores	Rs 5 crores by March 31, 2025 Rs 10 crores by March 31, 2027				No change, that is, Rs 15 crores by March 31, 2022 Rs 20 crores by March 31, 2023	
NPA Norms	>150 days overdue By March 31, 2024 >120 days overdue By March 31, 2025 > 90 days By March 31, 2026		No change, that is, > 89 days				
Appointment of Director	Appoint at least one of the directors having relevant experience of having worked in a bank/ NBFC						
IPO funding ceiling, if extending such loans	Rs 1 crore per borrower [effective from 1st April, 2022]						

Net Owned Funds Requirements

NOF for different categories of NBFCs

2 Crore			10 Crore			20 Crore	100 Crore	150 Crores	250 Crores	300 Crore	
NBFC-P2P	NBFC-AA	ICC w/o public funds & customer interface	Other NBFC-ICC	NBFC-Factor	NBFC-MFI	HFC	NBFC-MGS	SPDs undertaking only core activities	SPDs which also undertake non-core activities	NBFC-IDF	NBFC-IFC
No Change	No Change	No Change	Currently 2 Crores	Currently 5 Crores (2 Crores in NE)	Currently 5 Crores	No change	No change	No Change	No Change	No Change	No Change

NPA Transition for NBFC-NSI

- As on March 31, 2023

>180 DPD

- By March 31, 2024

>150 DPD

- By March 31, 2025

>120 DPD

- By March 31, 2026

>90 DPD

NPA classification will be based on 90 DPD or as per applicability?

Will NBFC-SI falling in BL avail the transition benefit or continue with 90 DPD?

Streamlining of IRAC Norms

- Specification of repayment date/due date
  - Exact due dates, frequency of repayment, breakup between principal and interest, examples of SMA/NPA classification dates, etc to be specified in agreements
- Classification as SMA/NPA
  - Day-end processing
  - Classification is to freeze at "day-end"
- NPA classification in case of interest payments
  - In case of interest payments in respect of term loans, an account will be classified as NPA if the interest applied at specified rests remains overdue for more than 90 days
- Upgradation to standard status
  - Upgradation of NPA to standard only if the interest or principal remains overdue for a period of 90 days or three months and above
    - February 15 Circular- NBFCs had time till September 30, 2022 to put in place the necessary systems
  - For borrowers having more than one credit facility, upgradation only upon repayment of entire arrears of interest and principal pertaining to all the credit facilities
- Consumer education
  - Lenders to educate borrowers about recognition of NPA, SMA status, through appropriate literature

EMERGING REGULATORY FRAMEWORK

Regulatory Provisions- Corporate Governance

List of Regulatory Provisions	NBFC-NSI		NBFC-SI			HFC	
	Without customer interface and public funds	With customer interface or public funds	Asset size between 500-1000 crores	Asset size 1000 crores and above	Top 10 or identified as such	Not in Top 10	Top 10 or identified as such
Supervisory category	BL	BL	BL	ML	UL	ML	UL
Risk Management Committee, at board or executive level	To be constituted	To be constituted	To be constituted	To be constituted	To be constituted	To be constituted	To be constituted
Disclosures to include types of exposure, related party transactions, loans to Directors/ Senior Officers and customer complaints.	Applicable	Applicable	Applicable	Applicable	Applicable	Applicable	Applicable
Board approved policy on grant of loans to directors, senior officers and relatives of directors and to entities where directors or their relatives have major shareholding	Applicable	Applicable	Applicable	Applicable	Applicable	Applicable	Applicable
Composition of the Board should ensure mix of educational qualification and experience within the Board	NA	NA	NA	NA	Applicable	NA	Applicable
Mandatory listing of equity within 3 years of identification	NA	NA	NA	NA	Applicable	NA	Applicable
Reporting removal of Independent Directors before tenure	NA	NA	NA	NA	Applicable	NA	Applicable

Risk Management Committee

- Composition
  - To be formed at board or executive level
  - No prescription for qualification, experience, etc., for the members of the Risk Management Committee.
  - Frequency of meetings may be based on requirement- decided by the Board
- Roles and Responsibilities
  - Identification, monitor and measurement of the risk profile of the Company;
  - Overseeing development and implementation of risk measurement system;
  - Ensure that the Company has an appropriate and effective mechanism to identify, measure, control and monitor all applicable risks on a timely basis and as accurately as feasible; and
  - Perform such other act, including the acts and functions stipulated by the Act, the Reserve Bank of India and any other regulatory authority, as prescribed from time to time.
  - In order to strengthen the corporate governance structure, the Board may delegate monitoring and reviewing of the risk management plan to the Committee and such other functions as it may deem fit (such as cyber security)
  - Evaluate the overall risk faced by the NBFC, including liquidity risk, and report the same to the Board

Regulatory Provisions- Prudential Norms

List of Regulatory Provisions	NBFC-NSI		NBFC-SI			HFC	
	Without customer interface and public funds	**With customer interface or public funds**	**Asset size between 500-1000 crores**	**Asset size 1000 crores and above**	**Top 10 or identified as such**	**Not in Top 10**	**Top 10 or identified as such**
Supervisory category	**BL**	**BL**	**BL**	**ML**	**UL**	**ML**	**UL**
Limits on Concentration of credit/investment	NA	NA	NA	Merged single exposure limit of 25% for single borrower/ party and 40% for single group of borrowers/ parties anchored to Tier I capital instead of Owned Funds	To be followed till Large Exposure Framework is put in place	Merged single exposure limit of 25% for single borrower/ party and 40% for single group of borrowers/ parties anchored to Tier I capital instead of Owned Funds	To be followed till Large Exposure Framework is put in place

Concentration Limits

Existing limit (as a percentage of Owned Fund)

	Lending	Investment	Total
Single borrower/ party	15	15	25
Single group of borrowers/ parties	25	25	40

Revised limit (as a percentage of Tier I Capital)

