Scale-Based Regulation for NBFCs: A Refined Framework for Risk and Resilience (A brief insight)

The Reserve Bank of India's (RBI) Scale-Based Regulation (SBR), effective October 1, 2022, marks a transformative shift from a one-size-fits-all supervisory model to a nuanced, risk-sensitive architecture for Non-Banking Financial Companies (NBFCs). The SBR framework differentiates regulatory intensity based on size, complexity, and systemic relevance, introducing dynamic oversight mechanisms tailored to institutional risk profiles.

I. Regulatory Stratification and Classification

The framework establishes four regulatory layers:

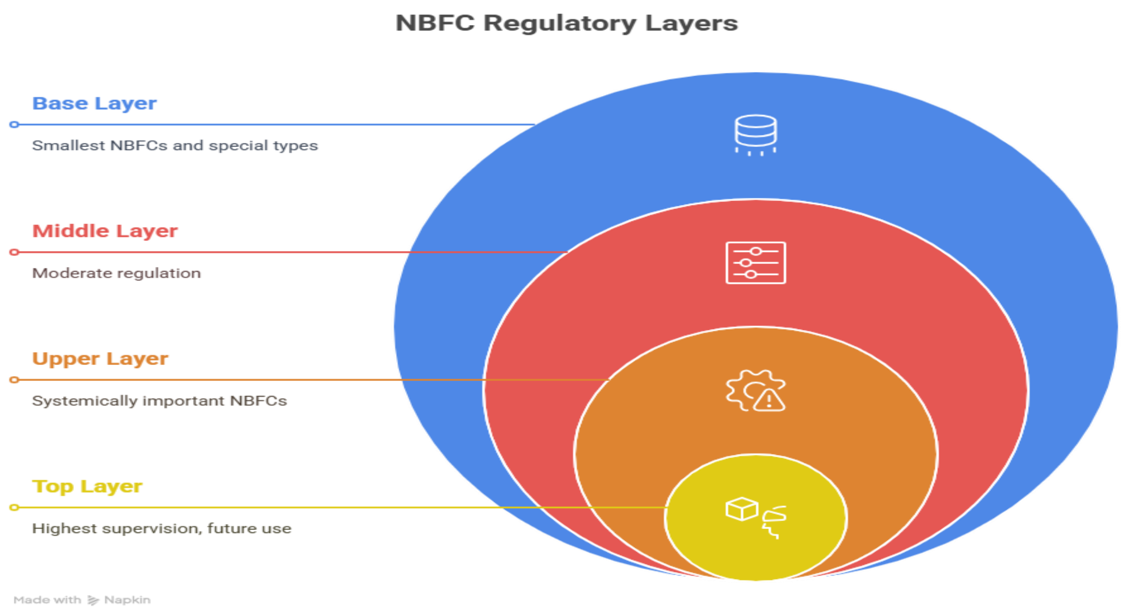
- **Base Layer**: Covers non-deposit-taking NBFCs with assets below ₹1,000 crore, such as Peer-to-Peer Lending Platforms and Account Aggregators. NBFCs previously classified as non-deposit-taking systemically important (NBFC-ND-SI) with assets between ₹500–1,000 crore are also placed here, unless specified otherwise.

- **Middle Layer**: Includes all deposit-taking NBFCs, Housing Finance Companies (HFCs), Infrastructure Finance Companies (NBFC-IFCs), Core Investment Companies (CICs), Standalone Primary Dealers (SPDs), and Infrastructure Debt Funds (IDF-NBFCs). These entities are subject to strengthened prudential norms and governance oversight.

- **Upper Layer**: Determined via a scoring methodology incorporating size, interconnectivity, complexity, and leverage. The RBI populates this layer with systemically important NBFCs.

- **Top Layer**: Currently unoccupied, this layer is reserved for NBFCs demonstrating critical systemic risk or serious governance lapses.

