

SERIES:

**SHADOW BANKING, SHAKY
FOUNDATIONS:**

THE NBFC GOVERNANCE DILEMMA

PART - B

DHFL

IL&FS



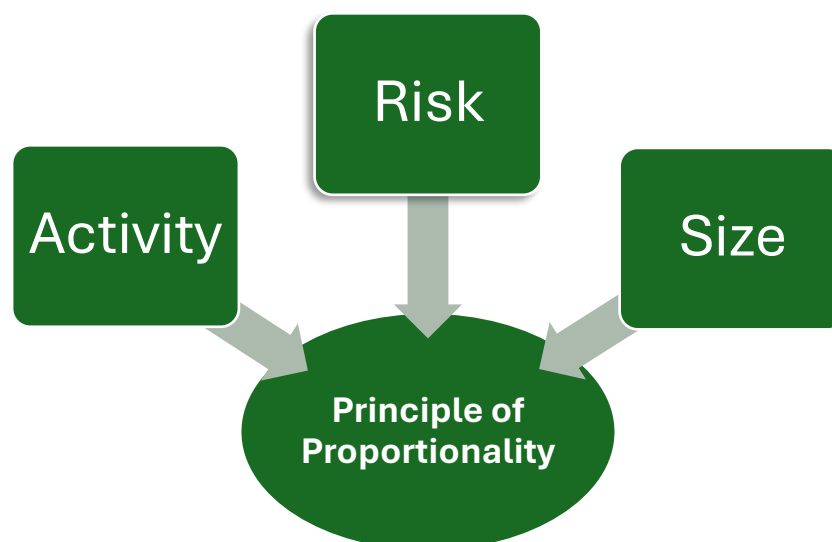
In the previous article of this Series, we traced the evolution of the regulatory landscape governing NBFCs in India. Building on that discussion, this article examines the most recent development in this trajectory i.e. the introduction of the Scale-Based Regulation framework by the RBI (“**SBR Framework**”).

As noted in the RBI’s Discussion Paper dated January 22, 2021, unchecked growth within a lightly regulated yet highly interconnected financial ecosystem can pose systemic risks. The failure of a large, deeply interconnected NBFC has the potential to transmit shocks across the financial sector, adversely impacting even small and mid-sized entities. In response to these growing risks, the regulatory architecture for NBFCs required a fundamental shift to align with emerging realities.

Central to the SBR Framework is the **principle of proportionality**, which ensures that regulatory oversight is commensurate with an NBFC’s size, complexity, and its systemic importance. The framework classifies NBFCs into four distinct layers: **Base, Middle, Upper, and Top**, with a respective enhanced regulatory structure for each level. This four-tiered structure enables the risk-sensitive supervision, efficient regulatory resource deployment, and intends to avoid imposing undue compliance burdens on smaller and less complex NBFCs.

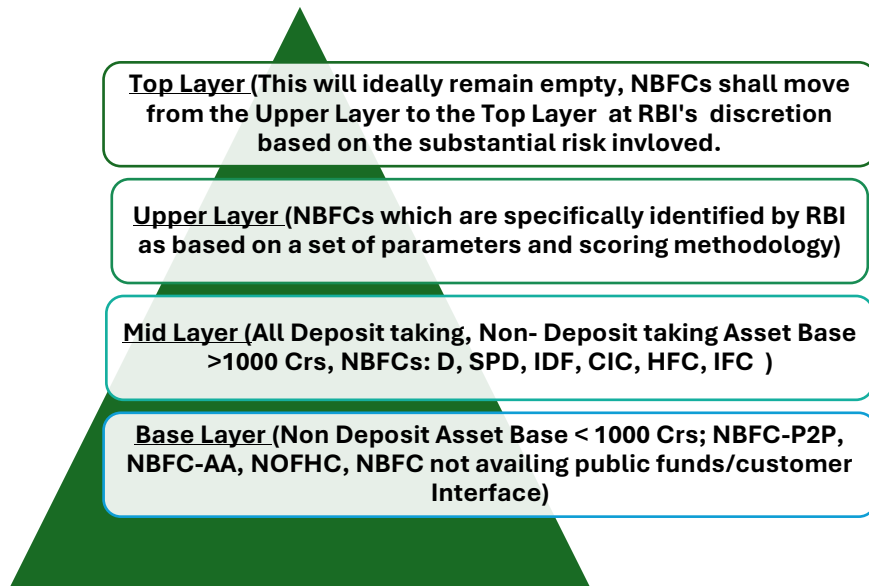
This article aims to **decode the SBR Framework** and critically examine its **structure, regulatory aspects, and implications on the NBFC sector**.