	Total Exposure
Single borrower/ party	25
Single group of borrowers/ parties	40

- The earlier limits were as a percentage of Owned Funds, the revised limits are basis the Tier I capital
- Earlier, there were sub-limits for lending and investment as a part of the total exposure limit to a single/ group borrower, now there is a single limit for aggregate exposure to a single/group entity
- Extant instructions on concentration norms for different categories of NBFC, other than the limit changes, will continue to remain applicable

- Will securitization exposure also be subjected to concentration limits?
  - As per para 70 of the SSA Directions, securitisation exposures of lenders will be governed by the Large Exposures Framework; however LEF is applicable to UL only

Regulatory Provisions- Prudential Norms

List of Regulatory Provisions	NBFC-NSI		NBFC-SI			HFC	
	Without customer interface and public funds	With customer interface or public funds	Asset size between 500-1000 crores	Asset size 1000 crores and above	Top 10 or identified as such	Not in Top 10	Top 10 or identified as such
Supervisory category	BL	BL	BL	ML	UL	ML	UL
Sensitive Sector Exposure (SSE), that is, exposure to commercial real estate and capital markets	NA	NA	NA	Fix board-approved internal limits	Fix board-approved internal limits	Same as existing	
Regulatory Restrictions on 1. Loans to directors, senior officers, relatives of directors, entities where directors or their relatives have major shareholding 2. Need for ensuring appropriate permission while appraising real estate loan proposals	NA	NA	NA	Applicable	Applicable	Applicable	Applicable
Large Exposure Framework	NA	NA	NA	NA	Applicable	NA	Applicable
Internal Exposure Limits to be set by the Board on certain specific sectors to which credit is extended	NA	NA	NA	NA	Applicable; details awaited	NA	Applicable; details awaited

Regulatory Provisions

List of Regulatory Provisions	NBFC-NSI		NBFC-SI			HFC	
	Without customer interface and public funds	With customer interface or public funds	Asset size between 500-1000 crores	Asset size 1000 crores and above	Top 10 or identified as such	Not in Top 10	Top 10 or identified as such
Supervisory category	BL	BL	BL	ML	UL	ML	UL
Internal Capital Adequacy Assessment Process (ICAAP)	NA	NA	NA	Applicable	Applicable	Applicable	Applicable
Maintain Common Equity Tier I capital of at least 9 per cent of Risk Weighted Assets	NA	NA	NA	NA	Applicable	NA	Applicable
Leverage limits (in addition to CRAR)	NA	NA	NA	NA	To be prescribed	NA	To be prescribed
Differential standard asset provisioning	NA	NA	NA	NA	To be prescribed	NA	To be prescribed

Regulatory Provisions- Corporate Governance

List of Regulatory Provisions	NBFC-NSI		NBFC-SI			HFC	
	Without customer interface and public funds	With customer interface or public funds	Asset size between 500-1000 crores	Asset size 1000 crores and above	Top 10 or identified as such	Not in Top 10	Top 10 or identified as such
Supervisory category	**BL**	**BL**	**BL**	**ML**	**UL**	**ML**	**UL**
Except for directorship in a subsidiary, KMP shall not hold any office (including directorships) in any other NBFC-ML or NBFC-UL	NA	NA	NA	To ensure compliance by October 1, 2024			
Independent director shall not be on the Board of more than three NBFCs (NBFC-ML or NBFC-UL) at the same time	NA	NA	NA	To ensure compliance by October 1, 2024			
Additional Disclosures in Annual Financial Statements **i) Corporate Governance report containing composition and category of directors, shareholding of non-executive directors, etc.** **ii) Disclosure on modified opinion, if any, expressed by auditors, its impact on various financial items and views of management on audit qualifications.** **iii) Items of income and expenditure of exceptional nature.** **iv) 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.** **v) Divergence in asset classification and provisioning above a certain threshold to be decided by the Reserve Bank.**	NA	NA	NA	Applicable with effect from March 31, 2023			

Disclosure Requirements

- Common template for disclosures specified for all categories of NBFCs (i.e. ICC, HFC, CIC, etc.).
- Omission of line items/disclosures which are not applicable/permitted or no exposure/transaction in CY and PY
- Mere mention of an activity, transaction or item does not imply that it is permitted,
- Disclose comparative information in respect of the PY for all amounts reported in CY (even for narrative and descriptive information, if relevant)
- Disclosures for directors and relatives of directors should be made separately in separate columns from other KMPs and relatives of other KMPs
- Additional disclosures- do not substitute disclosures specified under other laws, regulations, or accounting and financial reporting standards.
  - However, if already covered repetition not required

Effective for annual financial statements for FY 2022-23 and onwards

Exposures

- Exposure to real estate sector
- Exposure to capital market
- Sectoral exposure
- ***(new)*** Intra-group exposures
- ***(new)*** Unhedged foreign currency exposure & policies to manage currency induced risk

Related Party Disclosure *(new)*

- Related party – as per Companies Act, 2013 and applicable accounting standard
- Disclosures include: Borrowings#, deposits#, advances#, investments#, purchase/sale of assets, interest paid/received, etc. ***# The outstanding at the year end and the maximum during the year are to be disclosed.***

Disclosure of Complaints

- Received from customer
- ***(new)*** Received from the office of Ombudsman
- ***(new)*** Top five grounds of complaints received from customers *(indicative list has also been provided)*

Section I (Applicable for annual financial statements of NBFC-BL, NBFC-ML and NBFC-UL)

Corporate Governance Report *new)*

- Listed NBFC: as per SEBI LODR Regulations
- Unlisted NBFC:
  - As per formats given in this Circular which includes Board & committees' composition
  - Details of non-compliances, penalties, etc., shareholding of directors, no. of meetings.

