



Accounting and Auditing Update

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Foreword

Over time, the number of Non-Banking Financial Companies (NBFC) has increased many folds and the sector has evolved in terms of size, operations, complexity and technological sophistications. NBFCs have entered into diverse areas of business and have a complex web of inter-linkages with banks, capital market and other financial sector entities. These deep interlinkages of the NBFC sector within the financial system can also lead to potential systemic risks. Therefore, to protect the deposits placed by investors with NBFCs, there was a need to align the regulations of NBFCs with their changing risk profile. Accordingly, in January 2021, the Reserve Bank of India (RBI) issued a Discussion Paper on Revised Regulatory Framework for NBFCs- A Scale-Based Approach.

In October 2021, RBI finalised and issued the Scale-Based Regulation (SBR). This covers capital requirements, governance standards and prudential regulations for the NBFC sector.

The SBR calibrates the degree of regulatory prescriptions based on the systemic importance of NBFCs and the contagion risk they may pose to other entities in the financial system.

Under the SBR, NBFCs are categorised into four layers – base layer, middle layer, upper layer and a possible top layer.

The SBR framework is likely to have a significant impact on all NBFCs, distinctively to the NBFCs that are classified in the middle and upper layer. It introduces a set of fresh regulations with their respective timelines. Post issue of this regulation, RBI has issued

further clarifications over a period from February 2022 to June 2022. However, clarifications on certain matters are still awaited.

This edition of the Accounting and Auditing Update (AAU) is dedicated to NBFCs and the impact of SBR on them. We have summarised the new regulatory requirements introduced by the SBR framework, into seven topics e.g. an overview of the SBR, related party provisions, non-performing assets, loans to directors, capital requirements, disclosure requirements and other key provisions of SBR.

Our articles on each of the above topics also highlight at relevant places the requirements of the Companies Act, 2013 and the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements)

Regulations, 2015 applicable to listed entities in India.

Most of the SBR amendments are applicable from 1 October 2022 or thereafter, however, the amendment pertaining to ceiling on IPO funding is applicable from 1 April 2022.

As is the case each month, we also cover a regular round-up of some recent regulatory updates in India and internationally.

We would be delighted to receive feedback/suggestions from you on the topics we should cover in the forthcoming editions of AAU.



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CHAPTER 1

Scale-based framework – the revised regulatory framework for NBFCs

This article aims to:

Highlight the importance of NBFCs in the economy and the new and enhanced regulations introduced for greater regulation.



Background

Non-Banking Financial Companies (NBFCs) have increasingly been playing a significant role in financial intermediation by complementing and competing with banks, and by bringing in efficiency and diversity into the financial ecosystem. NBFCs enjoy greater operational flexibility to take up wider scale of activities, enter into new geographies and sectors and thus grow their operations. This is mainly due to less stringent regulatory provisions applicable to NBFCs as compared to banks (often referred to as the regulatory arbitrage in favour of NBFCs).

Over the years, the NBFC sector has evidenced tremendous growth. However, due to the recent stress observed in the NBFC sector, and the contagion risk it posed to other entities due to the interconnectedness of NBFCs in the financial system, there was a need to protect the deposits that investors placed with the NBFCs. Accordingly, the regulatory approach adopted for NBFCs was re-examined in order to reorient it to keep pace with the changing realities in the financial sector.

With a view to develop a strong and resilient financial system, in October 2021, the Reserve Bank of India (RBI) had prescribed a ‘scale-based regulation’ for the NBFC sector. The Scale-Based Regulatory (SBR) approach renders the regulation and supervision of the NBFCs to be a function of their size, activity and perceived riskiness. Subsequently, RBI has issued clarifications on various provisions of the SBR. These regulations would be applicable to NBFCs effective 1 October

2022. However, an amendment with regard to ceiling on an IPO funding is applicable from 1 April 2022.

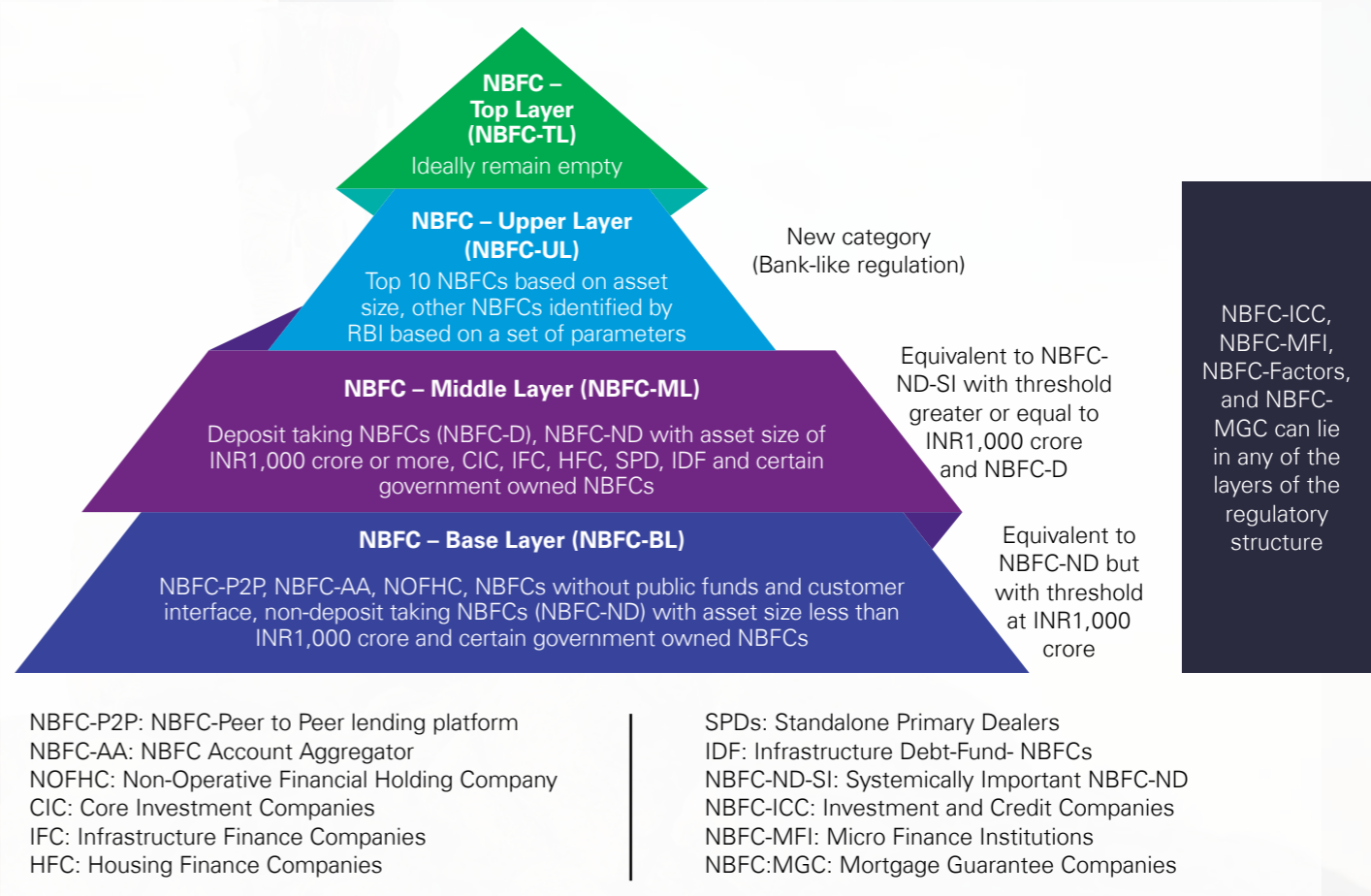
In this article, we aim to provide an overview of the different layers in the scale-based regulation introduced by RBI, the NBFCs that would be classified in each of these layers and the revisions in the structural and regulatory framework applicable to NBFCs in each of the layers.



The scale-based regulatory approach

The SBR framework can be visualised as a pyramid with regulatory intervention being the least at the bottom of the pyramid and increasing as one moves up. This is depicted in figure 1 below:

Figure 1: SBR framework



(Source: KPMG in India’s analysis, 2022, read with Scale Based Regulation (SBR): A Revised Regulatory Framework for NBFCs issued by RBI on 22 October 2021)

The regulatory structure

Base layer (NBFC-BL)

The **base layer** will be equivalent to the existing non-deposit taking non-systemically important NBFCs (NBFC-NDs) Systemically important, non-deposit taking NBFCs having asset size of INR500 crore and above but below INR1,000 crore (except those necessarily featuring in the middle layer) will be part of NBFC-BL. It will specifically include

- NBFC-P2P (NBFC-Peer to Peer lending platform)
- NBFC-AA (NBFC-Account Aggregator)
- NOFHC (Non-Operative Financial Holding Company) and
- NBFCs without public funds and customer interface¹.

While higher level of prudential regulations will not be applicable to such entities, there will be an increase in the transparency requirements through additional disclosures and improved governance standards.

Middle layer (NBFC-ML)

The **middle layer** will be equivalent to the existing deposit taking NBFCs (NBFC-D) and systemically important non-deposit taking NBFCs (NBFC-ND-SI). It will specifically include the SPD (i.e. Standalone Primary Dealers) and IDF (Infrastructure Debt

Funds) (which will always remain in the middle layer). It will also include NBFC-D, irrespective of their asset size, NBFC-ND-SI with asset size greater than INR1,000 crore, CIC, IFC and HFCs². Government owned NBFCs will not be placed in the upper layer, till further notice, and accordingly, will be placed in NBFC-BL or NBFC-ML.

There will be a higher level of regulatory supervision in this layer, which aims to plug the areas of regulatory arbitrage between banks and NBFCs.

Upper layer (NBFC-UL)

The **upper layer** has been conceived as a new category of NBFCs, in which a chosen few, systemically significant NBFCs would be specifically identified by RBI through parametric analysis of certain quantitative and qualitative criteria³, which will be reviewed periodically. Accordingly, entities that meet the specified criteria will move from the middle layer to the upper layer of the scale-based framework. The top 10 eligible NBFCs in terms of their asset size will always reside in the upper layer, irrespective of any other factor. Higher prudential regulations and intensive supervision will be applicable for such entities proportionate to their systemic significance.

1. RBI is expected to come out with separate regulations for such NBFCs in due course.
2. NBFC-D, CIC, IFC and HFCs can either be a part of NBFC-ML or NBFC-UL, as the case may be (and not NBFC-BL).
3. The quantitative criteria majorly consists of size and leverage, interconnectedness and complexity, and the qualitative criteria majorly consists of nature and type of liabilities, group structure and segment penetration.

Transition path to the upper layer

NBFCs would be advised about their classification to the upper layer

Once an NBFC is identified for inclusion as NBFC-UL, it would be advised about its classification by the Department of Regulation, RBI, and will be placed under the regulation applicable to the upper layer. For this purpose, the following timelines should be adhered to:

- **Board approved policy and implementation plan to be prepared within three months:** Within three months of being advised by the RBI regarding its inclusion in the NBFC-UL, the NBFC should put in place a board approved policy for adoption of the enhanced regulatory framework and chart out an implementation plan for adhering to the new set of regulations. This board approved implementation plan will be submitted to RBI and be subject to a supervisory review
- **Adherence with stipulations for NBFC-UL within 24 months:** The Board of Directors (BoD) of the NBFC should ensure that the stipulations prescribed for NBFC-UL are adhered to, and the board approved implementation plan should be subsumed within a maximum time-period of 24 months from the date of advise of the NBFC’s classification in the upper layer.

Transition of NBFCs in the upper layer

Once an NBFC is identified as NBFC-UL, it will be subject to enhanced regulatory provisions **at least for a period of five years** from its classification in this layer, even if it does not meet the parametric criteria in the subsequent year(s). However, an NBFC classified in the upper layer would be allowed to move out of the enhanced regulatory framework only if the movement is reflected as a voluntary strategic move as clearly laid out by its BoD. However, NBFCs classified in the upper layer that have scaled down operations due to adverse situations specific to the NBFC will not be permitted to move down to a lower regulatory regime.

Intimation to NBFCs close to meeting the NBFC-UL parameters

NBFCs which are close to meeting the parameters and benchmarks that would render them eligible for classification as NBFC-UL, will be intimated about the same in advance to enable them to initiate measures and re-adjust operations in case they intend to continue in the NBFC-ML on a long-term basis and do not want to feature in the upper layer.

