SHARP & TANNAN

Sharp byTes

28 April 2022

Reserve Bank of India ('RBI') notifies large exposures framework for Non-Banking Financial Companies ('NBFC')

Background

Over the years, the NBFC sector in India has evolved in terms of size, operations and technological sophistication with entry into new areas of financial services and products. Regulations have also evolved to address various accompanying risks and concerns to keep pace. Today NBFCs are the largest net borrowers of funds from the financial system. Failure of any large NBFC or Housing Finance Corporation (HFC) may translate into a risk to its lenders with the potential to create a contagion. Similarly, the failure of any large and deeply interconnected NBFC can also disrupt the operations of the small and mid-sized NBFCs through a domino effect by limiting their ability to raise funds. Thus, NBFCs have become systemically important to the country's financial system.

Scale based regulations

In October 2021, RBI introduced scale based regulations (SBR), which apply to NBFCs in proportion to their size, activity, and risk profile. It requires NBFCs to comply with the capital, prudential and governance guidelines.

Accordingly, NBFCs are categorised as:

1. Base Layer (NBFC-BL)
   a. non-deposit taking non-systemically important NBFCs below the asset size of INR 1,000 crore (NBFC-NDs),
   b. NBFCs without public funds and customer interface and
   c. certain NBFCs undertaking specific activities (e.g. peer-to-peer lending platform, account aggregator, etc.)

2. Middle Layer (NBFC-ML)
   a. deposit taking NBFCs
   b. non-deposit taking NBFCs with asset size of INR 1,000 crore and above
   c. systemically important non-deposit taking NBFCs (NBFC-NDSI) like: standalone primary dealers (SPD), infrastructure debt funds (IDF), core investment companies (CIC), housing finance corporations (HFC), infrastructure finance companies (IFC).

3. Upper Layer (NBFC-UL): Those specifically identified by RBI as warranting enhanced regulatory requirement. The top ten eligible NBFCs in terms of their asset size shall always reside in the upper layer, irrespective of any other factor.

4. Top Layer (NBFC-TL): Ideally an empty layer, where an NBFC would be slotted at RBI's discretion if such NBFC is contributing significantly to systemic risk.

Large Exposures Framework (LEF)

W.e.f. 1 October 2022, NBFC-UL will have to adopt the LEF for appropriate disclosure to RBI of its large exposures.

- Large Exposure (LE) means the sum of all exposure values of a NBFC-UL measured (as indicated) in the regulations to a counterparty and/or a group of connected counterparties if it is equal to or above 10% of the NBFC-UL's eligible capital base.
- RBI has fixed upper limits on NBFC-UL for LE through lending to single as well as a group of connected counterparties.
- The framework will apply to NBFC-UL at solo-level as well as 'group' level.
- Exposure shall mean on and off-balance sheet exposures.

Reserve Bank of India ('RBI') notifies large exposures framework for Non-Banking Financial Companies ('NBFC')

The LE limits are summarised as under

Exposure towards	NBFC-UL (other than IFC)*	NBFC-UL (IFC)
Single Counterparty	• 20% • additional 5% with Board approval • additional 5% if exposure towards Infrastructure loan/investment (Single counterparty limit shall not exceed 25% in any case)	• 25% • additional 5% with Board approval
Group of connected Counterparties	• 25% • additional 10% if exposure towards Infrastructure loan/investment	35%

*Infrastructure Finance Company

NBFC-UL will henceforth report its following LEs:

1. 10 Largest exposures to counterparties (single as well as a group of connected counterparties) irrespective of their values relative to NBFC-UL's eligible capital base
2. Large exposures with values equal to or above 10% of Tier I Capital
3. Other exposures
4. Exempted exposures with values equal to or above 10% of Tier I Capital

Weblink

https://rbidocs.rbi.org.in/rdocs/notification/PDFs/NOT3218AC484A16F2413B825A4E6DB1B84E45.PDF

Therefore

As per the RBI data, there are 9,651 NBFCs spread across products, customer segments, and geographies. As of 31 March 2021, the NBFC sector (including HFCs) has assets worth more than INR 54 lakh crore (INR 54 trillion), equivalent to about 25% of the asset size of the banking sector. It is equally important to have a defined set of regulations for NBFCs similar to banks. RBI has been adding and standardising the norms covering NBFCs according to their risk, size and exposures to bring them at par with banks.