NBFCs such as Investment and Credit Companies (NBFC-ICCs), Microfinance Institutions (NBFC-MFIs), NBFC-Factors, and Mortgage Guarantee Companies (MGCs) may be assigned to different layers based on asset size and operational complexity. Notably, government-owned NBFCs are exempt from Upper Layer classification.


NBFC Regulatory Layers
Base Layer
Smallest NBFCs and special types
Middle Layer
Moderate regulation
Upper Layer
Systemically important NBFCs
Top Layer
Highest supervision, future use
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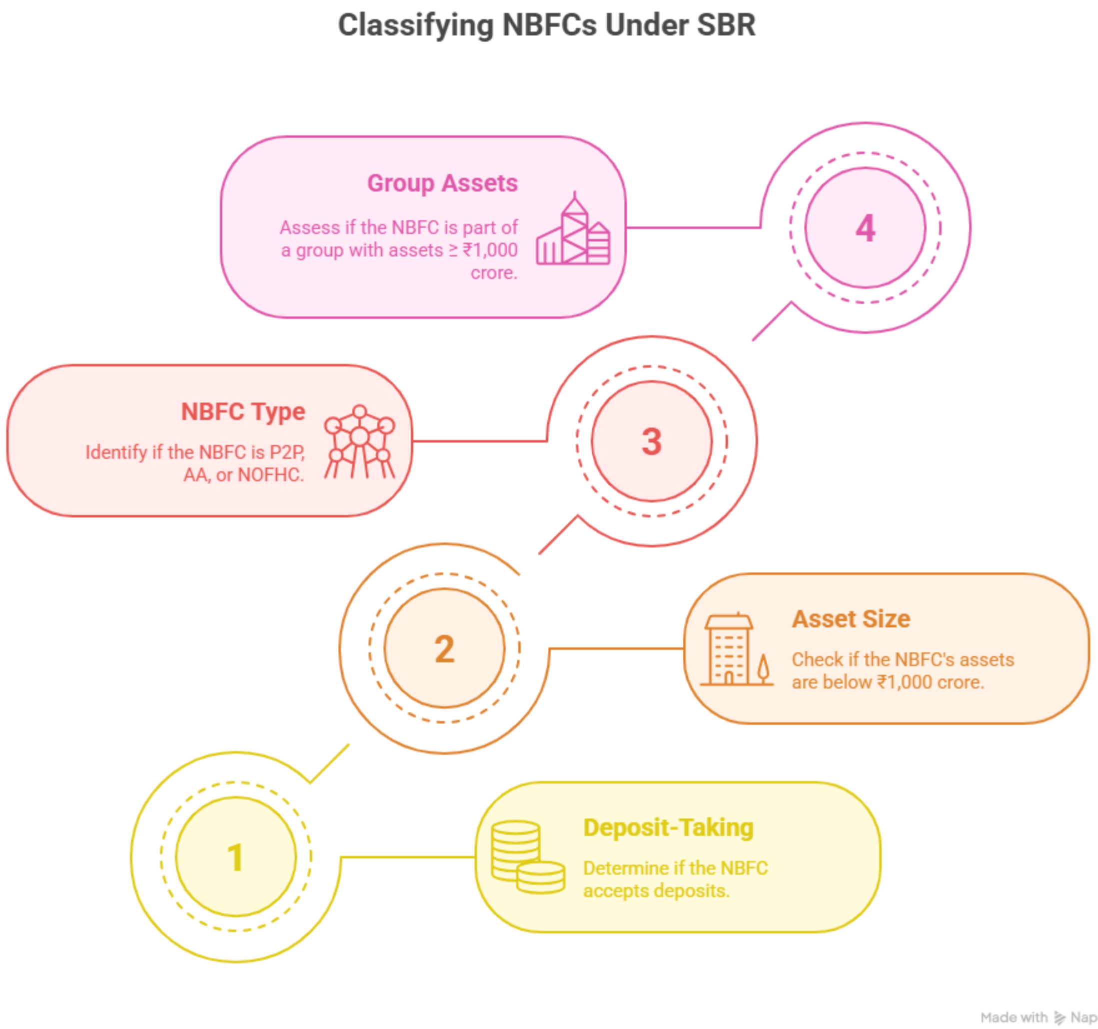
Classifying NBFCs Under SBR
Group Assets
Assess if the NBFC is part of a group with assets ≥ ₹1,000 crore.
4
NBFC Type
Identify if the NBFC is P2P, AA, or NOFHC.
3
2
Asset Size
Check if the NBFC's assets are below ₹1,000 crore.
1
Deposit-Taking
Determine if the NBFC accepts deposits.
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II. Group-Wide Supervision and Threshold Monitoring