Other disclosures

- ***(new)*** Breach of covenant of loan availed/debt securities
- ***(new)*** Divergence in Asset Classification and Provisioning.
  - Based on the assessment by RBI/NHB
- Roadmap for compliance with disclosure requirements of SEBI LODR ***(This is Section III- only for NBFC-UL)***

Section II (Applicable for annual financial statements of NBFC-ML and NBFC-UL)

Contents of the disclosures

Additional Disclosures in AFS

- Corporate Governance report containing composition and category of directors, shareholding of non-executive directors
- Disclosure on modified opinion, if any, expressed by auditors, its impact on various financial items and views of management on audit qualifications
- 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 above a certain threshold to be decided by the Reserve Bank

- Meaning of Exposure:
  - Fund based and non-fund-based exposures?
  - On balance sheet and off-balance sheet exposure?
  - Credit and Investment?
- Related Party:
  - all related parties as per the applicable AS
  - as defined under Section 2(76) of the CA, 2013
  - include trusts and other bodies in which the NBFC can directly or indirectly (through its related parties) exert control or significant influence
  - Relatives as defined under section 2(77)

Regulatory Provisions- Corporate Governance

List of Regulatory Provisions	NBFC-NSI		NBFC-SI			HFC	
	Without customer interface and public funds	With customer interface or public funds	Asset size between 500-1000 crores	Asset size 1000 crores and above	Top 10 or identified as such	Not in Top 10	Top 10 or identified as such
Supervisory category	BL	BL	BL	ML	UL	ML	UL
Appointment of a Chief Compliance Officer (CCO)	NA	NA	NA	To be ensured by October 1, 2022			
Compensation guidelines The guidelines shall at the minimum include, a) constitution of a Remuneration Committee, b) principles for fixed/ variable pay structures, and c) malus/ claw back provisions. The Nomination and Remuneration Committee shall ensure that there is no conflict of interest.	NA	NA	NA	To be ensured by October 1, 2022			
Other Governance matters i) The Board shall delineate the role of various committees (Audit Committee, Nomination and Remuneration Committee, Risk Management Committee or any other Committee) and lay down a calendar of reviews. ii) Formulate a whistle blower mechanism for directors and employees to report genuine concerns. iii) Board shall ensure good corporate governance practices in the subsidiaries of the NBFC.	NA	NA	NA	To be ensured by October 1, 2022			
Adoption of Core Banking Solution	NA	NA	NA	Applicable if having more than 10 branches- glide path of 3 years with effect from October 01, 2022 to be provided			

Summarising the revised regulatory framework

- 4 layers for regulatory supervision; most smaller NBFCs to be in the base layer. The present classification of "systemically important" NBFCs to be changed to "middle layer", with an asset threshold of Rs 1000 crores.
- Middle layer to additionally include all core investment companies, housing finance companies.
- Upper layer entities to be identified by RBI based on a scoring methodology –
  - will require compliance with the Large Exposure Framework
  - Minimum CET 1 requirement as well as well leverage restrictions
  - Differential provisioning requirements for standard assets
  - Internal limits on exposure to 'important sectors' to be laid down
  - NBFC-UL shall be mandatorily listed within 3 years of identification
- More compliance at Middle-level entities - risk management committee, restrictions on loans to directors, concentration limits, limits on exposure to sensitive sectors, restrictions on loans to directors/senior officers, etc.
- Corporate governance report to be applicable to all middle layer entities from 31st March 2023. Other compliances, including Chief Compliance Officer, compensation committee, implementation of core banking solutions for NBFCs with 10 and more branches etc.
- Minimum Net owned funds of NBFCs to be increased from Rs 2 crores to Rs 10 crores, in two phases, first milestone 31st March, 2025 and second milestone 31st March, 2027.
  - No clarity on implication for not meeting the milestones
- NBFCs with no public funds and customer interface may continue with NOF of Rs 2 crores, despite the above increase
- NPA recognition threshold to be aligned to 90 days in case of all NBFCs, in a phased manner - starting 31st March, 2024 and ending 31st March 2026.
- All NBFCs to have at least one director with bank/NBFC experience.
- Bar on IPO funding, in excess of Rs 1 crore per borrower, to be effective from 1st April, 2022
- A short shrift to 8000 odd smaller NBFCs - the Directions say they deserve a differential approach, however, till the differential approach is finalised, extant regulations to continue to apply
- Merging of the credit concentration limits prescribed for NBFCs separately for lending and investment

GUIDELINES FOR NBFC-NSI

Applicability on NBFC-ND-SI

	Customer Interface	Public Funds*	Applicability
TYPE II	✓	✓	Entire Directions
TYPE II	✓	✗	Entire Directions, except Prudential Norms
TYPE II	✗	✓	Entire Directions, except FPC, KYC Directions and CIC Registration
TYPE I	✗	✗	Entire Directions, except FPC, KYC Directions, CIC Registration, Prudential Norms and LRM Framework

Public Funds

- Public Deposits
- Inter corporate deposits
- Bank Finance
- Commercial Papers
- Debentures (other than CCDs)

"customer interface" means interaction between the NBFC and its customers while carrying on its business.

Compliances upon receiving registration

- Pass a resolution stating that the company shall not receive any public deposits (every year within 30 days);
- Adopt necessary policies such as FPC, KYC Policy, Interest Rate Policy, Credit/Loan Policy, etc;
- Appointment of Principal Officer and Designated Director;
- Register with:
  - FIU-IND;
  - Credit Information Companies (with customer interface);
  - CKYCR, NeSL, CERSAI (if applicable);
- Inform RBI about commencement of business as an NBFC along with Auditor's Certificate

Leverage restriction on NBFC-ND-NSI

$$\textbf{Leverage} = \frac{\textbf{Outside Liabilities}}{\textbf{Owned Funds}}$$

total liabilities as appearing on the liabilities side of the balance sheet excluding 'paid up capital' and 'reserves and surplus', instruments compulsorily convertible into equity shares within a period not exceeding 5 years from the date of issue but including all forms of debt and obligations having the characteristics of debt, whether created by issue of hybrid instruments or otherwise, and value of guarantees issued, whether appearing on the balance sheet or not.