Top layer

The **top layer** would ideally remain empty and NBFCs will be slotted into this layer from the upper layer of the scale-based framework at the discretion of RBI if it is of the opinion that the entity is contributing significantly to the systemic risk. Such entities would be required to comply with significantly higher regulatory and supervisory requirements.

Regulatory changes under the scale-based regulatory framework

The scale-based regulatory framework envisages a progressive increase in the intensity of regulations. Therefore, regulatory revisions⁴ applicable to lower layers of NBFCs will automatically be applicable to NBFCs residing in higher layers, unless stated otherwise. The regulatory revisions applicable to the various layers of NBFC are given in the table below:

Regulatory revision	Regulatory revisions applicable to			Additional clarifications received from RBI ⁵
	Base Layer (NBFC-BL ⁶)	Middle Layer (NBFC-ML ⁷)	Upper Layer (NBFC-UL ⁸)	
A. Regulatory revisions applicable to all layers of NBFCs				
Revisions in regulatory guidelines				
Raising minimum Net Owned Fund (NOF) for certain NBFCs	Raised minimum NOF requirement for NBFC-ICC, NBFC-MFI and NBFC-factors to INR10 crore. A glide path to achieve this requirement has been provided.			Not Applicable (NA)
Harmonising Non-Performing Assets (NPA) classification norms	NBFC-ND are now required to classify assets with an overdue period of more than 90 days as NPA. A glide period for complying with this norm has been provided	No impact, since NBFCs classified under these layers are already required to follow the 90-day NPA norm		This has been discussed in Chapter 3
Experience of the board	At least one of the directors in the BoD should have relevant experience of having worked in a bank/NBFC. This is a new requirement for all NBFCs.			NA
Ceiling on Initial Public Offer (IPO) funding	A limit of INR1 crore per borrower has been set for financing subscription to IPOs (currently, NBFCs have no ceiling on an IPO funding). Ceiling on an IPO funding has been made applicable from 1 April 2022.			NA

4. The regulatory provisions discussed in this article are the revisions that will be made in the existing regulatory framework.

5. The circular issued in October 2021, provided a holistic view of the SBR structure. Detailed guidelines on certain amendments were to be issued subsequently.

6. NBFC-BL would largely continue to be subjected to regulation that is currently applicable for NBFC-ND. Since NBFC-ND with asset size upto INR1,000 crore will now be classified as NBFC-BL (as per current regulations, non-deposit taking NBFCs with an asset size of less than INR500 crore are considered as non-systemically important NBFCs. Under the scale-based regulations, non-deposit taking NBFCs with an asset size of upto INR1,000 crore will be classified in the

base layer of the regulatory framework.), the existing regulatory framework should be supplemented by enhanced governance and disclosure standards. The specific changes in regulations for NBFC-BL is given in the table.

7. NBFCs in the middle layer will be governed by the extant regulations applicable to NBFC-ND-SIs, NBFC-Ds, CICs, SPDs and HFCs as discussed in the table.

8. NBFCs in the upper layer will be subject to regulations applicable to NBFC-ML and to the regulatory revisions stipulated in the table.

Regulatory revision	Regulatory revisions applicable to			Additional clarifications received from RBI
	Base Layer (NBFC-BL)	Middle Layer (NBFC-ML)	Upper Layer (NBFC-UL)	
Revisions in governance guidelines				
Risk Management Committee (RMC)	Could be at board or executive level, as per discretion of BoD	Board-level RMC	Board-level RMC	NA
Disclosures	Disclosure requirements for NBFCs have been expanded, to include related party transactions, loans to directors/senior officers and customer complaints			Yes, these have been discussed in subsequent chapters
Loans to directors, senior officers and relatives of directors	NBFCs to have a board approved policy on these matters	Not applicable	Not applicable	Yes, this has been discussed in Chapter 4
B. Regulatory revisions applicable to NBFC-ML and NBFC-UL				
Revisions in capital guidelines				
Introduction of Internal Capital Adequacy Assessment Process (ICAAP)	Not applicable	NBFCs in the middle and upper layer are required to make a thorough internal assessment of the need for capital, commensurate with the risks in their business, on similar lines as ICAAP for commercial banks		NA
Revisions in prudential guidelines				
Concentration of credit/investment	Current norms are applicable- no change in limits	The separate lending and investment exposure limits have now been merged into a single exposure limit. Limit will now be computed as a percentage of Tier 1 capital (instead of being computed as a percentage of owned fund)	NBFCs in the upper layer of the SBR are required to follow the Large Exposure Framework (LEF)	Yes, detailed regulation on the LEF has been issued by RBI. This is briefly discussed in Chapter 7
Sensitive Sector Exposure (SSE)	Not applicable	BoD approved internal limits to be fixed for SSE, separately for capital market and commercial real estate exposures. No change in norms for HFCs, which will continue to follow current regulations		NA
Regulatory restrictions on loans	Not applicable	Regulatory restrictions applicable on loans to directors, senior officers and on appraising loan proposals involving real estate		Yes, this has been discussed in Chapter 4

Regulatory revision	Regulatory revisions applicable to			Additional clarifications received from RBI
	Base Layer (NBFC-BL)	Middle Layer (NBFC-ML)	Upper Layer (NBFC-UL)	
Revisions in governance guidelines				
Key Managerial Personnel (KMP)	Not applicable	Restrictions on KMPs from holding any office (including directorships) in any other NBFC-ML or NBFC-UL		NA
Independent director (ID)	Not applicable	IDs are restricted from being on the BoD of more than three NBFCs at the same time		NA
Disclosures in annual financial statements	Not applicable	With effect from 31 March 2023 , NBFCs are required to make the following additional disclosures in their annual financial statements: <ul style="list-style-type: none">• Corporate governance report• Disclosure on modified opinion• Exceptional income or expenses• Breaches in terms of covenants or defaults• Divergence in asset classification and provisioning		Further clarification on corporate governance disclosures, breaches in terms of covenants or defaults and on divergence in asset classification and provisioning has been provided by RBI. These are discussed in subsequent chapters. ⁹
Chief compliance officer	Not applicable	NBFCs in the middle and upper layer are required to have an independent compliance function and appoint a Chief Compliance Officer (CCO)		Yes, this is briefly discussed in Chapter 7
Compensation guidelines	Not applicable	NBFCs to put in place a BoD approved compensation policy for KMP and senior management, which includes: <ul style="list-style-type: none">• Constitution of a remuneration committee• Principles for fixed/variable pay structures• Malus/claw back provisions		Yes, this is briefly discussed in Chapter 4
Additional governance matters	Not applicable	Additional governance matters to be complied with include: <ul style="list-style-type: none">• Delineate the role of various committees• Formulate a whistle blower mechanism• Ensure good corporate governance practices in subsidiaries		Clarification on these matters is awaited.
Introduction of core financial services solution	Not applicable	Mandatory for NBFCs with 10 or more branches		Yes, this is briefly discussed in Chapter 7

9. Clarification on disclosures of modified opinion and exceptional income and expenses is awaited.

Regulatory revision	Regulatory revisions applicable to			Additional clarifications received from RBI
	Base Layer (NBFC-BL)	Middle Layer (NBFC-ML)	Upper Layer (NBFC-UL)	
C. Regulatory revisions applicable only to NBFC-UL				
Revisions in capital guidelines				
Common Equity Tier (CET) 1	Not applicable	Not applicable	CET 1 of at least nine per cent of risk weighted assets ¹⁰	Yes, this has been discussed in Chapter 5
Leverage	Not applicable	Not applicable	Leverage requirement will be applicable. A suitable ceiling for leverage will be prescribed by RBI	Clarification on this matter is awaited
Differential standard asset provisioning	Not applicable	Not applicable	Differential standard asset provisioning applicable, similar to provisions applicable to banks	Yes, this is further discussed in Chapter 3
Revisions in prudential guidelines				
Internal exposure limits	Not applicable	Not applicable	BoD approved internal exposure limits to be set for important sectors to which credit is extended ¹¹ . This is in addition to SSE limits which is applicable to NBFCs in both, the middle and upper layer	NA
Revision in governance guidelines				
Qualification of board members	Not applicable	Not applicable	Composition of BoD to include a mix of educational qualification and experience	This has been discussed in Chapter 4
Listing and disclosures	Not applicable	Not applicable	NBFCs in the upper layer to get listed within three years of identification as NBFC-UL. Unlisted NBFC-ULs to draw up board approved road map for compliance with disclosure requirements of listed companies.	Yes, this has been discussed in Chapter 6
Removal of independent directors	Not applicable	Not applicable	NBFCs in the upper layer are required to report to RBI in case any ID is removed/resigns before the completion of his/her normal tenure. Earlier NBFCs were not required to report removal/resignation by an ID.	Not applicable

10. Currently, the provisions with regard to maintenance of CET 1 is not applicable to NBFCs.

11. This is a new provision, NBFCs were not required to set such internal limits earlier.

CHAPTER 2

Related party provisions and disclosures

This article aims to:

Elucidate the provisions pertaining to related party transactions and disclosures, that are applicable to NBFCs.



Background

Related Party Transactions (RPTs) have been an area of focus for regulators, auditors and shareholders. Thus, the Companies Act, 2013 (the 2013 Act), and the Securities and Exchange Board of India (SEBI) (Listing Obligations and Disclosure Requirement) Regulations, 2015 (Listing Regulations) lay a lot of emphasis on RPTs.

Entities are required to obtain prescribed approvals under the 2013 Act and the Listing Regulations for certain RPTs entered into by them. Additionally, the accounting standards (both Ind AS and the accounting standards¹) and Listing Regulations require entities to disclose RPTs in the annual financial statements and to the stock exchange, respectively. While the current guidelines of RBI require NBFCs to disclose RPTs in the financial statements, it neither prescribes the transactions that need to be covered, nor does it provide a format, thus no separate disclosures are being provided by NBFCs apart from what was disclosed as part of the accounting standards.

The RBI vide the SBR framework and a circular issued in April 2022² has now specified the format for disclosure of RPTs in the annual financial statements. This disclosure will be applicable for financial statements for the year ending 31 March 2023 for NBFCs in all layers of the SBR.

In this article, we aim to provide an overview of the provisions of the 2013 Act, the Listing Regulations, RBI guidelines and accounting standards applicable to RPTs entered into by NBFCs and disclosures of such RPTs.




1. Accounting Standards prescribed under the Companies (Accounting Standards) Rules, 2021.
2. Circular dated 19 April 2022 on ‘Disclosures in Financial Statements- Notes to Accounts of NBFCs’.
3. The RBI does not define ‘related parties’ or ‘related party transactions’, hence NBFCs need to consider the applicable provisions under the 2013 Act, accounting standards and the Listing Regulations (for listed NBFCs) while complying with RPT requirements.

Determining related parties and RPTs

The definition of related parties, is provided in Section 2(76) of the 2013 Act, AS 18, *Related Party Disclosures*, Ind AS 24, *Related Party Disclosures* and the Listing Regulations. However, this definition is not fully aligned, as can be seen in table 1 below:

Table 1: Definition of related parties under various provisions³

The 2013 Act (Section 2(76))	Ind AS 24	AS 18	Listing Regulations
<div>i. A director or his/her relative; ii. A KMP or his/her relative; iii. A firm, in which a director, manager or his/her relative is a partner; iv. A private company in which a director or manager or his/her relative is a member or director; v. A public company in which director or manager is a director and holds along with his/her relatives, more than two per cent. of its paid-up share capital; vi. Any body corporate whose Board of Directors (BoD), managing director or manager is accustomed to act in accordance with the advice, directions or instructions of a director or manager;</div>	<div>a. A person or a close member of that person's family is related to a reporting entity if that person: i. Has control or joint control of the reporting entity; ii. Has significant influence over the reporting entity; or iii. Is a member of the KMP of the reporting entity or of a parent of the reporting entity. b. An entity is related to a reporting entity if any of the following conditions applies: i. The entity and the reporting entity are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others).</div>	<div>a. Enterprises that directly, or indirectly through one or more intermediaries, control, or are controlled by, or are under common control with, the reporting enterprise (this includes holding companies, subsidiaries and fellow subsidiaries); b. Associates and joint ventures of the reporting enterprise and the investing party or venturer in respect of which the reporting enterprise is an associate or a joint venture; c. Individuals owning, directly or indirectly, an interest in the voting power of the reporting enterprise that gives them control or significant influence over the enterprise, and relatives of any such individual;</div>	<div>• A related party as defined under the 2013 Act • A related party as defined under the applicable accounting standards • Any person or entity forming a part of the promoter or promoter group of the listed entity; or • Any person or any entity, holding equity shares in the listed entity either directly or on a beneficial interest basis as provided under Section 89 of the 2013 Act at any time, during the immediate preceding financial year: i. Of 20 per cent or more; or ii. Of 10 per cent or more, with effect from April 1, 2023;</div>

The 2013 Act (Section 2(76))	Ind AS 24	AS 18	Listing Regulations
<p>vii. Any person on whose advice, directions or instructions a director or manager is accustomed to act:</p> <p>viii. Any company which is:</p> <p> A. A holding, subsidiary or an associate company of such company; or</p> <p> B. A subsidiary of a holding company to which it is also a subsidiary;</p> <p> C. An investing company or the venturer of the company</p> <p>ix. Such other person as may be prescribed;</p>	<p>ii. One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member).</p> <p>iii. Both entities are joint ventures of the same third party.</p> <p>iv. One entity is a joint venture of a third entity and the other entity is an associate of the third entity.</p> <p>v. The entity is a post-employment benefit plan for the benefit of employees of either the reporting entity or an entity related to the reporting entity. If the reporting entity is itself such a plan, the sponsoring employers are also related to the reporting entity.</p> <p>vi. The entity is controlled or jointly controlled by a person identified in (a).</p> <p>vii. A person identified in (a)(i) has significant influence over the entity or is a member of the KMP of the entity (or of a parent of the entity).</p> <p>viii. The entity, or any member of a group of which it is a part, provides KMP services to the reporting entity or to the parent of the reporting entity.</p>	<p>d. KMP and relatives of such personnel; and</p> <p>e. Enterprises over which any person described in (c) or (d) is able to exercise significant influence. This includes enterprises owned by directors or major shareholders of the reporting enterprise and enterprises that have a member of key management in common with the reporting enterprise.</p>	

(Source: KPMG in India’s analysis, 2022)

Likewise, the definition of RPT under the 2013 Act, Ind AS, AS and the Listing Regulations is not fully aligned as given in table 2 below.