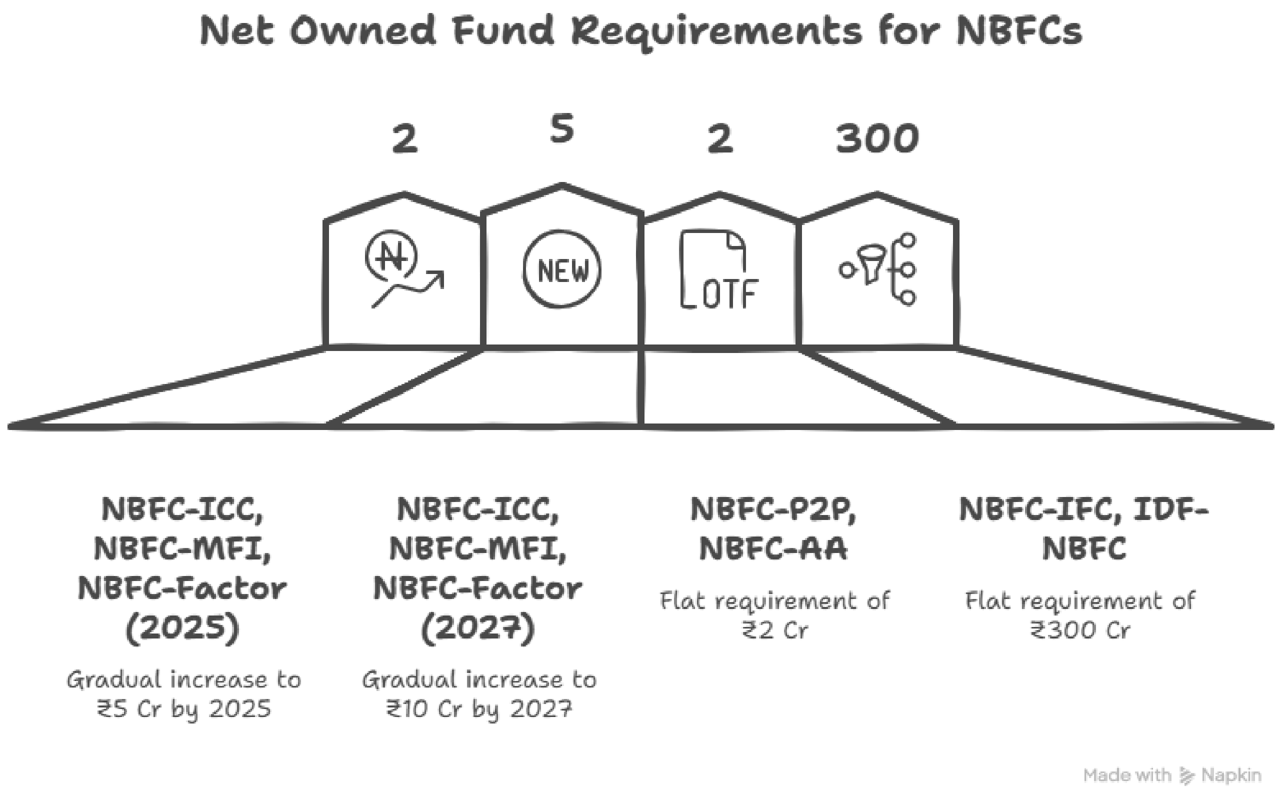
A core feature is group-level classification. If the aggregate asset size of NBFCs within a group exceeds ₹1,000 crore, each NBFC is mandatorily placed in the Middle Layer, irrespective of individual size. Annual certification by statutory auditors is required to verify group consolidation and avoid regulatory circumvention.