paid up equity capital, preference shares which are compulsorily convertible into equity, free reserves, balance in share premium account and capital reserves representing surplus arising out of sale proceeds of asset, excluding reserves created by revaluation of asset, as reduced by accumulated loss balance, book value of intangible assets and deferred revenue expenditure, if any

- Leverage to be maintained at **7 times**

Definition of deposit and public deposit

- Deposit as per section 45-I(bb) of the RBI Act, 1934
  - Any amount of money by way of deposit or loan or in any other form excluding the following–
    - raised by way of share capital
    - contributed as capital by partners of the firm
    - received from a scheduled bank or a co-operative bank or any other banking company defined under Banking Regulations, 1949
    - received from SFC or any other financial institution under IDBI or any other prescribed institution
    - received in the ordinary course of business as
      - security deposit, dealership deposit, earnest money, advance against orders for goods
    - received from firm or an AOP not being a body corporate and registered under enactment related to money lending
    - received by way of subscriptions in respect of a chit.
- Public deposit – Deposit as per the RBI Act, 1934 except certain items mentioned in the next slide

- Exceptions to Public Deposits
  - amount received from CG, SG, local authority, foreign government or citizen
  - any amount received from IDBI or LIC or GIC and its subsidiaries SIDBI or UTI or NABARD or Electricity Board and such Government companies that are notified by RBI
  - any amount received as hybrid debt or subordinated debt
  - any amount received by a company from another company
  - any amount raised by issuance of NCD in accordance with RBI guidelines
  - unsecured loan brought in by the promoters
  - any amount raised by the issue of bonds or debentures secured by the mortgage of any immovable property of the company or any other asset
  - any amount received by a NBFC-SI-ND by issuance of 'perpetual debt instruments' in accordance with RBI Guidelines
  - any amount raised by the issue of infrastructure bonds by an IFC as specified by CG u/s 80CCF of the IT Act
  - any amount received from a relative of a director of the NBFC
  - amount received and held in accordance with the provisions of the CA, 2013 towards subscription of securities, including share application money
  - amount received from a director of a company or a shareholder of a private company
  - any amount received by MFs regulated by SEBI and issuance of commercial paper in accordance with guidelines

Instruments of funding for financial entities- Not treated as Deposits

1. Secured Bonds/ Debentures
2. CCBs/CCDs
3. NCDs having minimum subscription of Rs. 1 crore and minimum maturity of 1 year
4. Hybrid Debt Instruments
5. Subordinated Debt Instruments
6. Commercial Paper
7. Infrastructure Bonds
8. Perpetual Debt Instruments (for NBFC-ND-SI)

Asset Classification, Income Recognition & Provisioning Norms as per RBI Direction

Asset classification

- Standard Assets
- Sub-standard assets
- Doubtful assets
- Loss assets

Non-Performing Assets

Income recognition:
On accrual basis

Income recognition:
On cash or recovery basis

PROVISIONING REQUIREMENTS:

- Standard assets: 0.25%
- Sub-standard: 10%
- Doubtful assets:
  - Unsecured portion → 100%
  - Secured portion
    - 1st year- 20%
    - 2nd year-30%
    - 3rd year onwards- 50%
- Loss Asset: 100% write off

Fair Practice Code

- Loan appraisal, its processing and terms/conditions
    - Loan application forms shall include necessary information such as rate of interest, tenure, amount of loan etc.
    - NBFCs should devise a system of giving acknowledgement of applications received
    - Manner of loan appraisal
    - Details to be disclosed in vernacular language – Amount sanctioned, terms and conditions, annualised rate of return etc
- Fair Practice Code will have to adopted and mentioned at all places of business and website
    - Refrain from interference in the affairs of the borrower
    - Not charging excessive interest rates
    - NBFC/its representatives shall not resort to undue harassment viz; persistently bothering the borrowers at odd hours, use muscle power for recovery of loans etc.
    - No foreclosure charges/ pre-payment penalties on any floating rate term loan sanctioned for purposes other than business to individual borrowers
- Loan agreements must have built in repossession clause
- Interest rate policy must be adopted by the Board of Directors to set down the principles of determining interest rate on loans
- Grievance redressal mechanism has to be set up by the Board
- Appointment of Nodal Officer/ Principal Nodal Officer (under Integrated Ombudsman Scheme in case of Customer Interface)

Acquisition/Transfer Of Control

Prior approval from RBI

- For **takeover or acquisition of control** of an NBFC, which may or may not result in change of management
- For **change in the shareholding of an NBFC**, which would result in **acquisition/ transfer of shareholding of 26 per cent or more of the paid up equity capital**
- For **change in the management** of the NBFC which would result in change in **more than 30 per cent of the directors**, excluding independent directors

Prior public notice

- For change in **control or ownership**

- At least 30 days public notice will have to be given
- In at least one leading national and one leading local regional language newspaper

Change of Control Norms/ Prior Approval

- For takeover or acquisition of control of an NBFC, which may or may not result in change of management
- For change in the shareholding of an NBFC, which would result in acquisition/ transfer of shareholding of 26 per cent or more of the paid up equity capital
  - The transfer need not be at one go, it can be cumulative as well.
  - Includes progressive transfers over time – but time period not mentioned
  - Transfer of preference share capital will have no impact
  - Does not cover change in shareholding due to buyback of shares/reduction of capital, which has been approved by competent court
- For change in the management of the NBFC which would result in change in more than 30 per cent of the directors, excluding independent directors
  - For computation of total strength of the BOD – Independent Directors are to be excluded
  - Does not cover re-election of directors subject to retirement by rotation
- Prior approval of the Bank shall be obtained in cases of opening of branch/subsidiary/joint venture/representative office or undertaking investment abroad
  - Investment in non-financial service sectors shall not be permitted
  - Investments shall be permitted only in those entities having their core activity regulated by a financial sector regulator in the host jurisdiction

LRM Framework

- Applicable on NBFC-ND with asset size of Rs.100 crore and above and excluding Type I NBFC-ND

Internal monitoring mechanism

- Obtain approval of Board of Directors for revising the existing ALM policy or adopt a new LRM Framework.
- Include parameters such as concentration of funding, availability of unencumbered assets, early warning market-based indicators for liquidity risk etc.