Balancing Risk and Reach: Proportionality in the SBR Architecture!



SBR FRAMEWORK DECODED: LAYERED AND REGULATORY STRUCTURING

I. LAYERED CATEGORISATION OF NBFCs BASED ON ACTIVITY, RISK AND SIZE:



Decoding NBFC Layers: Activity-Based Breakdown

[*Note: Please note that Top Layer NBFC will be subject to higher regulatory requirements which shall be specifically communicated to such NBFCs at the time of their classification in the Top Layer. Hence, the reference to top layer is not added in the below analysis.*]

S. No.	Types of NBFC (based on Activity)	Base Layer	Mid Layer	Upper Layer
i.	Investment and credit companies (NBFC-ICC)	SBR criteria shall apply (i.e. Asset base of less than 1000 Crs.)	SBR criteria shall apply (i.e. Asset base more than 1000 crs.)	SBR criteria shall apply (i.e. Scoring Methodology of RBI.)
ii.	Micro finance institution (NBFC-MFI)	SBR criteria shall apply	SBR criteria shall apply	SBR criteria shall apply
iii.	Factors (NBFC Factors)	SBR criteria shall apply	SBR criteria shall apply	SBR criteria shall apply
iv.	NBFC-Deposit taking (NBFC-D)	NA	This will at least fall in the Middle Layer irrespective of the SBR criteria.	SBR criterial shall apply

v.	Housing finance companies (HFC)	NA	This will at least fall in the Middle Layer irrespective of the SBR criteria	SBR criterial shall apply
vi.	Infrastructure finance company (NBFC-IFC)	NA	This will at least fall in the Middle Layer irrespective of the SBR criteria	SBR criteria shall apply
vii.	Infrastructure debt fund (IDF-NBFC)	NA	This will at least fall in the Middle Layer irrespective of the SBR criteria	
viii.	Core investment company (CIC)	NA	This will at least fall in the Middle Layer irrespective of the SBR criteria	
ix.	Mortgage guarantee company (NBFC-MGC)	SBR criteria shall apply	SBR criterial shall apply	SBR criteria shall apply
x.	Non-Operative financial holding company (NOFHC)	SBR criterial shall apply.	SBR criterial shall apply	SBR criterial shall apply
xi.	Peer to peer lending platform (NBFC-P2P)	However, if these NBFCs are not availing public funds and not having any customer interface, they will always remain in the Base Layer irrespective of the SBR criteria.	SBR criterial shall apply	SBR criterial shall apply
xii.	Account aggregator (NBFC-AA)		SBR criterial shall apply	SBR criterial shall apply
xiii.	Standalone Primary Dealers (SPD)	NA	This will at least fall in the Middle Layer irrespective of the SBR criteria	SBR criterial shall apply

It is important to note that the categorisation and analysis set out hereunder is based solely on the SBR Framework. The discussion is limited to the RBI's perspective on classification of entities under the SBR Framework and does not extend to, or incorporate, requirements under other laws or regulations such as the Foreign Exchange Management Act (FEMA), the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019, or any sector-specific guidelines.

II. KEY REGULATORY CHANGES INTRODUCED ACROSS DIFFERENT LAYERS:

- A. Increase in net owned fund requirement:** Under the SBR Framework, RBI has now mandated a minimum Net Owned Fund (“**NOF**”) of: a) INR 10 crore for NBFC-ICC, NBFC-MFI, and NBFC-Factor; b) INR 2 crore for NBFC-P2P, NBFC-AA, and those without public funds or customer interface; and c) INR 300 crore for NBFC-IFC and NBFC-IDF. NBFCs failing to meet these norms within the specified period will be ineligible for registration.