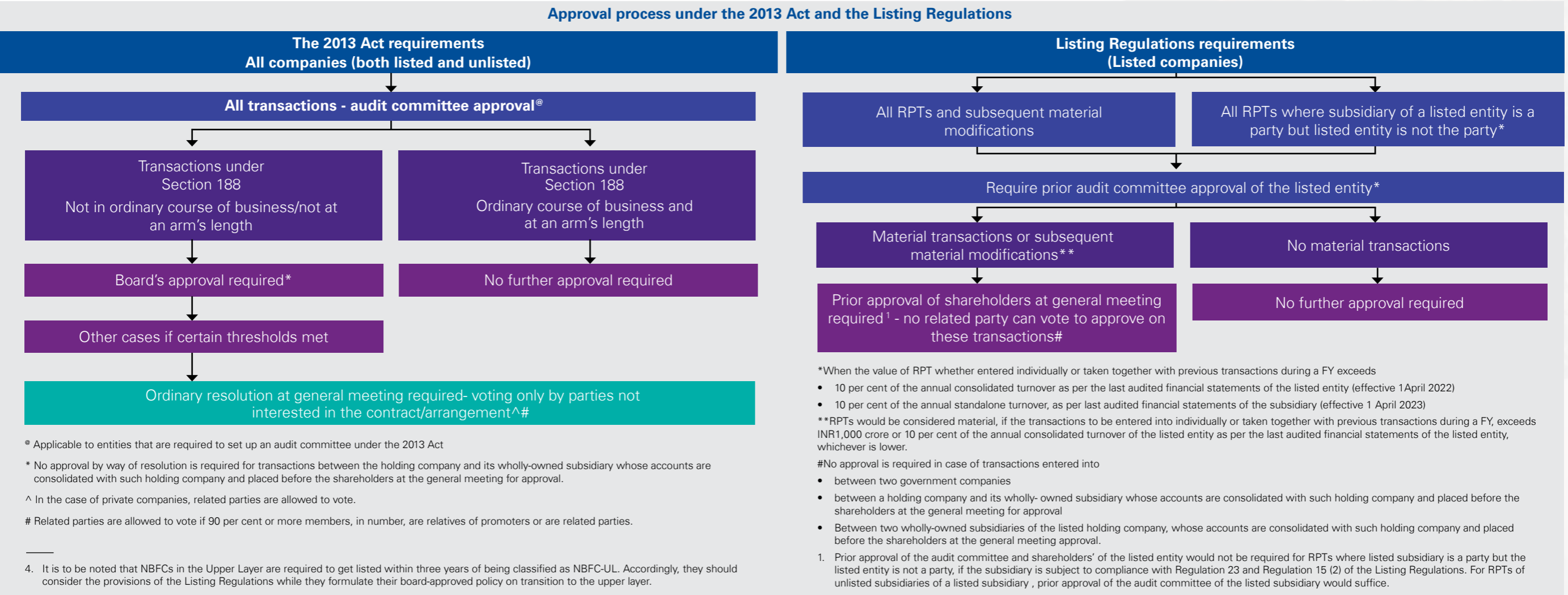
Table 2: Definition of RPTs under various provisions

The 2013 Act	Ind AS 24	AS 18	Listing Regulations
<p>A definition of RPT is not specifically provided in the 2013 Act, Section 188 of the 2013 Act prescribes specific approval mechanism for specific RPTs, which are given below:</p> <ul style="list-style-type: none">• Sale, purchase or supply of any goods or materials• Selling or otherwise disposing of, or buying, property of any kind• Leasing of property of any kind• Availing or rendering of any services• Appointment to any office or place of profit in the company, subsidiary company or associate Company• Underwriting the subscription of any securities or derivatives of the company	<p>A RPT is a transfer of resources, services or obligations between a reporting entity and a related party, regardless of whether a price is charged.</p>	<p>RPT - a transfer of resources or obligations between related parties, regardless of whether or not a price is charged.</p>	<p>RPT means a transaction involving a transfer of resources, services or obligations between:</p> <ul style="list-style-type: none">i. A listed entity or any of its subsidiaries on one hand and a related party of the listed entity or any of its subsidiaries on the other hand; orii. A listed entity or any of its subsidiaries on one hand, and any other person or entity on the other hand, the purpose and effect of which is to benefit a related party of the listed entity or any of its subsidiaries, with effect from April 1, 2023. <p>Regardless of whether a price is charged and a 'transaction' with a related party shall be construed to include a single transaction or a group of transactions in a contract.</p> <p>Additionally, certain transactions are specifically excluded from the purview of RPT.</p>

(Source: KPMG in India's analysis, 2022)

Thus, while entering into a transaction with a person or an entity, NBFCs would need to evaluate whether the person or entity is a related party as per the above provisions and whether the transaction would be considered as an RPT. Accordingly, approvals would be required under the 2013 Act and Listing Regulations (where the NBFC is listed)⁴. An overview of the approval process under both the 2013 Act and the Listing Regulations is given in figure 1 below:

The process for approvals of RPTs has been summarised in the flow chart below:



Disclosures of RPT

Transactions with related parties may impact the financial position and performance of a company- this is because entities having control, joint control or significant influence over the investee have the ability to affect its operating and financial policies.

In this view, it is imperative that users of financial statements have knowledge of an entity’s transactions, outstanding balances, including commitments, and relationships with related parties. This information could have an impact on the assessment of an entity’s operations, including assessment of risks and opportunities facing the entity.

Accordingly, the accounting standards⁵ have prescribed the related party relationships and transactions that need to be reported. Additionally, Schedule V of the Listing Regulations prescribes certain related party disclosures (which should be in compliance with the accounting standards) to be made in the annual report of entities that have listed their non-convertible securities⁶.

With a view to provide greater transparency in this area, the SBR has prescribed a disclosure format for RPTs (as given in Figure 2 below). Disclosures are required in the annual financial statements of NBFCs within all the levels of the SBR.

Figure 2: Format of RPT disclosures prescribed in the SBR

Related Party Items	Parent (as per ownership or control)		Subsidiaries		Associates/ Joint ventures		KMP@		Relatives of KMP		Others*		Total	
	Current year	Previous year	Current year	Previous year	Current year	Previous year	Current year	Previous year	Current year	Previous year	Current year	Previous year	Current year	Previous year
Borrowings#														
Deposits#														
Placement of deposits#														
Advances#														
Investments#														
Purchase of fixed/other assets														
Sale of fixed/ other assets														
Interest paid														
Interest received														
Others*														

(Source: RBI circular on Disclosures in Financial Statements – Notes to Accounts of NBFCs, dated 19 April 2022)

5. As per Ind AS 24, entities are required to disclose all RPT where control exists (i.e. parent company, ultimate controlling party and where required, next most senior parent that prepares CFS, irrespective of whether there is a transaction entered into with such entities. Compensation paid to KMP also needs to be disclosed. With regard to RPTs, entities are required to disclose the amount of transaction, outstanding balances (including commitments and guarantees) and terms and conditions of these balances- i.e. whether they are secured and nature of consideration to be provided on settlement. Provision for doubtful debts and expense recognised in respect of bad or doubtful debts due from related parties. These disclosures are required to be made separately for the parent, entities with joint control or significant influence over the entity, subsidiaries, associates, joint ventures in which the entity is a joint venturer, KMP of the entity or its parent and other related parties. Similar disclosures are required as per AS 18.

6. Regulation 23(9) of the Listing Regulations also requires entities that have listed their specified securities and HVDLEs to submit related party disclosures in a prescribed format to the stock exchange within the prescribed time period.

Notes

Related party, in the context of the aforementioned disclosure, would include all related parties as per the applicable accounting standards, and certain related parties as defined in the 2013 Act.

@ Disclosures for directors and relatives⁷ of directors should be made separately in separate columns from other KMPs⁸ and relatives of other KMPs.

The outstanding amount at the year end and the maximum amount during the year are to be disclosed

* Specify item if total for the item is more than 5 per cent of total RPTs. Related parties would include trusts and other bodies in which the NBFC can directly or indirectly (through its related parties) exert control or significant influence.

In view of the overlapping disclosure requirements in the regulations and accounting standards pertaining to related parties, NBFCs may consider disclosing a single consolidated note on related parties in the annual financial statements. Listed NBFCs, will also have to comply with the applicable Listing Regulations⁹.

7. Relative is defined under Section 2(77) of the 2013 Act, read with Rule 4 of the Companies (Specification of definitions details) Rules, 2014, which includes member of a Hindu Undivided Family, spouse, father, mother, son, son's wife, daughter, daughter's husband, brother, sister

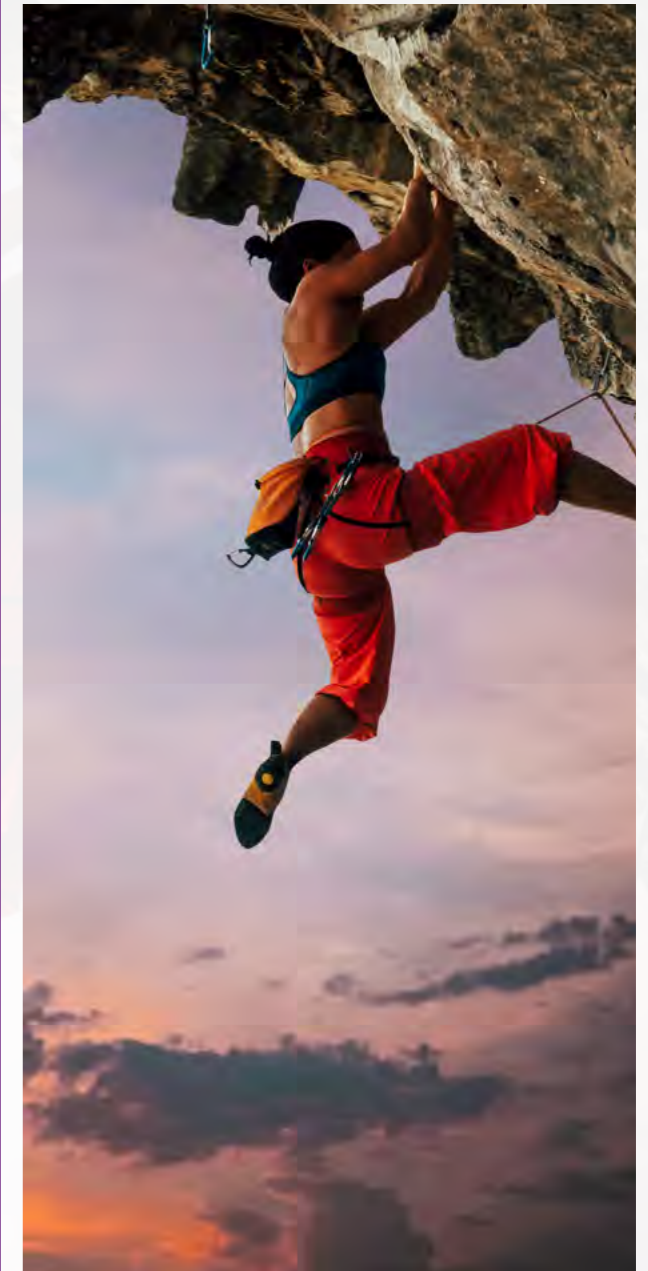
8. KMP includes the persons defined under Section 2(51) of the 2013 Act, which includes CEO or the managing director or the manager, the company secretary, the whole-time director, CFO, such other officer, not more than one level below the director, who is in whole-time employment, designated as KMP by the BoD, and such other officer as may be prescribed.