Bucketing

- Statement of Structural Liquidity to be segregated into granular buckets of 1-7 days, 8-14 days, and 15-30 days.
- The net cumulative negative mismatches not to exceed 10%, 10% and 20% of the cumulative cash outflows in the respective time buckets.

Committees

- Constituted to oversee the implementation of ALM system and review its functioning to be substituted with ALM Support Group.
- The RMC to consist of CEO)/ MD & heads of various risk verticals. RMC to be responsible for evaluating the overall risks faced including liquidity risk.

Disclosure

- Disclosure requirements separately provided to be made quarterly on the website and as notes to accounts in Annual financial statements.
- Granularity in the time buckets also to be applicable while interest rate sensitivity statement.

MIS System

- Put in place a MIS provide timely and forward-looking information on the liquidity position of the NBFC and the Group, both under normal and stress situations

Other Requirements

- **Policy on Demand/ Call Loans-** Board of Directors to frame a policy on Demand/ Call Loans
- **Lending against gold-** Separate set of directions governing gold lending
- **Lending against security of shares-** NBFC with asset size of Rs.100 crores and above have to maintain LTV of 50%
- **Norms for restructuring of advances-** On the lines of the norms specified by the RBI for banks as modified and set forth
- **Information with respect to change of address, directors, auditors etc. -** Inform the RBI within one month from the date of occurrence
- **Outsourcing Guidelines-** Several aspects to be checked and ensured before entering into transaction and executing agreements

Immediate actions to be taken upon becoming an NBFC-SI

Asset size crosses the mark of Rs. 500 crores → The asset size to be seen as per the last audited financial statements → Total asset size as disclosed in the balance sheet to be considered.

- Committees to be constituted:
  - Audit Committee
  - Nomination Committee
  - IT strategy Committee
  - IT Steering Committee
- Obtain declaration and enter into deed of covenants as per Fit and Proper Criteria.
  - Thereafter, ensure compliance the said criteria while appointment of directors;
- Henceforth, ensure reporting requirements applicable to NBFC-SIs are complied
- Adopt policies required to be formulated by NBFC-SI

List of Policies to be adopted by NBFC-NSI as per RBI guidelines

- Credit Policy
- Investment Policy
- Demand/Call Loan Policy, if applicable
- Risk Management Policy and strategy
- Liquidity Risk Management Policy (including ALM Policy), if asset size more than 100 crores
- Fair Practice Code & Grievance Redressal Mechanism
- Know Your Customer and AML Policy (including Anti Money Laundering Measures, Customer Acceptance Policy and Policy with regard to appointment of brokers/ agents , there due diligence by NBFCs and Fraud Reporting to Fraud Investigation Unit (FIU) Suspicious Transaction policy)
- Policy on lending against gold, if applicable
- MIS Policy
- Non-cooperative borrowers policy
- Information Technology Policy
- Business Continuity Policy
- Outsourcing Policy, if applicable
- Board approved Code of conduct for DSA/DMA/Recovery Agents
- Asset Classification and Provisioning Policy, if required
- Policy on Resource planning
- Policy on purchase and sale of NPA, if required
- Interest rate policy

Snapshot of Applicability of Various Requirements

	NBFC-ND-NSI with PF	NBFC-ND-NSI without PF	NBFC-ND-SI with PF	NBFC-ND-SI without PF	CIC	CIC-SI
Concentration Norms	Not Applicable	Not Applicable	Applicable	Not Applicable	Not Applicable	Not Applicable
Capital Adequacy	Not Applicable	Not Applicable	Applicable	Applicable	Not Applicable	Applicable (ANW)
Provisioning norms	Applicable	Not Applicable	Applicable	Applicable	Not Applicable	Applicable
Asset Classification	Applicable	Not Applicable	Applicable	Applicable	Not Applicable	Applicable
Statutory Auditor Certificate	Applicable	Applicable	Applicable	Applicable	Not Applicable	Applicable
Leverage Ratio	Applicable	Not Applicable	Not Applicable	Not Applicable	Not Applicable	2.5 times
Corporate Governance Norms	Not Applicable	Not Applicable	Applicable	Applicable	Not Applicable	Not Applicable
KYC Norms	Applicable (with CI)	Applicable (with CI)	Applicable (with CI)	Applicable (with CI)	Applicable	Applicable
CIC Reporting	Applicable (with CI)	Applicable (with CI)	Applicable (with CI)	Applicable (with CI)	Applicable	Applicable

Various Registration and Reporting Requirement

- Registration with FIU-IND
  - Applicable only if the NBFC has customer interface
  - The Reporting Entity shall identify and appoint a Principal Officer + Designated Director (both have to be different)
  - Reporting of cash and suspicious transactions
- Registration with CKYC Portal
  - RE with customer interface to identify and authorise its Compliance Officer/Nodal Officer/Authorised Signatory to register the RE on the online platform
  - Reporting of every loan transaction within 10 days
- All applicable NBFCs (other than those which are purely into investment activities without any customer interface) shall become member of all four CICs (Credit Information Bureau (India) Limited, Equifax Credit Information Services Private Limited, Experian Credit Information Company of India Private Limited and CRIF High Mark Credit Information Services Private Limited) and submit data (including historical data) to them
- Registration with IU (at present National E-Governance Services Limited (NeSL)) and submission of the required information with respect to the debt
- Applicable NBFCs shall register all types of mortgages with the Central Registry of Securitisation Asset Reconstruction and Security Interest of India (CERSAI) including equitable mortgages created in their favour
- CRILC Reporting for exposure of 50 million+ monthly
- RBI :
  - XBRL reporting
  - Fraud reporting, for NBFC-SI
  - Periodic and event-based reporting: change in director, change in control, etc.
  - Auditor Certificate: SAC
  - Liquidity Risk Management and Liquidity Coverage Ratio reporting, if applicable
  - Disclosures in financial statements and website: as prescribed
  - Auditor's Report: as prescribed by RBI