Glide Path for NBFC-ICC, MFI and Factor:

(Amount in INR Crs.)

NBFCs	Current NOF	By March 31, 2025	By March 31, 2027
NBFC-ICC	2	5	10
NBFC-MFI	5	7	10
NBFC-Factor	5	7	10

Implication:

- A higher NOF acts as a filter, ensuring that only serious, well-capitalized players can enter and remain in the sector.
- It ensures that even Base Layer NBFCs have sufficient skin in the game, aligning the regulation with the increasing complexity and scale of operations in the sector.
- A larger capital buffers ensures that NBFCs possess adequate loss-absorbing capacity, thereby reducing systemic vulnerabilities and strengthening the sector’s shock absorption capabilities.

- B. NPA Classification:** Earlier the NBFCs-ND with an asset size of less than INR 500 crore classified assets with an overdue period of more than 180 days as NPA. Under the SBR Framework, this NPA classification norm stands changed to an overdue period of more than 90 days for all the NBFCs including the ones in Base Layer. For smooth transition, a glide path is provided to applicable NBFCs to adhere to the 90 days NPA norm as under:

NPA Norms	Timeline
>150 days overdue	By March 31, 2024
>120 days overdue	By March 31, 2025
> 90 days	By March 31, 2026

Implication:

- The revised NPA classification norms, enable timely identification of stressed assets for proactive resolution.
- Promotes clearer disclosure of asset quality, improving stakeholder confidence.
- Encourages market discipline, robust credit appraisal and monitoring practices across the NBFC sector.

C. Introduction of the Internal Capital Adequacy Assessment Process (ICAAP):

Under the SBR Framework, NBFCs classified in the Middle and Upper Layers are mandated, (similarly on the lines with commercial banks), to undertake a comprehensive Internal Capital Adequacy

Assessment Process (“ICAAP”). This process requires a rigorous evaluation of the institution’s capital needs, commensurate with the nature, scale, and complexity of risks inherent in its operations.

Implication:

- The primary objective of ICAAP is to ensure the continued availability of adequate capital to absorb potential losses arising from all material risks, while simultaneously fostering the development and integration of advanced internal risk management systems.
- This approach reinforces a culture of proactive risk governance and promotes long-term financial resilience.

D. Restriction on IPO Financing: Under the SBR framework, RBI has capped the amount an NBFC in the Middle Layer or Upper Layer can lend to a single borrower for the purpose of subscribing to an Initial Public Offering (IPO) at INR 1 Crore.

Implication: This restriction prevents excessive leveraged applications, thereby reducing risk for the NBFC and limiting systemic exposure to volatile IPO outcomes. It also ensures that public or borrowed funds are not overly channelled into speculative short-term investments.

E. Stronger Corporate Governance norms across the Layers:

S. No.	Particulars	Base Layer	Mid Layer	Upper Layer
i.	Risk Management Committee (“RMC”)	<ul style="list-style-type: none"> • Overall roles and responsibilities laid out. • RMC can be a Board or Executive level committee (as may be decided by the Board). 	Mandatorily Board level RMC is required.	Mandatorily Board level RMC is required.
ii.	Expertise for Board members	<ul style="list-style-type: none"> • Adequate experience and educational qualification in accounts/corporate governance. • At least one of the directors should have experience in retail lending in a bank/NBFC. 		
iii.	Constitution of Nomination and Remuneration Committee	Not Provided	Constitution of NRC, Principle of fixed and variable pay, and Claw back	Constitution on similar lines as applicable for Private Sector Banks, including guidelines on