9. SEBI vide circular SEBI/HO/CFD/CMD1/CIR/P/2021/662 dated 22 November 2021 has provided a format for reporting of RPTs identified basis the Listing Regulations. These disclosures are required to be made on a six-monthly basis to stock exchanges by entities that have listed their specified securities (i.e. equity instruments and convertible securities) and by High-Value Debt Listed Entities (HVDLE).

Next Steps

Some of the incremental provisions that are applicable to NBFCs, on account of the SBR framework are:

- NBFCs should note that separate disclosures are required to be provided for transactions with directors and relatives of directors and other KMPs and relatives of other KMPs, further, other transactions that are more than 5 per cent of the total RPT need to be disclosed separately.
- The SBR has broadened the related party definition as is currently defined in the 2013 Act, by specifically calling out, the trusts and other bodies where NBFCs (itself or through its related parties) may exert control or significant influence. This is in line with the requirements of Ind AS which requires reporting entities to evaluate whether a trust needs to be consolidated in the first instance.
- Currently, disclosure of maximum amount outstanding during the year for loans, advances in the nature of loans and investments is required under the Listing Regulations for entities that have listed their non-convertible securities on a recognised stock exchange. The SBR framework, has now brought into the ambit all the NBFCs (listed and unlisted) and widened the transactions for which maximum amount is required to be disclosed to borrowings, deposits, placement of deposits, advances and investments.



CHAPTER 3

Non-performing assets and Provisioning

This article aims to:

Explicate the regulations pertaining to provisioning of assets in the financial statements and as per the regulatory requirements, and disclosures thereon.



Background

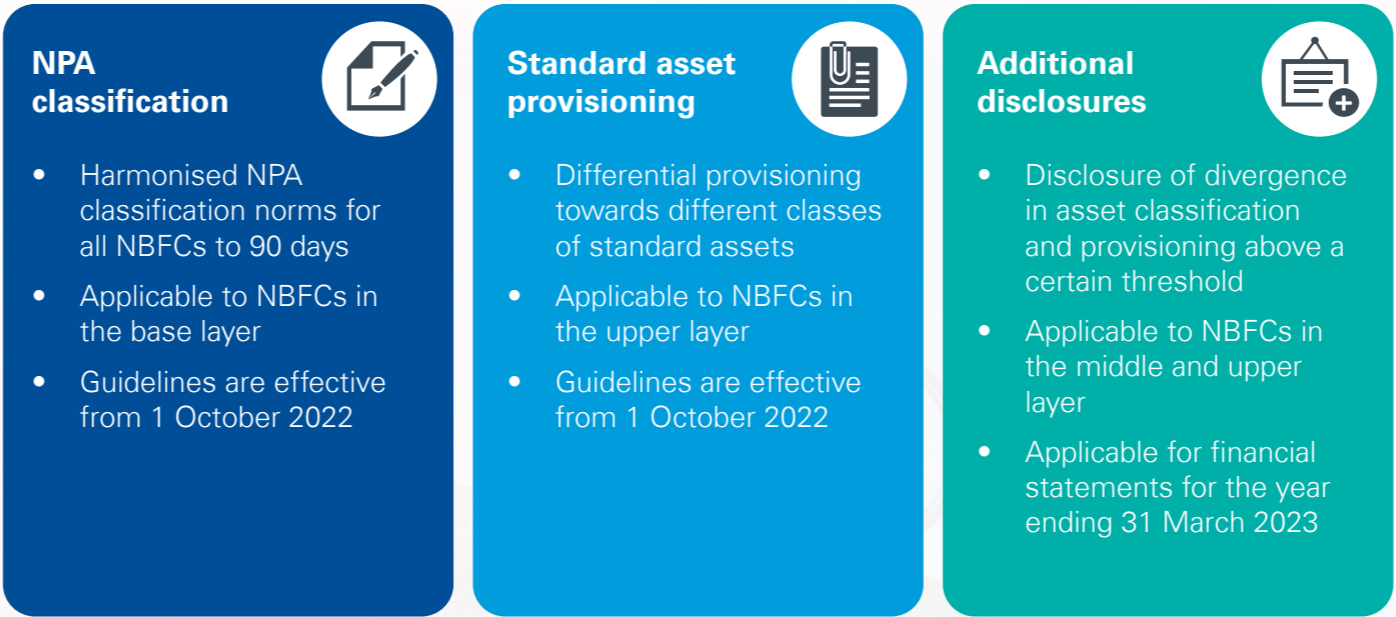
As per the regulations issued by RBI, provisioning of assets is critical for all entities in the financial services sector. Currently, the SI-NBFC Master Directions¹, NSI-NBFC Master Directions² and HFC Master Directions³ (collectively termed as Master Directions) provide norms for asset classification and provisioning for NBFCs. As per the Master Directions every NBFC shall, after considering the degree of well-defined credit weaknesses and extent of dependence on collateral security for realisation, classify its lease/hire purchase assets, loans and advances and any other forms of credit into the following classes, namely:

- (i) Standard assets;
- (ii) Sub-standard assets;
- (iii) Doubtful assets; and
- (iv) Loss assets.

Provisioning is required for each of these assets at the rates prescribed by RBI. Additionally, NBFCs are required to disclose provisions made as per the RBI regulations in their financial statements.

The RBI, vide the SBR has prescribed certain additional regulations pertaining to provisioning and disclosures of provisions for certain layers of the NBFCs, as given in figure 1 below:

Figure 1: Additional regulations pertaining to provisioning issued under SBR



(Source: KPMG in India’s analysis,2022, read with RBI circulars, Scale Based Regulation (SBR): A Revised Regulatory Framework for NBFCs issued on 22 October 2021, Disclosure in Financial Statements- Notes to Account issued on 19 April 2022 and Provisioning for Standard assets by Non-Banking Financial Company – Upper Layer, issued on 6 June 2022)

In this article, we aim to provide an overview of the current requirements pertaining to NPA classification and provisioning under the RBI regulations and under the Ind AS and explicate the amendments issued under the SBR.

1. Master Direction - Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016.

2. Master Direction - Non-Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016.

3. Master Direction – Non-Banking Financial Company – Housing Finance Company (Reserve Bank) Directions, 2021.

Non-Performing Assets (NPA) classification

Currently, the NBFCs-ND with an asset size of less than INR500 crore (i.e. non-systemically important, non-deposit taking NBFCs) classify assets with an overdue period of more than 180 days as NPA (NPA norm). All other NBFCs have an NPA norm of 90 days.

The RBI has now harmonised the NPA norms for all NBFCs to 90 days. This amendment will impact the NBFCs in the base layer, which includes the NBFC-ND (i.e. the non-systemically important, non-deposit taking NBFCs). Accordingly, a glide path has been provided to NBFCs in the base layer to adhere to the 90 days NPA norm, as given below:

NPA norm	Timeline
> 150 days	By 31 March 2024
> 120 days	By 31 March 2025
> 90 days	By 31 March 2026



Clarifications issued by RBI on NPA classifications

On 1 October 2021, RBI issued a Master Circular on Prudential Norms on Income Recognition Asset Classification and Provisioning (IRACP) which is applicable to all commercial banks (excluding regional rural banks). Subsequently, on 12 November 2021 and 15 February 2022, RBI issued circulars providing certain clarifications on IRACP norms to ensure uniformity in its implementation and harmonising certain requirements for all lending institutions⁴. Some clarifications that will impact NPA classification for NBFCs with effect from 1 October 2022 include:

- SMA classification applicable to NBFC-ND:** Currently, the requirement to classify overdue borrower accounts as SMA as prescribed in the ‘Prudential Framework for Resolution of Stressed Assets’ is applicable to NBFC-ND-SI and NBFC-D (i.e. all systemically important, non-deposit taking NBFCs and all deposit taking NBFCs), however, it is not applicable to NBFC-ND (i.e. non-systemically important, non-deposit taking NBFCs).

With the clarifications issued by RBI, these provisions will now apply even to NBFC-ND.

However, references to ‘90 days’ for SMA-2/NPA classification may be read as per the NPA norms applicable to NBFC-ND (non-systemically important, non-deposit taking NBFCs).

- Upgradation of accounts classified as NPAs:** The IRACP norms state that accounts classified as NPA can be upgraded to ‘standard account’ category if arrears of interest and principal are paid by the borrower. RBI observed that many lending institutions upgrade NPA accounts to ‘standard’ category upon payment of only interest overdue, partial overdues, etc.

The RBI clarified that loan accounts classified as NPAs may be upgraded as ‘standard’ asset only if entire arrears of interest and principal are paid by the borrower. Circular dated 15 February 2022 has provided NBFCs time till 30 September 2022 to put in place the necessary systems to implement this.

4. This includes all commercial banks, co-operative banks, All-India Financial Institutions and all NBFCs (including HFCs).

Provisioning requirements and computation of a prudential floor

While dealing with provisioning for assets, NBFCs should look at two aspects i.e. the regulatory aspect and the accounting aspect. The Master Directions instruct NBFCs that are required to implement Ind AS to prepare their financial statements in accordance with the principles enunciated in Ind AS. NBFCs that are not required to adopt Ind AS, should comply with the requirements of the notified Accounting Standards (AS) insofar as they are not inconsistent with the Master Directions.

It is expected that most NBFCs in the middle and upper layer of the SBR will have a net worth of INR250 crore or more, hence they would be within the purview of Ind AS. Such NBFCs would need to refer to the principles of Ind AS 109, *Financial Instruments* while provisioning for assets in the financial statements.

In parallel NBFCs/Asset Reconstruction Companies (ARCs) should also maintain the asset classification and compute provisions as per extant prudential norms on Income Recognition, Asset Classification and Provisioning (IRACP) including borrower/beneficiary wise classification, provisioning for standard as well as restructured assets, NPA ageing, etc. (termed as Prudential floor)⁵. A comparison between provisions required under IRACP and impairment allowances made under Ind AS 109 should be disclosed in the prescribed format by NBFCs/ARCs in the notes to their

financial statements to provide a benchmark to their BoD, RBI supervisors and other stakeholders, on the adequacy of provisioning for credit losses.

Where impairment allowance under Ind AS 109 (which is recorded in the financial statements) is lower than the provisioning required under IRACP (including standard asset provisioning), NBFCs/ARCs should appropriate the difference from their net profit or loss after tax to a separate 'Impairment Reserve'.

Some of the key requirements prescribed by Ind AS and the provisioning requirements applicable to NBFCs are discussed below.

Accounting as per Ind AS

Requirements of Ind AS 109 with regard to provisioning of assets is given below:

A. Classification and measurement of financial assets

An entity should classify financial assets as subsequently measured at amortised cost, Fair Value through Other Comprehensive Income (FVOCI) or at Fair Value Through Profit or loss (FVTPL) on the basis of both:

- The business model for managing the financial assets; and
- The contractual cash flow characteristics of the financial assets

B. Expected credit losses (ECL)

The impairment model in Ind AS 109 is an expected credit loss model, which means that it is not necessary for a loss event to occur before an impairment loss is recognised. As a result, all financial assets generally carry a loss allowance, however, there are some exceptions from recognising a loss allowance. ECLs are a probability-weighted estimate of credit losses – i.e. the present value of cash shortfalls over the expected life of the financial instrument. A cash shortfall is the difference between the cash flows that are due to an entity in accordance with the contract and the cash flows that the entity expects to receive. Because ECL consider the amount and timing of payments, a credit loss arises even if the entity expects to be paid in full but later than when contractually due.

Significant increases in credit risk

Entities should initially recognise a 12-month ECL on all financial assets, and subsequently, on every reporting date test whether there has been a significant increase in credit risk of that asset, in which case, a lifetime ECL is recognised on such asset.