NBFCs crossing the ₹1,000 crore threshold are immediately governed by Middle Layer regulations. Reclassification following asset contraction necessitates RBI approval, post-audit.

III. Capitalization Standards and Prudential Rules

Minimum Net Owned Fund (NOF) thresholds:

- ₹10 crore by March 31, 2027, for NBFC-ICCs, NBFC-MFIs, and NBFC-Factors
- ₹2 crore for NBFC-P2Ps and Account Aggregators
- ₹300 crore for IFCs and IDF-NBFCs



Additional capital provisions:

- Base Layer NBFCs cannot include perpetual debt instruments as Tier 1 capital.
- Revaluation reserves on self-used property may count toward CET1 capital, subject to a 55% haircut.
- Risk weights: 0% for sovereign exposures, 100% for defaulted state guarantees.

IV. Asset Quality, Liquidity Management, and Governance Norms

- NPAs are to be classified as:
  - Sub-standard: overdue ≤18 months
  - Doubtful: overdue >18 months
  - Loss assets: confirmed by auditors, NBFC, or RBI
- Income from NPAs is recognized on a cash basis, except for government securities, where accrual is permitted.
- NBFCs with assets exceeding ₹100 crore must:
  - Implement liquidity risk management systems
  - Conduct periodic stress testing
  - Maintain demonstrable asset marketability (e.g., via repo or outright sale)

Key governance provisions include:

- RBI approval for control changes
- Permitted CDS participation only as protection buyers
- Phased Legal Entity Identifier (LEI) adoption, with lending restrictions for non-compliance
- Lending to relatives of senior officials must be escalated to higher sanctioning authorities
- Real estate exposures require statutory approvals
- Guarantees to overseas subsidiaries are prohibited
- Private placement of non-convertible debentures (NCDs) is restricted by ticket size and investor cap

V. Stress Resolution and Disclosure Protocols

- Corporate Debt Restructuring (CDR) for exposures ≥₹10 crore across lenders
- SME-specific restructuring mechanisms with quarterly monitoring

Comprehensive disclosure mandates include:

- Sectoral credit allocation
- Derivatives exposure
- Asset-liability maturity profiles

- Composition of advances and investments
- Restructured asset reporting by classification category

VI. Conclusion

The SBR framework offers a calibrated, multi-tiered regulatory infrastructure designed to enhance financial stability, promote sound governance, and mitigate systemic vulnerabilities in the NBFC sector. Through differentiated oversight aligned with institutional risk and complexity, the RBI has reinforced its commitment to a robust, forward-looking financial ecosystem.

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Mumbai (Fort)

First Floor, Laxmi Building,
Sir P.M. Road, Fort,
Mumbai – 400001
Tel: +022-66261600/17
Email: **contact@dsaca.co.in**

Mumbai (Goregaon)

119, Shivam Chambers, 1st Floor,
S V Road, Goregaon (W),
Mumbai 400 062
Tel: +022-49791142
Email: **contact@dsaca.co.in**

Hyderabad

H No. 272/3RT, Flat No: 301,
Padmaja Apartments,
Beside Axis Bank, S R Nagar,
Hyderabad – 500 038
Tel: +918096205680
Email: **venkat@dsaca.co.in**

Doha-Qatar

Al Rufaa Tower, 1st Floor,
Office No.1,2&3, Old Salata,
PO Box: 30653, Doha – Qatar
Mob: +97466039427
Contact: **naresh@aksaa.qa**
Website: **https://www.aksaa.qa**