RBI Returns to be Filed for NBFC- NSI

Source statute	Return Name	Description	Remarks	Frequency	Due Date	Applicability
Communicated to the entities through email intimation. Master Directions to be issued soon.	DNBS02-Important Financial Parameters - Annual	Financials details like sources of funds, leverage ratio, components of assets and liabilities, details of income and expenses, NOF, details of exposure to sensitive sectors, details of foreign funds, sector-wise quality of assets, changes in ratings, shareholding pattern, details of Board of Directors, details of top 25 subscribers of debt instruments/CP, ICDs, borrowers, investments, NPAs, etc. details of group entities, and branches of the NBFC.	Replacing NBS-8 and NBS-9	Annual	15 days from end of quarter	ND-NSI
	DNBS04A- Short Term Dynamic Liquidity (STDL) - Quarterly	Details of mismatch in projected future cash inflows and outflows based on the business projections.	Replacing ALM Returns	Quarterly	15 days from end of quarter This has replaced returns in the master directions	NDSI, ND-NSI with assset size > 100 cr
	DNBS04B-Structural Liquidity & Interest Rate Sensitivity - Monthly	Details of - (i) Mismatch in projected future cash inflows and outflows based on the maturity pattern of assets and liabilities at the end of the reporting period for NBFCs-NDSI; (ii) Interest rate risk.	Replacing ALM Returns	Monthly	15 days from end of month	NDSI, ND-NSI with asset size > 100 cr
	DNBS10-Statutory Auditor Certificate	To ensure continued regulatory compliance.		Annual	One month from finalisation of Balance sheet or December 31 whichever is earlier.	NDSI ND-NSI
	DNBS13-Overseas Investment Details	To capture details of overseas investment for all NBFCs having overseas investment.		Quarterly	15 days from end of quarter	NDSI ND-NSI
Master Directions on NBFC Returns	Certificate on compliance with FDI norms	Compliance with the stipulated minimum capitalization norms and that activities are restricted to the activities prescribed under FEMA.		Half-yearly	30 days from end of half-year	All NBFCs having FDI

MAJOR AREAS OF CONCERNS IN NBFC-NSI COMPLIANCES

Most common omissions/errors

- Asset classification
  - Nature of Transaction- for eg. demand and call loans
  - Classification based on DPD
- Evergreening of loans
  - NPA classification and provisioning
- Restructuring practices
  - restructuring without borrower consent
  - restructuring without change of classification - new loans with payout of earlier loan
- Intimations
  - Director appointment, Change in authorized signatory, Change in auditor, Registered Address
- Weakness in loan exposures
  - Loan origination process
  - KYC and AML compliances
  - LTVs, poor credit scores
  - Internal rating process and scoring models
  - Grievance Redressal Mechanism
- Liquidity Risk Management
- Prior Approval
  - Issue/transfer of shares
  - Change in directors
- Common types of transactions
  - Transactions with group/known entities
    - Is it customer interface? Loan documentation required?
    - Related-party transaction/ Loan to directors-section 185
  - Extending advances
    - Interest
    - Documentation
  - Receipt of advances
    - Deposit
- Fairness of lending practices:
  - Disclosure of annualised percentage rate
  - Transparency of terms and conditions
  - Loan agreement and other terms provided to borrower

Most common omissions/errors

- Miscellaneous
  - Format of auditor's report
  - Disclosure about NOF in auditor's report
  - Resolution for non-acceptance of deposit within 30 days after beginning of FY
  - Disclosure wrt to cost and market value of investments
  - Investments/holdings in Partnership firms/LLPs
  - Policies and their review and updation
- Appointments
  - Principal Officer
  - Designated Director
- Registrations
  - CKYCR
  - CICs

Why will the RBI probe into my compliances?

Several reasons:

- At the time of prior approval for takeover/acquisition
- RBI has the authority to investigate affairs of NBFCs
- Increase in scale of operations and customer outreach may attract attention
- Data from MCA wrt issuance of shares/change in directors

APPOINTMENT OF AUDITOR GUIDELINES

RBI Guidelines on Appointment of Auditors (w.e.f. 27.04.21)

Applicability

- Commercial Banks,
- UCBs and
- NBFCs and HFCs with asset size of 1000 crores or more
  - For the first time for UCBs and NBFCs for FY 21-22
  - Flexibility to adopt from H2-FY 21-22 - However appointment was to be done in AGM
- Not Applicable on RRBs and ND-NBFCs not covered above – (optional)

Eligibility Criteria

- To fulfil eligibility criteria as mentioned in the Guidelines (Annex I)
- Number and qualification, experience of partners/employees and years of association with the firm
- Additional Consideration
  - Section 141 of Companies Act
  - Debarment by ICAI, NFRA, RBI
  - Compliance to ICAI's code of ethics
  - Directorship held by auditor in any PSB
  - Auditor/Partner holding directorship in group
  - For UCB – fair knowledge of sector
  - Knowledge of CAATTs and GAS for entities with asset size> 1000 crore

Number of auditors for an entity

- Minimum two auditors for entities having asset size of more than 15,000 crores- Prior to the issue of the Guidelines, **the concept of joint auditors was limited to banks only now be extended to NBFCs as well**
  - However, Entities should decide on the number of SCAs/SAs based on a Board/Local Management Committee (LMC) Approved Policy, considering factors such as Size and spread of assets, ccomplexity of transactions
  - Also, maximum cap on number of auditors has been prescribed
- All figures to be considered on a Standalone basis – "Multiple NBFC" concept not applicable

Number of audits by an auditor

- One audit firm can concurrently take up statutory audit of a maximum of four Commercial Banks [including not more than one PSB or one AIFI or RBI], eight UCBs and eight NBFCs during a particular year – **NBFCs with asset size less than 1000 crores are also considered**
- Section 143 is clear that either the central auditor or a separate branch auditor can conduct branch audit. Note that, there is no limit on the number of branch audits that a single branch auditor or the central auditor can undertake