Generally, for assessing whether there has been a significant increase in credit risk, entities compare the probability of defaults on the financial asset at the reporting date with the probability of default on the financial asset at the date of initial recognition.

Ind AS 109 also provides a rebuttable presumption, wherein the credit risk of a financial asset is presumed to have increased significantly since initial recognition when contractual payments are more than 30 days past due. An entity can rebut this presumption if the entity has reasonable and supportable information that is available without undue cost or effort, that demonstrates that the credit risk has not increased significantly since initial recognition even though the contractual payments are more than 30 days past due.

Default

Ind AS 109 does not define the term 'default', but instead requires each entity to do so. The definition has to be consistent with that used for internal credit risk management purposes for the relevant financial instrument and has to consider qualitative indicators - e.g. breaches of covenants - when appropriate. The definition of default is applied consistently, unless information that becomes available indicates that another default definition is more appropriate for a particular financial instrument.

There is a rebuttable presumption that default does not occur later than when a financial asset is 90 days past due unless an entity has reasonable and supportable information to corroborate a more lagging default criterion.

5. This is in accordance with RBI circular dated 13 March 2020 on 'Implementation of Indian Accounting Standards'

Provisioning requirements under the Master Directions

The Master Directions prescribe the provisioning requirements for standard assets, sub-standard assets, loss assets and doubtful assets for NBFCs and HFCs as given below:

Asset classification ⁶	Provisioning for NBFCs	Provisioning for HFCs
Loss assets	Entire asset to be written off Or 100 per cent provision on outstanding amount	Entire asset to be written off Or 100 per cent provision on outstanding amount
Doubtful assets	A. <u>Unsecured portion</u> 100 per cent provision B. <u>Secured portion</u> 20 per cent to 50 per cent provision on the basis of period for which asset is considered doubtful	A. <u>Unsecured portion</u> 100 per cent provision B. <u>Secured portion</u> 25 per cent to 100 per cent provision on the basis of period for which asset is considered doubtful
Sub-standard assets	Provision of 10 per cent on outstanding amount	Provision of 15 per cent on outstanding amount
Standard assets	A. <u>For all NBFCs MFI and IFC and for Factors with asset size less than INR500 crore</u> 0.25 per cent of standard asset B. <u>For other NBFCs, including Factors with asset size greater than INR500 crore</u> 0.4 per cent of standard asset (This provision has been amended for NBFCs in the upper layer of the SBR framework, see the section below.)	Differential standard asset provisioning based on category of assets.

(Source: KPMG in India’s analysis, 2022 read with SI-NBFC-Master Directions, NSI-NBFC-Master Directions and HFC-Master Directions)

6. Additional rates and provisions have been given for lease and hire purchase assets. These are not covered in this article

Amendments issued by the scale based regulations (effective 1 October 2022)

The RBI has issued detailed guidelines for NBFCs falling in the upper layer of SBR to adopt ‘**differential standard asset provisioning norms**’⁷ while computing the provisions on standard assets. These norms are in line with those prescribed for banks:

Category of standard assets	Rate of provision on standard assets
Individual housing loans and loans to Small and Micro Enterprises (SMEs) ⁸	0.25 per cent
Housing loans extended at teaser rates ⁹	2 per cent, which will decrease to 0.4 per cent after one year from the date on which the rates are reset at higher rates (if accounts remain standard)
Advances to Commercial Real Estate ¹⁰ – Residential Housing (CRE-RH) ¹¹ sector	0.75 per cent
Advances to Commercial Real Estate (CRE) sector (other than CRE-RH)	1 per cent
Restructured advances	As stipulated in the applicable prudential norms for restructuring of advances
All other loans and advances not included above, including loans to Medium Enterprises ⁸	0.4 per cent

(Source: RBI circular, Provisioning for Standard assets by Non-Banking Financial Company – Upper Layer, issued on 6 June 2022)

7. Detailed guidelines on differential standard asset provisioning have been issued vide circular dated 6 June 2022.

8. Definition of the terms Micro Enterprises, Small Enterprises, and Medium Enterprises shall be as per the circular FIDD.MSME & NFS.BC.No.3/06.02.31/2020-21 dated July 2, 2020 on ‘Credit flow to Micro, Small and Medium Enterprises Sector’ as updated from time to time.

9. Housing loans extended at teaser rates shall mean housing loans having comparatively lower rates of interest in the first few years after which the rates of interest are reset at higher rates.

10. Commercial Real Estate (CRE) would consist of loans to builders/ developers/ others for creation/acquisition of commercial real estate (such as office building, retail space, multi-purpose commercial premises, multi- tenanted commercial premises, industrial or warehouse space, hotels, land acquisition, development and construction etc.) where the prospects for repayment, or recovery in case of default, would depend primarily on the cash flows generated by the asset by way of lease/rental payments, sale etc. Further, loans for third dwelling unit onwards to an individual will be treated as CRE exposure.

11. Commercial Real Estate – Residential Housing (CRE–RH) is a sub-category of CRE that consist of loans to builders/ developers for residential housing projects (except for captive consumption). Such projects should ordinarily not include non-residential commercial real estate. However integrated housing project comprising of some commercial spaces (e.g. shopping complex, school etc.) can also be specified under CRE-RH, provided that the commercial area in the residential housing project does not exceed 10 per cent of the total Floor Space Index (FSI) of the project. In case the FSI of the commercial area in the predominantly residential housing complex exceed the ceiling of 10 per cent, the entire loan should be classified as CRE and not CRE-RH.

Further, current credit exposures¹² arising on account of the permitted derivative transactions would also attract provisioning requirement as applicable to the loan assets in the ‘standard’ category, of the concerned counterparties. All conditions applicable for treatment of the provisions for standard assets would also apply to the aforesaid provisions for permitted derivative transactions.

Since these provisions are in line with the existing provisions pertaining to differential standard asset provisioning applicable to HFCs, the HFCs that are classified in the upper layer of the SBR will not be impacted by this amendment.

It is to be noted, these revised provisions will be applied while computing the prudential floor with effect from 1 October 2022.

12. Current credit exposure is defined as the sum of the gross positive mark-to-market value of all derivative contracts with respect to a single counterparty, without adjusting against any negative marked-to-market values of contracts with the same counterparty.

13. NBFCs that are preparing financial statements as per Ind AS would additionally be required to provide disclosures prescribed in Ind AS 107, *Financial Statements: Disclosures*

Additional disclosure requirements

Currently, the Master Directions prescribe the disclosure requirements pertaining to asset classification and provisioning, which includes an analysis of the NPAs and comparison of provisions computed as per Ind AS and with the provisions computed in accordance with RBI regulations (this is for NBFCs that have adopted Ind AS)¹³.

In addition to the existing requirements, the SBR requires NBFCs in the middle and upper layer to disclose divergences in asset classification and provisioning between those computed by the

NBFCs, by following the RBI regulations, and those computed by RBI (as part of its evaluation of the NBFC’s asset classification and provision for assets computation). The disclosure of divergence in asset classification and provisioning is required to be provided in accordance with the format (table 1) as given below. Disclosures of divergence would be required if either or both of the following conditions are satisfied:

- The additional provisioning requirements assessed by RBI (or National Housing

Bank (NHB) in the case of Housing Finance Companies) exceeds five per cent of the reported profits before tax and impairment loss on financial instruments for the reference period, or

- The additional Gross NPAs identified by RBI/ NHB exceeds five per cent of the reported Gross NPAs for the reference period

Table 1: Format for reporting divergence in asset classification and provisioning

Sr.	Particulars	Amount
1	Gross NPAs as on March 31, 20XX* as reported by the NBFC	
2	Gross NPAs as on March 31, 20XX as assessed by the Reserve Bank of India/ NHB	
3	Divergence in Gross NPAs (2-1)	
4	Net NPAs as on March 31, 20XX as reported by the NBFC	
5	Net NPAs as on March 31, 20XX as assessed by Reserve Bank of India/ NHB	
6	Divergence in Net NPAs (5-4)	
7	Provisions for NPAs as on March 31, 20XX as reported by the NBFC	
8	Provisions for NPAs as on March 31, 20XX as assessed by Reserve Bank of India/ NHB	
9	Divergence in provisioning (8-7)	
10	Reported Profit before tax and impairment loss on financial instruments for the year ended March 31, 20XX	
11	Reported Net Profit after Tax (PAT) for the year ended March 31, 20XX	
12	Adjusted (notional) Net Profit after Tax (PAT) for the year ended March 31, 20XX after considering the divergence in provisioning	

* March 31, 20XX is the close of the reference period in respect of which divergences were assessed

CHAPTER 4

Directors and Key Managerial Personnel

This article aims to:

Provide an overview of additional requirements applicable to directors under the SBR.



Background

Directors play a critical role in the operations and management of a company and are empowered by shareholders to take pivotal decisions for the company. Various regulations including the 2013 Act, the Listing Regulations and the RBI provisions cover a number of aspects regarding directors such as those pertaining to appointment, remuneration, number of directorships, resignation, compensation, transactions with directors, etc.

The SBR framework prescribes certain additional provisions pertaining to the directors (including Independent Directors (IDs), Key Managerial Personnel (KMP) and senior managers of NBFCs. These additional provisions have been given in figure 1 below:



In this article, we aim to provide an overview of the provisions issued by SBR pertaining to directors and KMP and expound the existing regulations prescribed in the 2013 Act and the Listing Regulations pertaining to those provisions.

(Source: KPMG in India's analysis, 2022 read with RBI circular, 'Scale Based Regulation (BSR): A Revised Regulatory Framework for NBFCs, issued on 22 October 2021)

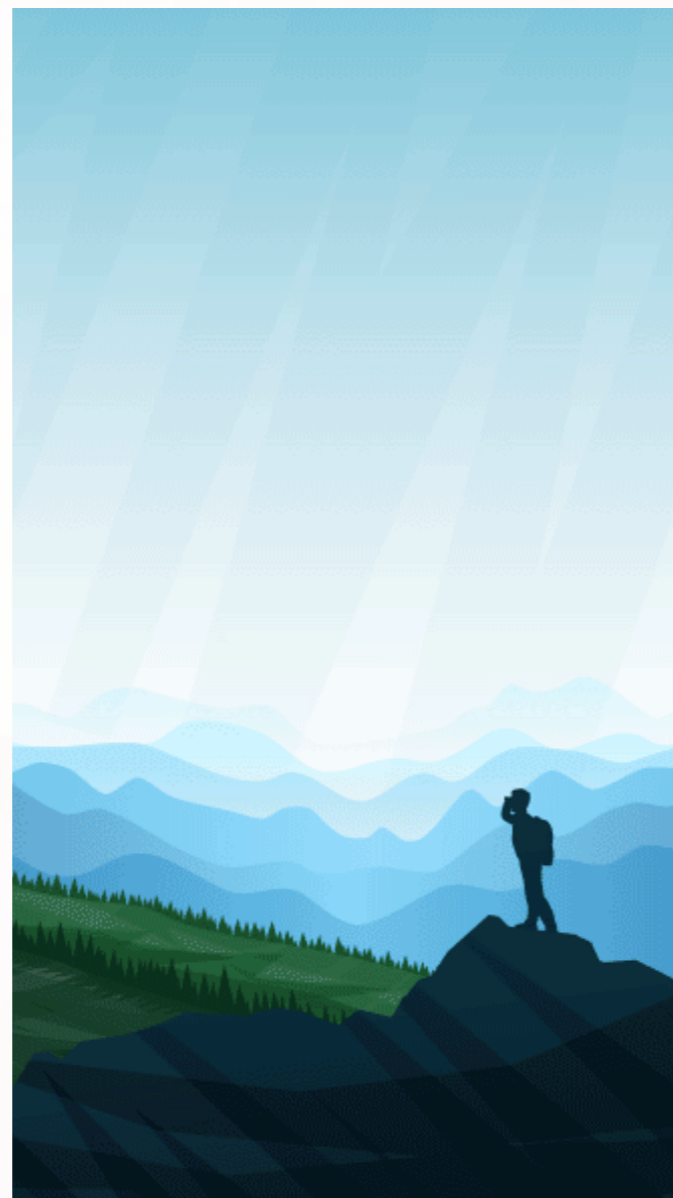
Overview of additional provisions

The BoD have to exercise strategic oversight over business operations of the NBFC, ensure compliance with legal framework and financial accounting and reporting systems. Hence, it is essential for the BoD to ensure that the board has directors with relevant qualifications, adequate compliance and control over their transactions with the entity, number of directorships are within the maximum threshold, etc. These requirements are further discussed below:

Qualification and experience of BoD

In order to consider the need for professional experience in managing the affairs of NBFCs, the SBR framework requires NBFCs in all layers to ensure that at least one of the directors has relevant experience of having worked in a bank or NBFC.