			requirements provided.	general compensation policy.
iv.	Rotation of Statutory Auditors/ Firms	Not Provided	A uniform tenure of 3 consecutive years; After completion of 3 years, mandatory cooling period of 6 years (two tenures) before reappointment.	Same as Mid Layer
v.	KMPs- whole time employee in the nature of CEO, CFO, CS and WTD	To be appointed as per Companies Act, 2013	No KMP of an NBFC shall hold office in any other NBFC-ML or NBFC-UL or its subsidiaries An Independent Director cannot be director in more than two NBFCs NBFC-ML and NBFC-UL at the same time	Same as Mid Layer
vi.	Appointment of Chief Compliance Officer	Not Provided	Mandatory	Mandatory
vii.	Listing	Not mandatory	Not mandatory	Adequate phase-in-time for mandatory listing.
viii.	Removal of Independent Directors with Supervisory approval	Not Provided	Not Provided	Requires Supervisory approval
ix.	Business Conduct and Disclosure Regulations	Additional disclosures on type of exposures, related party transactions, customer complaints are provided.	Additional disclosures requirements provided	To be at par with banks

Implication:

- **Intends to enhance Decision-Making Quality:** Diverse expertise fosters well-rounded, informed decisions that balance growth ambitions with risk prudence.
- **Strengthen risk governance:** Specialized knowledge in risk management and regulatory compliance equips boards to identify, assess, and mitigate complex financial and operational risks proactively
- **Ensure robust financial controls:** Financial and accounting proficiency ensures accuracy and integrity in financial reporting, bolstering stakeholder confidence.

SBR FRAMEWORK: A NECESSARY SHIFT OR A REGULATORY OVERREACH ?

Though the SBR Framework seeks to enhance financial system stability, fortify corporate governance standards, and harmonize the regulatory architecture of NBFCs with that of commercial banks. Its implementation presents several challenges and poses following pertinent questions:

How will RBI ensure transparency and consistency in the selection of NBFCs for the Upper Layer and Top Layer, especially when exercising discretionary powers beyond defined thresholds?

- While the SBR framework specifies parameters for classifying NBFCs into different layers, RBI also retains the right to use supervisory judgment for inclusion of Upper Layer. **Without clear disclosure of the criteria or weightages, there is a risk of inconsistent application** and regulatory uncertainty for market participants.
- This **discretionary element introduces uncertainty** and may be perceived as arbitrary or lacking consistency, affecting market confidence.
- Further, once categorized in the Upper Layer, **there is no formal process for NBFCs to appeal**, request review, or seek clarity on the rationale behind their classification.

How does RBI plan to align SBR Framework with sector-specific frameworks (e.g., HFCs, MFIs) and other regulatory regimes like FEMA, FDI, and ECB Regulations to avoid overlaps and contradictions?

- While the SBR framework focuses on enhancing prudential norms and governance for domestic NBFC operations, it **does not comprehensively address the regulatory treatment of ECBs and foreign equity capital in layered NBFCs**, particularly in the Middle and Upper Layers. There is limited clarity on how ECB exposure (i.e., funds borrowed from foreign lenders) will be factored into the assessment of risk, capital adequacy, and liquidity under the SBR framework.
- It is unclear whether large ECB inflows could influence an NBFC's movement to a higher regulatory layer (e.g., from Middle to Upper Layer).

What support or transitional guidance will be provided to smaller and mid-sized NBFCs struggling with the operational and cost burden of enhanced compliance under Middle and Upper Layer norms?

- NBFCs moving into higher regulatory layers may find it difficult to meet new governance, disclosure, and capital requirements within short timelines. Structured guidance, capacity-building initiatives, or phased implementation plans would help ease the transition and preserve financial inclusion efforts.
- RBI's role in offering transitional guidance such as phased implementation timelines, capacity-building initiatives, technical assistance, and financial support will be crucial to help these NBFCs comply

How will the RBI address the potential unintended consequence of regulatory arbitrage or credit migration to less regulated entities due to stringent capital and governance norms under the SBR Framework?

- The imposition of stringent capital, governance, and compliance norms under the SBR framework aims to mitigate systemic risks.
- However, overly rigid regulations may also push borrowers or financial activity to unregulated fintech's, informal lenders, or loosely monitored NBFCs, potentially increasing systemic risk.
- RBI must ensure the framework is proportionate and does not inadvertently incentivize risk migration outside the formal system. Preventing credit migration would require a comprehensive approach that discourages risk transfer to opaque segments while maintaining an enabling environment for legitimate credit flow.