Compliances under the Circular

Prior Approval of RBI/ Intimation

- Prior approval required for appointment of auditors for Commercial Banks and UCBs
  - To be submitted to Central/Regional office of RBI
  - What if prior approval not received before AGM?
- NBFCs to **file intimation (in Form A) within 1 month from appointment/ratification intimation to Regional office**
  - This intimation is required to be filed even for NBFCs not covered under the Circular
  - Such intimation may be amended to state that company has been exempted from the requirement to obtained eligibility certificate
  - To the extent applicable, the company has verified the said firm's compliance with all eligibility norms prescribed

Tenure of Appointment

- Appointment to be made for 3 years
- To be ratified by the Board of Directors/ the ACB every year, and shall be intimated to RBI.
- Role of Board/ACB limited to eligibility verification
- Removal of Auditor
  - Approval of RBI required for commercial banks and UCBs
  - Intimation to be filed in case of NBFCs
- An audit firm would not be eligible for reappointment in the same Entity for six years (two tenures) after completion of full or part of one term of the audit tenure.
- However, audit firms can continue to undertake statutory audits of other Entities.
- Is this in conflict with tenure under Companies Act?

No Conflict of Interest and Independence of Auditors

- Criteria to ensure independence of auditor:
  - Joint auditors should not be under the same network or have same partners
  - Concurrent auditors not to be appointed as SCA/SA – Appoint after 1 year of cessation
  - Audit/non-audit works for **Group Entities** – not to be appointed
    - The term 'Group Entities' shall refer to the RBI Regulated Entities in the Group only, which fulfill the definition of Group Entity, as provided in the Guidelines.
    - For other group entities, (which are not regulated by RBI), Entity must review that there is no conflict of interest and independence of auditors is ensured,
  - Same network firms also covered for above points
  - Consideration to be given to the fact that the bank has a common auditor as that of an entity on which it has large exposure [as defined in large exposure framework]
    - Not a complete bar
  - Maintaining a time gap of 1 year between non-audit services taken from the firm and its appointment as SCA/SA or firms under the same network/having same partners
- The time gap of one year shall not be applicable in cases where auditor is allowed to provide **services that may not result in conflict of interest**

Meaning of group - related to each other through any of the following relationships, viz.

- Subsidiary – parent (defined in terms of AS 21),
- Joint venture (defined in terms of AS 27),
- Associate (defined in terms of AS 23),
- Promoter-promotee [as provided in the SEBI (Acquisition of Shares and Takeover) Regulations, 1997] for listed companies,
- a related party (defined in terms of AS 18),
- Common brand name, and
- Investment in equity shares of 20% and above.

The services wherein there is no conflict of interest, that can be provided by the Auditor (indicative list):

- Certificates required to be issued by the statutory auditor as per statutory or regulatory requirements.
- Tax audit, tax representation and advice on taxation matters,
- Reporting on financial information or segments thereof, as defined in Rule 6(3) of the Companies (Audit & Auditors) Rules, 2014
- Audit of interim financial statements.

Transition into Guidelines – FY 21-22

- The Guidelines were effective from the date of publication itself, that is, 27th day of April 2021.
- NBFC and UCB shall have the flexibility to adopt these Guidelines from H2 (second half) of FY 2021-22 in order to ensure that there is no disruption.
  - However, since the auditors are appointed in the AGM itself, NBFCs and UCBs had to ensure compliance in the AGM held in 2021.
- Impact on auditors on date of publishing of the circular
  - **Where the auditor does not meet eligibility** - Change of auditor required however this shall not be considered as removal auditor
  - **Auditor for >3 years for NBFCs** - Given the operational difficulties involved and that for NBFCs and UCBs, the transition time is till 2nd-half of 2021-22, a logical view will be to let the auditor continue at least for FY 2021-22.
  - **Auditor has more than permitted audit clients -** Auditor shall rationalise its clientele
- Do the Guidelines have a retrospective effect on existing auditors tenure?
  - Yes
  - If completed, 1 or 2 year can be reappointed subject to fulfilment of eligibility
- Will vacation of office of auditor during the year due to requirement under this circular be considered as removal or resignation?
  - No
  - Existing auditor has to vacate the position of the auditor due to a dis-qualification caused by a statutory regulation/guideline and the same is not a voluntary act of its own
  - SEBI circular dated October 18, 2019 regarding 'Resignation of Statutory Auditor from listed entities and their material subsidiaries', get attracted

Operational Concerns

Procedure for Vacation and Appointment

Section 141(4) - when the auditor vacates office due to his disqualification, it shall be deemed to be a casual vacancy.

Section 139(8) - specifies the manner in which such casual vacancy shall be filled in.

While resigning, the Auditor shall

send a letter to the Board citing reason as ineligibility under the RBI Guidelines	file ADT-3 with the MCA within 30 days

Board to accept the letter & initiate the process for appointing a new auditor under the Guidelines;

Audit Committee/Board to identify new auditor and check his/her eligibility by obtaining a certificate from the new auditor confirming his eligibility;

Considering it to be a case of casual vacancy not due to resignation but ineligibility due to introduction of new laws, the board is to appoint the new auditor within a period of 30 days of such vacation;

The said auditor should be able to hold office till the next AGM where the appointment can be regularised;

File ADT-1 for the appointment of the new auditor both after the board has appointed as in case of a casual vacancy and then at the time of regularisation at the AGM

Other Requirements

- Adoption of a board approved policy which will form the basis of appointment of SCAs/SAs covering the process of appointment, audit assessment, independence, branch audit, audit fees and removal of auditor
- The appointment of auditors can be made only at the general meeting of the members and the role of Board/AC is to make a yearly assessment whether the SAs meet the eligibility criteria.
  - The Board/AC is required to file the certificate specified in Form A, where the affirmation on eligibility is given for each term
- Visit and audit at least the Top 20 branches/Top 20% of the branches (in case of entities having less than 100 branches), to be selected in order of the level of outstanding advances, in such a manner as to cover a minimum of 15% of total gross advances of the entities
  - Sec. 143 (8) of the Act requires either the appointed SAs or any other person qualified to be appointed as the auditor to conduct the audit of the branch offices.