Additionally, considering that NBFCs in the upper layer pose higher systemic risk and need to maintain highest corporate governance standards, they need to ensure that composition of BoD has relevant educational qualification and experience. Specific expertise of board members would be a prerequisite for appointment of directors depending on the type of business pursued by the NBFC-UL.



Current provisions of the 2013 Act and Listing Regulations

The Companies (Appointment and Qualification of Directors) Rules, 2014 require independent directors to possess appropriate skills, experience, and knowledge in one or more fields of finance, law, management, sales, marketing, administration, research, corporate governance, technical operations, or other disciplines related to the company's business.

Certain independent directors are also required to undertake an online proficiency self-assessment test in accordance with Rule 6 of the Companies (Appointment and Qualification of Directors) Rules, 2014.

Under the Listing Regulations, Part D of Schedule II of the Listing Regulations¹, requires the Nomination and Remuneration Committee (NRC) to formulate the criteria for determining qualifications, positive attributes, and criteria to evaluate independence of a director, identify persons who are qualified to become directors in accordance with the criteria laid down, and recommend to the BoD for their appointment.

1. Roles of committees (other than audit committees)

Restriction on directorships of KMP and ID

Both, the 2013 Act and the Listing Regulations prohibit a person from holding the office of a director in more than prescribed number of companies. This helps ensure that directors spend adequate time in considering the issues and efficiently discharge their functions as directors in the companies they have been appointed. The RBI guidelines were silent on the number of directorships and did not prescribe such restrictions.

The SBR has now advocated the maximum number of directorships that a KMP or ID in an NBFC in the middle or upper layer can undertake. A comparison of the provisions pertaining to maximum number of directorships under the 2013 Act, Listing Regulations and SBR framework is given in the table below:

Director/KMP	Maximum number of directorships ² as prescribed under		
	2013 Act	Listing Regulations	SBR Framework
Executive directors (including Whole-Time Director (WTD))	20 companies in total (10 public companies)	Seven listed entities. ID in not more than seven listed entities. If person is a MD ³ /WTD, then ID in not more than three listed entities.	Executive director cannot hold any office (including directorship) in any other NBFC-ML or NBFC-UL ⁴ . However, directorship in a subsidiary of the company in which he/she is an Executive director is permitted
KMP ⁵ (excluding whole-time directors, covered above)	No restriction	No restriction	KMP cannot hold any office (including directorship) in any other NBFC-ML or NBFC-UL. ⁴ However, directorship in a subsidiary of the company in which he/she is a KMP is permitted
Independent director	20 companies in total (10 public companies)	In not more than seven listed entities	ID cannot be a director in more than three NBFCs (NBFC-ML and NBFC-UL) ⁴ at the same time

Source: KPMG in India’s analysis, 2022

2. Including alternate directorships
3. Managing Director
4. Directorship in NBFC-BL is permitted

5. Key managerial personnel in relation to a company, means the Chief Executive Officer or the managing director or the manager; the company secretary; the whole-time director; the Chief Financial Officer; such other officer, not more than one level below the directors who is in whole-time employment, designated as key managerial personnel by the BoD; and such other officer as may be prescribed.

Effective date: The above restrictions are applicable to NBFC-ML and NBFC-UL. Time of two years is provided with effect from 1 October 2022 to NBFCs to ensure compliance with these norms (i.e. amendment is applicable from 1 October 2024).

Loans to directors, senior officers, and relatives of directors

The SBR framework prescribes certain restrictions on loans to directors and senior officers. This will help bring about transparency and to strengthen the disclosures around loans and advances provided by the NBFCs to directors, senior officers, and relatives of directors,

a. Board approved policy on loans and advances to directors, senior officers, and relatives of directors (for NBFCs in the base layer)

NBFCs in the base layer are required to prepare Board approved policies on grant of loans to directors, senior officers, and relatives of directors and to entities where directors or their relatives have major shareholding. The BoD approved policy should include a threshold beyond which loans to above mentioned persons shall be reported to the BoD. Additional disclosures of loans and advances

7. The term ‘relative’ includes members of a Hindu Undivided Family, spouse, mother, father, son, son’s wife, daughter, daughter’s husband, brother, or sister

sanctioned to directors, senior officers and relatives of directors and senior officers would be required (in the format given in the next page).

b. Restrictions on loans and advances to directors and relatives of directors (for NBFCs in the middle and upper layer)

As per the SBR framework, NBFCs (ML and UL) can grant loans and advances to (subject to certain conditions):

- Their directors (including Chairman and Managing director) or relatives⁶ of directors
- Any firm in which any of their directors or their relatives are interested as a partner, manager, employee, or guarantor.
- Any company in which any of their directors, or their relatives are interested as a major shareholder⁷, director, manager, employee, or guarantor.

These loans can be granted after obtaining a sanction from BoD/Committee of Directors if the loan and the advance amount is equal to or more than INR5 crores. If the amount is less than INR5 crores, then it may be sanctioned by the appropriate authority in the NBFC under powers vested in such authority, but the matter is required to be reported to the BoD.

8. A director or his/her relatives would be deemed to be interested in a company being a subsidiary or holding company if he/she is a major shareholder or is in control of the respective holding or subsidiary company.

c. Loans and advances to senior officers⁸ (for NBFC ML and UL)

While sanctioning loans and advances to a senior officer, NBFCs in the middle and upper layer need to consider the following:

- Loans and advances sanctioned should be reported to the BoD.
- No senior officer or any committee which *inter alia* includes a senior officer as member, can sanction any credit facility to a relative of that senior officer. The next higher sanctioning authority would be empowered for sanctioning such a credit facility.

Provisions under the 2013 Act and the Listing Regulations

NBFCs are currently exempted⁹ under the provisions of the Section 185 of the 2013 Act from obtaining a special resolution for advancing loans to directors, provided the loans granted to directors are at interest rates prescribed. However, these loans need to be approved by the audit committee of the company, under the provisions of Section 177¹⁰ of the 2013 Act and under the provisions of Regulation 23(2) of the Listing Regulations.

8. The term 'Senior Officer' has the same meaning as assigned to 'Senior Management' under Section 178 of the 2013 Act. 'Senior management' means personnel of the company who are members of its core management team excluding Board of Directors comprising all members of management one level below the executive directors, including the functional heads.

9. This is because NBFCs advance loans in the ordinary course of their business.

10. Approval of audit committee is required for NBFCs which are mandated to constitute an audit committee under Section 177 of the 2013 Act.

d. Compliance by NBFCs for loans and advances to directors, senior officers, and relatives of directors

While granting loans and advances mentioned in (b) and (c) above, NBFCs should:

- Obtain declaration from borrower (NBFC-ML and UL):** The borrower is required to provide declaration of their relationship with the directors/senior officers for loans and advances aggregating to INR5 crore and above. NBFC shall recall a loan if it comes to their knowledge that the borrower has given a false declaration.
- Communicate guidelines to directors:** The SBR guidelines are required to be placed before the NBFC's BoD.
- Specific disclosure format in annual financial statements (ML, UL, and BL):** NBFCs shall disclose in their annual financial statements, aggregate amount of such sanctioned loans and advances as per the template provided below:

Particulars	Current Year	Previous Year
Directors and their relatives		
Entities associated with directors and their relatives		
Senior Officers and their relatives		

Disclosure requirements pertaining to loans to directors under Listing Regulations

In the annual report

Schedule V of the Listing Regulations requires entities that have listed their non-convertible securities on a recognised stock exchange to provide certain disclosures on related party transactions in their annual reports. These disclosures *inter alia* include the amount at the year end and the maximum amount of loans/advances/investments outstanding during the year for loans and advances in the nature of loans to firms/companies in which directors are interested by name and amount both in the holding and subsidiary companies.

In the compliance report on corporate governance

Listed entities are also required to *inter alia* disclose loans or any other form of debt advanced to promoters, promoter group, directors or KMPs or any of the entities controlled by them in their compliance report on Corporate Governance¹¹.

11. As prescribed by circular SEBI/HO/CFD/CMD-2/P/ CIR/2021/567 dated 31 May 2021

As part of related party disclosures to stock exchange

Loans to directors will form part of related party disclosures required to be submitted to the stock exchange in the format prescribed by SEBI. This disclosure is required to be made by entities that have listed their specified securities on a recognised stock exchange and by high value debt listed entities within the time prescribed.

Disclosure requirements pertaining to loans to directors under Schedule III of the 2013 Act

Currently, Division III of the Schedule III to the 2013 Act requires NBFCs to provide certain disclosures with regard to loans or advances in the nature of loans granted to promoters, directors, KMPs and related parties that are repayable on demand or without specifying any terms or period of repayment. The disclosures pertain to:

- Total amount of loan or advance in the nature of loan outstanding
- Percentage of such loans granted to the total loans or advances in the nature of loan.

Further, debts due by directors or other officers of the NBFC or any of them either severally or jointly with any other person or debts due by firms including Limited Liability Partnerships (LLPs), private companies respectively in which any director is a partner or a director or a member are required to be disclosed as a separate note to the balance sheet caption 'receivables'.

Section 186(4) of the 2013 Act also requires companies to give full particulars of loans given, investment made or guarantee given or security provided and purpose for which the loan or guarantee or security is proposed to be utilised by the recipient.

Compensation guidelines of KMP and senior management in NBFCs

The SBR required NBFCs classified in the middle and upper layer of the SBR framework to put in place a compensation policy that is approved by the BoD. This will help address issues arising out of excessive risk taking caused by misaligned compensation packages.

In this regard, RBI (vide a notification dated 29 April 2022) has issued broad guidelines for formulating compensation policies of KMP and members of senior management. As per the guidelines, the compensation policy of an NBFC should at the minimum include the following provisions:

- **Constitution of Nomination and Remuneration Committee (NRC):** NBFC-ML and NBFC-UL should constitute an NRC, which will have the constitution, powers, functions, and duties as laid down in the 2013 Act. The NRC may work in close coordination with the Risk Management Committee of the NBFC to achieve effective alignment between

compensation and risks. The NRC may also ensure 'fit and proper' status of proposed/ existing directors and that there is no conflict of interest in appointment of directors in the BoD of the NBFC.

- **Principles for fixed/variable pay structures:** The proportion of variable pay in total compensation of a director or KMP should be commensurate with the role and prudent risk-taking profile of KMPs/senior management.
- **Malus¹²/claw back¹³ provisions:** The deferred compensation to directors/KMP/members of senior management may be subject to malus/claw back arrangements in the event of subdued or negative financial performance of the company and/or the relevant line of business or employee misconduct in any year.

Effective date: These guidelines will come into effect from 1 April 2023.

12. A malus arrangement permits the NBFC to prevent vesting of all or part of the amount of a deferred remuneration. Malus arrangement does not reverse vesting after it has already occurred.

13. A clawback arrangement is a contractual agreement between the employees and the NBFC in which the employee agrees to retrain previously paid or vested remuneration to the NBFC under certain circumstances.

Provisions under the 2013 Act and the Listing regulations

Currently, under the 2013 Act, all listed companies and certain public companies are required to constitute an NRC. The NRC is required to *inter alia* ensure that remuneration of directors, KMP and senior management involves a balance between fixed and incentive pay reflecting short and long-term performance objectives appropriate to the working of the company and its goals. As per the Listing Regulations, the NRC is required to recommend to the BoD all the remuneration that is payable to senior management.

Additionally, NBFCs are required to compute managerial remuneration in accordance with the provisions of Sections 197¹⁴ and 198¹⁵ of the 2013 Act and the rules made thereunder.

14. Overall maximum managerial remuneration and managerial remuneration in case of absence or inadequacy of profits. This section is applicable to public companies.

15. Calculation of profits (for computing managerial remuneration)

Independent directors - intimation on resignation/removal

The SBR requires all NBFCs in the upper layer to report to the RBI in case any ID is removed/ resigns before completion of his/her normal tenure.

Provisions under the 2013 Act and Listing Regulations

As per Section 169 of the 2013 Act, a company may remove an ID before the expiry of his/her term, by passing an ordinary resolution in his/her first term and by passing a special resolution in his/her second term after giving him/her a reasonable opportunity of being heard.

As per the Listing Regulations the appointment, re-appointment, or removal of IDs of a listed entity would be subject to the approval of shareholders by way of special resolution.