ROAD AHEAD:

Navigating this newly complex regulatory environment will also require NBFCs to significantly strengthen internal governance, enhance technological capabilities, and foster a culture of prudence and accountability.

A strategic realignment focused on operational resilience, investment in human capital, and adherence to enhanced disclosure and control standards will be critical.

With effective execution, the SBR framework is poised to contribute meaningfully to the development of a more transparent, resilient, and well-regulated NBFC sector aligned with India's broader financial sector objectives.

REFERENCES FOR PART-A & B OF THIS SERIES:

RBI's Master Direction – Reserve Bank of India (Non-Banking Financial Company – Scale Based Regulation) Directions, 2023: <https://fidcindia.org.in/wp-content/uploads/2023/10/RBI-MASTER-DIRECTION-NBFC-19-10-2023.pdf>

RBI's Discussion Paper On Revised Regulatory Framework For NBFCs- A Scale-Based Approach:

RBI report on NBFC Trends for FY 2023-24: <https://rbidocs.rbi.org.in/rdocs/Publications/PDFs/0RTP261220247FFF1F49DFC04C508F300904A90C7439.PDF>

Dvara Research :Our Response to RBI's Discussion paper on Revised Regulatory Framework for NBFCs - A Scale-Based Approach, 2021: <https://dvararesearch.com/wp-content/uploads/2023/12/Our-Response-to-RBIs-Discussion-paper-on-Revised-Regulatory-Framework-for-NBFCs-A-Scale-Based-Approach-2021.pdf>

A Study on Scale Base Approach of RBI on NBFCs Banking in India: <https://jier.org/index.php/journal/article/view/1960/1635>

DISCLAIMER

The contents of this document are intended for informational purposes only and are not in the nature of a legal opinion or advice. It provides general information and guidance as on date of preparation and does not express views or expert opinions of Begur & Partners. They may not encompass all possible regulations and circumstances applicable to the subject matter and readers are encouraged to seek legal counsel prior to acting upon any of the information provided herein. Begur & Partners will not be liable for any damages of any kind arising from the use of this document, including but not limited to direct, indirect, incidental, punitive and consequential damages. It is recommended that professional advice be sought based on the specific facts and circumstances. This Article does not substitute the need to refer to the original pronouncements.



• MUMBAI

📍 The Capital, B/513, Bandra Kurla Complex, Bandra (East), Mumbai, Maharashtra 400051



(+9122) 40049800 | 40049801



communications@begurs.com

• BENGALURU

📍 236 Sumitra, 2'C Cross, 1st Main Rd, 2nd Stage, Domlur, Bengaluru, Karnataka 560071



(+91-80) 4123 9800 | 40936801



communications@begurs.com

• UAE

📍 A4-115, Building No. A4, Al Hamra Industrial Zone – FZ, RAK – United Arab Emirates.



(+971) 502234052



communications@begurs.com



Latest Awards and Recognitions

RSGI Resight (RSG India)

IBLJ A List

A List (2023-2024)

ALB India Law Awards 2025

Notable Firm (2024)

Legal 500

Private Equity (including Venture Capital) - Tier 5 (2025)

IFLR1000 (34th Edition) 2024

1. Rajesh Begur B Ranking: Leading Lawyer – Highly Regarded
2. Firm Ranking: Recommended Firm
3. Southern Asia, Australasia and Central Asia Ranking: Highly Regarded

Corporate INTL Global Awards

Cross Border Private Equity Transactions Law Firm of the Year in India - 2025

Forbes India – Legal Powerlist 2023

Top Law Firm (above 10 years' experience)

Asia Law 2022

Notable Firm – Private Equity, Investment Funds, Banking and Finance, Corporate and M&A

Global Law Expert 2021

Cross Border Private Equity Transactions Law Firm of the year

RSG Consulting 2019

Top 40 Indian Law Firm