Cooling Period

- The cooling off period between any non-audit works (services mentioned at Section 144 of Companies Act, 2013, internal assignments, special assignments, etc.) by the SCAs/SAs for the applicable entities or any audit/non-audit works for its group entities should be at least one year, before or after its appointment as SCAs/SAs
- RBI FAQs clarified that the requirement aforesaid cooling-off period shall be applicable prospectively
- Audit firm engaged with audit/non-audit works for the Group Entities (which are not regulated by RBI) may be considered for appointment as SCAs/SAs.
  - However, the Board/ACB/LMC of the Entity must review that there is no conflict of interest and the independence of auditors is ensured
- Audit firm whose partner is a director of an RBI regulated entity in the group shall not be eligible
  - However, if such directorship is in an entity that is not regulated by RBI, the said audit firm shall make appropriate disclosures to the AC as well as Board while being considered for the appointment.

Comparison of Critical aspects w.r.t to SA appointment

Basis of Difference	RBI Guidelines	Companies Act	Compliance for NBFCs
Applicability	CBs, UCBs and NBFCs (asset size >1000 crore)	All companies registered under the Act	Compliance with both, stricter to prevail
Eligibility Requirement	Auditor to meet the criteria as specified in Annex I	Auditor to meet the eligibility requirements specified in Sec. 141 read with Rule 10	Comply with eligibility norms under both Guidelines and Act. In case of conflict, sectoral regulator's norms to prevail.
Tenure	Continuous period of 3 years	Individual-1term of 5 years Audit firm- 2 terms of 5 years	Stricter provisions to apply
Cooling-off period	6 years (two tenures) after completion of full or part of one term	5 years from the completion of 1/2 term(s) of 5 years as applicable	Stricter provisions to apply
Individual Auditor Vs Audit firm	As per the Guidelines, only a firm of auditors can be appointed as the SAs (eligibility conditions)	Sec. 141 of the Act allows an individual as well as a firm of auditors to be appointed	Guidelines are stringent w.r.t to the eligibility norms

Comparison of Critical aspects w.r.t to SA appointment

Basis of Difference	RBI Guidelines	Companies Act	Compliance for NBFCs
Yearly ratification of appointment	Board/Audit committee to assess the eligibility of the SA on a yearly basis and to submit a certificate to this effect with the RBI	Requirement of yearly ratification was omitted by the Companies Amendment Act, 2017	New requirement to be complied with
Formulating a policy	Formulate a board approved policy for determining the number of auditors required.	No such obligation on the companies	New requirement to be complied with
Maximum number of auditors	Based on the asset size, maximum number fixed	Act does not provide any such restriction	New requirement to be complied with
Branch Audit	Visit and audit at least the Top 20 branches/Top 20% of the branches to cover atleast 15% of total gross advances of the entities.	Sec. 143 (8) requires the branch audit to be conducted by the SAs or any other person qualified for appointment as an auditor	New requirement to be complied with

DIVIDEND DECLARATION

Declaration of dividends by NBFCs

- RBI on June 24, 2021 came out with circular on declaration of dividend by NBFCs
- Effective for declaration of dividend from the profits of the financial year ending March 31, 2022 and onwards
- The Guidelines provide for:
  - Board Oversight
  - Eligibility Criteria
  - Quantum of Dividend
  - Reporting
- Restrictions on dividend payout essentially force financial sector entities to plough back a minimal part of their profits, and therefore, result in creation of a profit conservation - Statutory Reserve

- The opening statement of the Notification provides that the Notification is applicable on all NBFCs regulated by RBI.
  - Further, reference is made to the term 'Applicable NBFCs' as defined under the respective RBI Master Directions on NBFC-ND-SI and NBFC-ND-NSI
  - Hence, applicable to Daimler Financial Services
- Quantum capped based on Dividend Payout Ratio
- Dividend Distribution Policy required
- NBFC-SI – Report declaration of Dividend to Regional Office of the RBI within a fortnight
- Board to consider following before declaration of dividend
  - Supervisory findings of the Reserve Bank on divergence in classification and provisioning for NPA
  - Qualifications in the Auditors' Report to the financial statements
  - Long term growth plans of the NBFC.
  - Ceilings specified in these guidelines.

Eligibility Requirement And Quantum Restrictions

Category	Eligibility Requirement	Quantum (Dividend Payout Ratio)

NBFCs meeting prudential requirements	• Complies with **applicable regulatory capital adequacy** requirements for each of the last three financial years including the financial year for which the dividend is proposed
	• **Net NPA ratio shall be less than 6%** in each of the last three years, including as at the close of the financial year for which dividend is proposed to be declared.
	    • Calculation of NNPA - (GNPA – Provisions)
	    • 12th Nov Circular
	• Complies with the provisions of **Section 45 IC of the RBI Act**, as the case may be, that is to say, has transferred 20% of its net profits to the regulatory reserve fund
	• **No explicit restrictions** placed by the regulator on declaration of dividend
		• For NBFCs that do not accept public funds and do not have any customer interface - No limit
		• CICs and SPDs- 60%
		• **Other NBFCs- 50%**

NBFCs not meeting prudential requirements	• Complies with the applicable capital adequacy requirements in the financial year for which dividend is proposed to be paid • Has net NPA of less than 4% ***as at the close of the financial year***.	10%

'the ratio between the amount of the dividend payable in a year and the net profit as per the audited financial statements for the financial year for which the dividend is proposed.'

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Dividend - shall be restricted to only equity and CCPS dividend. Hence, dividend on redeemable preference shares shall be excluded.

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Profit for Year - refers to profits after tax. There is no question of adding the brought forward profits of earlier years,

Thank You!

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