Next Steps

Considering the systemic importance of NBFCs, there is a need to regulate the provisions pertaining to directors as they have a key role to manage and provide an oversight on all aspects of the NBFC. NBFCs would need to consider the provisions of the 2013 Act, the Listing Regulations, and the RBI regulations (including the SBR framework) while implementing these requirements.



CHAPTER 5

Capital requirements for NBFCs

This article aims to:

Provide an overview of the revised capital requirements for NBFCs under SBR.

Background

As per the current RBI guidelines, all NBFCs and HFCs are required to maintain a minimum capital ratio consisting of Tier I and Tier II capital, which shall not be less than 15 per cent of its aggregate risk weighted assets on-balance sheet and risk adjusted value of off-balance sheet items. The Tier I capital in respect of the NBFCs (except NBFC-Micro Finance Institution (NBFC-MFI) and Infrastructure Debt Fund-NBFC (IDF-NBFC)) at any point in time should not be less than 10 per cent of its aggregate risk weighted assets on-balance sheet and risk adjusted value of off-balance sheet items. NBFCs primarily engaged in lending against gold jewellery (such loans comprising 50 per cent or more of their financial assets) are required to maintain a minimum Tier I capital of 12 per cent of its aggregate risk weighted assets on-balance sheet and risk adjusted value of off-balance sheet items.

Regulatory revision

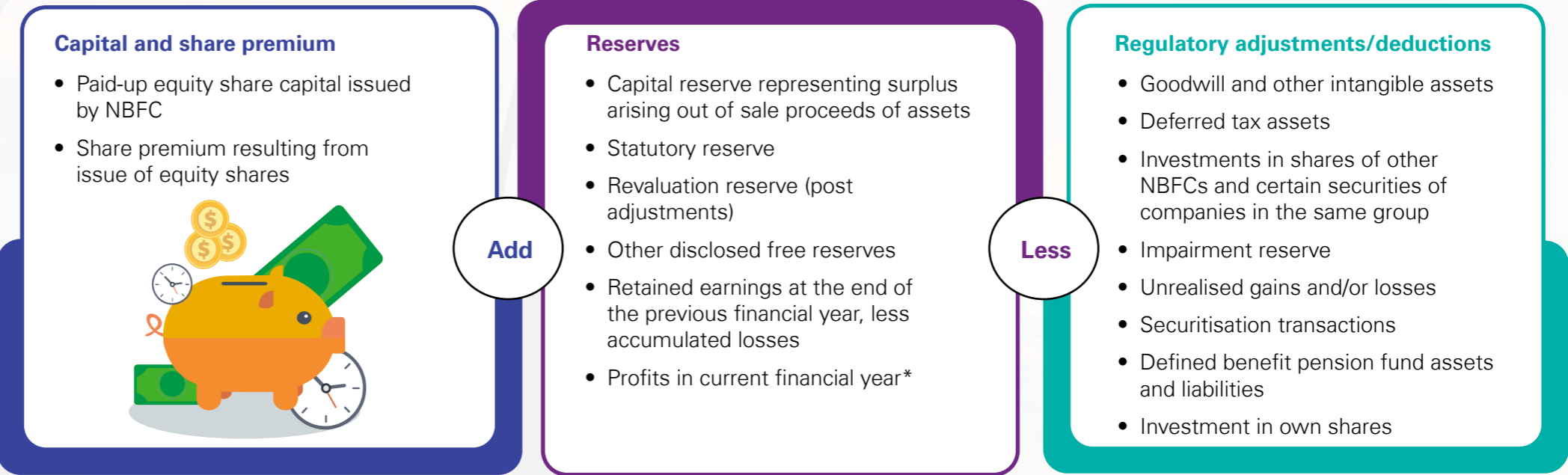
The RBI, vide the SBR framework requires all NBFCs in the upper layer (except Core Investments Companies (CICs)¹) to maintain, on an on-going basis, a Common Equity Tier 1 (CET 1) ratio of at least **nine per cent** of risk weighted assets. The new requirement is applicable from 1 October 2022. Detailed guidelines have been provided by RBI in this regard².

1. CICs identified as NBFC-UL shall continue to maintain, on an on-going basis, Adjusted Net Worth as per the Master Direction DoR (NBFC).PD.003/03.10.119/2016-17 - Core Investment Companies (Reserve Bank) Directions, 2016 dated August 25, 2016.
2. Detailed guidelines have been provided vide the RBI circular number DOR.CAP.REC.No.21/21.06.201/2022-23, Scale Based Regulation (SBR) for NBFCs: Capital requirements for Non-Banking Finance Companies – Upper Layer (NBFC-UL) dated 19 April 2022

CET 1 ratio =
$$\frac{\text{Common Equity Tier 1 Capital (CET 1 Capital) (Note 1)}}{\text{Total Risk Weighted Assets (Total RWAs) (Note 2)}}$$

Note 1: CET 1 Capital will be computed as given in figure 1 below:

Figure 1: Components of CET 1 Capital



* Profits in the current financial year may be included in this calculation on a quarterly basis if it has been audited or subject to limited review by the statutory auditors of the NBFC. The profits will be reduced by average dividend paid in the last three years. Losses in the current year will be fully deducted.

(Source: KPMG in India's analysis, 2022 read with SEBI circular Scale Based Regulation (SBR) for NBFCs: Capital requirements for Non-Banking Finance Companies – Upper Layer (NBFC-UL) dated 19 April 2022)

Note 2: The Total Risk Weighted Assets (RWAs) to be used in the computation of Tier I capital shall be the same as the total RWAs computed under the relevant Directions of the concerned NBFC category.

Other provisions pertaining to capital

Leverage: In addition to Capital Risk Adequacy Ratio (CRAR), NBFC-UL will also be subjected to leverage requirement to ensure that their growth is supported by adequate capital, among other factors. A suitable ceiling for leverage would be prescribed subsequently for these entities- further clarification on this provision is awaited from RBI.

Internal Capital Adequacy Assessment Process (ICAAP): The SBR framework introduced the ICAAP to NBFCs in the middle and upper layers, requiring them to undertake a thorough internal assessment of the needs for capital, commensurate with the risks in their business. This is on similar lines as the ICAAP prescribed for commercial banks under Pillar 2³.

The NBFCs would need to consider the following under ICAAP:

- **Board approved policy:** NBFCs need to develop a BoD approved policy (policy) for internal assessment of capital based on ICAAP. This internal assessment would be proportionate to the scale and operations of the NBFC and factor in credit risk, market risk, operational risk and all other residual risks as mentioned in the policy
- **Objective of ICAAP:** The objective of ICAAP is to ensure availability of capital to support all risks in business as also to encourage NBFCs to develop and use better internal risk management techniques for monitoring and managing their risks. This will facilitate an active dialogue between RBI and NBFCs on the assessment, monitoring and mitigation of risks.

This requirement is applicable from 1 October 2022



Next steps

- With ICAAP being applicable to NBFCs in the middle and upper layer from 1 October 2022, it is essential that these NBFCs develop a board-approved policy on internal assessment of capital considering the risks in their business. Reference may be made to the Master circular issued by RBI on Basel III Capital Regulations. As RBI would monitor the internal capital assessment process, NBFCs may consider having a dialogue with RBI while developing the policy.
- NBFCs which will be placed in the upper layer need to develop a transition plan in order to maintain CET 1 ratio at nine per cent of risk weighted assets, from the existing Tier I capital required to be maintained at 10 per cent of the NBFCs' aggregate risk weighted assets on-balance sheet and risk adjusted value of off-balance sheet items.
- NBFCs in the upper layer should watch out for further clarifications on leverage requirement from RBI.

3. Master Circular- Basel III Capital Regulations dated 1 July 2015

CHAPTER 6

Disclosure requirements for NBFCs

This article aims to:

Provide a synopsis of the additional disclosure requirements prescribed in the SBR.

Background

Disclosures in financial statements play a critical role in the financial reporting process, as they narrate the events that have taken place during the financial period and how the company has performed. Corporate disclosures are essential for users of financial statements to understand the liquidity and the financial position and performance of the company. Investors base their investment decisions basis the information they obtain from the financial statements, and regulators get more information about compliance related requirements. The RBI, being responsible for overseeing India’s credit and currency system needs to monitor the financial standing of NBFCs, and thus may require supplemental disclosures.

Current disclosure requirements for NBFCs

Currently, NBFCs are required to prepare their financial statements as per following guidelines:

- Format prescribed in Division III of Schedule III to the 2013 Act, and provide disclosures which are mandated therein.
- If an NBFC falls within the scope of the Ind AS road map, then it is also required to follow the Ind AS and provide the disclosures as per Ind AS¹.
- NBFCs that are listed on a recognised stock exchange in India are also required to comply with disclosure requirements prescribed in the SEBI Listing Regulations.

In conjunction with these requirements, RBI has from time-to-time prescribed a set of regulatory disclosures that are to be reported by the NBFCs². Recently through the SBR, RBI has advocated additional disclosures in the financial statements for financial periods ending 31 March 2023. RBI also provided clarifications on these disclosure requirements through its circular dated 19 April 2022 on ‘Disclosures in Financial Statements - Notes to Accounts of NBFCs’ (disclosure guidelines). Figure 1 depicts the provisions applicable to NBFCs for preparation and presentation of its financial statements and disclosures.

Figure 1: Disclosure requirements for NBFCs



(Source: KPMG in India’s analysis, 2022)

This article aims to provide an overview of the additional disclosure requirements prescribed by RBI as part of the SBR framework.

1. NBFCs which are not within the criteria prescribed for Ind AS road map by MCA are required to comply with the provisions of the Accounting Standards as mentioned in the Companies (Accounting Standards) Rules, 2021. For the purpose of this article, we have discussed the reporting requirements under Ind AS.

2. Since NBFCs prepare their financial statements considering various regulations (as mentioned above), the note on the ‘basis of preparation of financial statements’, which is part of notes to accounts should make an appropriate reference to Ind AS, the 2013 Act and the guidance issued by RBI.



Additional disclosure requirements prescribed by RBI

The RBI, vide the SBR disclosure guidelines has prescribed certain minimum disclosures. The RBI encourages NBFCs to provide comprehensive disclosures that would aid in the understanding of the financial position and performance of the company. NBFCs may omit line items/disclosures which are not applicable/not permitted or with no exposure/no transaction both in the reporting year and previous year. Further, disclosure requirements applicable to lower layers of NBFCs will be applicable to NBFCs in higher layers.

Table 1 below provides a snapshot of the additional disclosures required in the financial statements under SBR³

Disclosures		Existing/New disclosure requirements	Remarks
A. Disclosures applicable for annual financial statements of NBFCs in all layers (NBFC-BL, NBFC-ML and NBFC-UL)			
I. Exposures			
a. Exposure to real estate sector		This is an existing disclosure requirement.	Currently, Systemically Important non-deposit taking NBFCs and deposit taking NBFCs (SI-NBFCs) and HFCs are required to disclose their direct and indirect exposures to the real estate sector. Now, this requirement is applicable to all layers of NBFCs. There is no change in the format of reporting
b. Exposure to capital market		There is an amendment to the existing disclosure requirement by RBI	Refer Note A
c. Sectoral exposure		There is an amendment to existing disclosure requirement by RBI	Refer Note B
d. Intra-group exposure		This is a new disclosure requirement under RBI provisions	Refer Note C
e. Unhedged foreign currency exposure		This is a new disclosure requirement under RBI provisions	Disclosures of unhedged foreign currency exposure of financial instruments is currently required to be given under Ind AS 107, <i>Financial Instruments: Disclosures</i> Refer Note D

Disclosures		Existing/New disclosure requirements	Remarks
II. Related party disclosures		This is a new disclosure requirement under RBI provisions	Disclosures of related party transactions is currently required to be given under Ind AS 24, <i>Related Party Disclosures</i> . These requirements have been discussed in Chapter 2.
III. Disclosure of complaints from customers		There is an amendment to existing disclosure requirement by RBI	Refer Note E
Disclosures applicable for annual financial statements of NBFCs in the middle and upper layer (NBFC-ML and NBFC-UL)			
IV. Corporate governance disclosures		This is a new disclosure requirement under RBI provisions	Listed companies are already required to give these disclosures as per the provisions of the Listing Regulations Refer Note F
V. Breach of a covenant		This is a new disclosure requirement under RBI provisions	Refer Note G
VI. Divergence in asset classification		This is a new disclosure requirement under RBI provisions	These requirements have been discussed in Chapter 3.
Disclosures applicable for annual financial statements of NBFCs in the upper layer (NBFC-UL)			
VII. All disclosure requirements under Listing Regulations ⁴		New disclosure requirements under RBI provisions	Listed companies are required to give these disclosures as per the provisions of the Listing Regulations Refer Note H

(Source KPMG in India’s analysis, 2022 read with RBI circular dated 19 April 2022)

3. These disclosure requirements are in conjunction with the disclosures prescribed by SBR in the previous chapters
4. All NBFC-UL are required to get themselves listed within three years of identification as NBFC-UL, hence they need to comply with the provisions of the Listing Regulations

Notes

Disclosures applicable for annual financial statements of NBFCs in all layers of the SBR framework (NBFC-BL, NBFC-ML and NBFC-UL)

The disclosure requirements applicable to all layers of NBFCs is given below:

A. Exposure to capital market


Background

As per the current guidelines, Systemically Important NBFCs (SI-NBFCs) and HFCs are required to disclose their exposure to capital market in the financial statements as per the requirement of Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016 (SI-NBFC Master Directions) and Housing Finance Company (Reserve Bank) Directions, 2021 (HFC Master Directions)⁵. Currently, non-systemically important, non-deposit taking NBFCs (NBFC-ND) are not required to disclose the exposures to the capital market.

Amendment

The RBI, vide its SBR disclosure guidelines now requires NBFCs in all layers (i.e. including NBFC-NDs to provide the below mentioned additional details in the disclosure on 'exposure to the capital market'

- Underwriting commitments taken up by the NBFCs in respect of primary issue of equity instruments
- Financing to stockbrokers for margin trading (HFCs were already required to provide this disclosure)
- All exposures to Alternative Investment Funds (AIF)-in categories I, II and III.



B. Sectoral exposure

Background

Currently, SI-NBFCs (i.e. NBFCs that are systemically important) and HFCs are required to disclose sector-wise NPAs for the following sectors:

- Agriculture and allied activities
- MSME
- Corporate borrowers
- Services
- Unsecured personal loans
- Auto loans
- Other personal loans.

Additional details within each sector are not required to be given. NBFC-NDs (i.e. non-systemically, non-deposit taking NBFCs) are not required to provide such disclosures.

Amendment

As per the SBR disclosure guidelines, NBFCs in all layers of the SBR framework are now required to provide disclosures of total exposure (on and off-balance sheet), gross NPAs and percentage of gross NPAs to total exposure in the below mentioned sectors⁶:

- Agriculture and allied activities
- Industry (additional sectors are required to be disclosed within industry)
- Services (additional sectors are required to be disclosed within services)
- Personal loans (additional details are required to be disclosed within personal loans)
- Others, if any.

If exposure to a specific sub-sector/industry within each sector is more than 10 per cent of the Tier I capital of an NBFC (material sub-sector), then exposure to the material sub-sector is required to be disclosed separately within that sector. Exposures to other sub-sectors/industry within each sector which is less than 10 per cent of the Tier I capital of the NBFC are required to be aggregated and disclosed as 'others' within each sector.

5. As per the extant guidelines, disclosures pertaining to exposure to the capital market includes:

- Direct investment in equity shares, convertible bonds, convertible debentures and units of equity oriented mutual funds, the corpus of which is not exclusively invested in corporate debt (together termed as 'equity instruments')
- Advances to corporates or other entities (including individuals) against shares/bonds/debentures or other securities or on clean basis to individuals for investment in equity instruments or for meeting promoter's contribution to the equity of new companies
- Advances for any other purpose where equity instruments are fully or partly taken as primary security.

- Secured and unsecured advances to stockbrokers and guarantees issue on behalf of stockbrokers and market makers
- Bridge loans to companies against expected equity flows/issues and
- Exposure to venture capital funds.

6. Prescribed sectoral disclosures are required to be based on the Sector-wise and Industry wise Bank Credit (SIBC) return submitted by schedule commercial banks to RBI and published by RBI as 'Sectoral Deployment of Bank Credit'.

C. Intra-group exposures

Background

Currently, NBFCs or HFCs are not required to make any disclosures pertaining to intra-group exposures.

Amendment

The SBR disclosure guidelines require NBFCs in all layers of the SBR framework to provide the following disclosures with regard to intra-group exposures:

- Total amount of intra-group exposures,
- Total amount of top 20 intra-group exposures and
- Percentage of intra group exposures to total exposure of the NBFC on borrower/ customers.

These disclosures are required for the financial year being reported along with comparatives for the previous year.

D. Unhedged foreign currency exposure

Background

Currently, Ind AS 107 requires NBFCs⁷ to disclose the currency risk⁸ arising on financial instruments that are denominated in a foreign currency. This includes qualitative disclosures on the exposures to risk and how they arise, the NBFC’s objectives, policies and processes for managing the risk, and the methods used to measure the risk, and any changes to the exposure to risk or the NBFC’s objectives, policies and processes as compared to the previous year. Quantitative disclosures are also required regarding the NBFC’s exposure to the currency risk at the end of the reporting period, including, a sensitivity analysis for each currency to which the NBFC has significant exposure. However, a similar disclosure requirement is not there under any of the RBI provisions.

Amendment

The RBI now requires NBFCs to disclose details of its unhedged foreign currency exposures. Further, NBFCs need to disclose their policies to manage currency induced risk.

E. Disclosure of complaints to customers

Background

Currently, SI-NBFCs (i.e. systemically important NBFCs) and HFCs are required to disclose customer complaints in their financial statements as per requirement of SI-NBFC Master Directions and HFC-Master Directions⁹.

Amendment

The SBR disclosure guidelines now require NBFCs in all layers of the SBR framework to include the certain additional disclosures with regard to customer complaints in a prescribed format. The disclosures are as follows:

- Instead of reporting the number of complaints redressed, NBFCs will now disclose the number of complaints disposed during the year (which includes the number of complaints rejected by the NBFC)
- Details of maintainable complaints¹⁰ received by the NBFC from the Office of the Ombudsman (this includes number of complaints resolved in favour of the NBFC, number of complaints resolved after passing of awards against the NBFC, and complaints resolved through conciliation/mediation/ advisories)

- Number of awards unimplemented within the stipulated time (other than those appealed)
- Top five grounds of complaints received by the NBFCs from customers.



7. NBFCs that are required to prepare their financial statements in accordance with Ind AS

8. Risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates

9. This includes number of complaints pending at the beginning of the year, number of complaints received during the year, number of complaints redressed during the year, and number of complaints pending at the end of the year.

10. Maintainable complaints refer to complaints on the grounds specifically mentioned in Integrated Ombudsman Scheme, 2021 and covered within the ambit of the Scheme.

Disclosure of maintainable complaints shall only be applicable to NBFCs which are included under The Reserve Bank - Integrated Ombudsman Scheme, 2021

Disclosures applicable for annual financial statements of NBFCs in the upper layer and middle layer (NBFC-ML and NBFC-UL)


F. Corporate governance

Background Currently, as per the provisions of the Listing Regulations, NBFCs which have listed their specified securities ¹¹ on a recognised stock exchange are required to provide corporate governance disclosures as part of their annual reports. However, these disclosures are not required for unlisted entities or for debt listed entities ¹² .	during the current and previous financial year
Amendment <ul style="list-style-type: none">As per the SBR disclosure guidelines, non-listed NBFCs should endeavor to make full disclosure in accordance with the requirement of Listing Regulations. Unlisted NBFCs at the minimum should disclose the following under the corporate governance section of the annual report:Composition of the Board<ul style="list-style-type: none">Details of change in composition of the BoD	<ul style="list-style-type: none">Reasons for resignation given by independent director, where such resignation is before completion of his/her termRelationship amongst the directors inter-seCommittees of the Board and their composition (including the terms of reference of the committee, etc.)General Body Meetings (including resolutions passed at the meetings)Details of non-compliance with requirements of the 2013 Act (reasons for non-compliances should also be provided, including for accounting and secretarial standards)Details of penalties and strictures imposed on the NBFC by RBI.

11. Specified securities are equity shares and convertible debt instruments
12. Entities that have listed their non-convertible securities on a recognised stock exchange
13. NBFCs that are required to prepare their financial statements in accordance with Ind AS

G. Breach of a covenant

Background As per Ind AS 107, NBFCs ¹³ are required to disclose specified details of defaults and breaches of loan agreement terms. Similar information is currently not required under the extant norms of RBI.	Amendment As per the SBR disclosure guidelines, NBFCs are now required to disclose all instances of breach of covenant of loans availed or debt securities issued.
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Disclosures applicable for annual financial statements of NBFCs in the upper layer (NBFC-UL)

As per the SBR framework, NBFC-UL would be mandatorily listed within three years of identification as NBFC-UL. Accordingly, upon being identified as NBFC-UL, unlisted NBFC-ULs are required to draw up a BoD approved road map for compliance with the disclosure requirements of a listed company under the Listing Regulations.

The disclosure requirements in Schedule V of the Listing Regulations on annual reports would also be applicable. As per Schedule V, the annual report will include the Management Discussion and Analysis report issued by management, the corporate governance report, other affirmations and reports by management or auditors or company secretaries, etc.

Comparatives for all disclosures

NBFCs are required to disclose comparative information in respect of the previous period for all amounts reported in the current period’s financial statements. Further, NBFCs shall include comparative information for narrative and descriptive information if it is relevant to understanding the current period’s financial statements.

Next steps

The disclosure requirements prescribed in the SBR disclosure guidelines are expected to provide greater transparency on the operations and governance of the NBFC. Some of the information required is already reported by NBFCs under the provisions of other laws and regulations. Entities may thus disclose the additional disclosures as required by SBR along with the existing disclosure requirements, and may cross reference such information, where required to ensure there is no duplication of information in the financial statements. Additionally, entities should start preparing for the data requirements for some of the new disclosures required under the SBR.



CHAPTER 7

Other key provisions applicable for NBFCs

This article aims to:

Summarise other key regulatory revisions applicable to NBFCs as part of SBR framework.



Background

The SBR framework has revised the regulatory requirements that are pervasive to the operations, functioning and governance of all NBFCs. We have discussed some of the regulatory revisions in the previous chapters. Other key revisions prescribed in the SBR which the NBFCs need to comply with are:

Regulatory revision: Ceiling on IPO funding

Applicable to: All layers

Effective date: 1 April 2022

Regulatory revision: Large Exposure Framework

Applicable to: NBFC-UL

Effective date: 1 October 2022



Regulatory revision: Implementation of 'Core Financial Services Solution' (CFSS) by NBFCs

Applicable to: NBFC-ML and NBFC-UL with 10 or more fixed-point service delivery units

Effective date: 30 September 2025 and 30 September 2024 for 70 per cent fixed point service delivery units of NBFC-UL

Quarterly progress report on implementation of CFSS to be submitted from quarter ending 31 March 2023

Regulatory revision: Compliance framework within NBFC

Applicable to: NBFC-ML and NBFC-UL

Effective date: 1 October 2022

Set BoD approved policy by 1 April 2023

Establish compliance function, including appointment of Chief Compliance Officer (CCO) by 1 October 2023

(Source: KPMG in India's analysis, 2022)

1. 'Fixed point service delivery unit' is a place of operation from where the business activity of non-banking financial intermediation is carried out by the NBFC and which is manned either by its own staff or outsourced agents. It carries uniform signage with name of the NBFC and it functions under administrative control of the NBFC. Administrative Offices and Back Offices which do not have any direct interface with customers should not be treated as a 'Fixed point service delivery unit'.

In this article, we aim to provide an overview of these provisions.

Overview of the provisions

An overview of some of the other key provisions of the SBR is given below:

I. Ceiling on IPO Funding

In conjunction with the regulatory changes under the SBR framework, RBI has now set a ceiling limit of INR1 crore per borrower for financing subscription to Initial Public Offers (IPOs), with effect from 1 April 2022. While the ceiling limits have been set by RBI, NBFCs may opt to have more conservative limits. Before this revision, NBFCs had no ceiling limits on IPO funding.

II. Implementation of 'Core Financial Services Solution' by NBFCs

In line with the requirements stated under the SBR framework NBFCs with 10 or more branches need to adopt Core Banking Solution (CBS). Detailed guidelines on implementation of CBS has been provided by RBI (in a circular issued in February 2022)

As per the circular, NBFCs in the Upper Layer (NBFC-ULs) and NBFCs in the Middle Layer (NBFC – MLs) with 10 or more 'fixed point Service Delivery Units' (SDUs)¹ as on 1 October 2022 will be mandatorily required to implement 'Core Financial Services Solution (CFSS)' akin to the CBS adopted by banks. All NBFCs in the Base Layer (NBFC-BL) and NBFC-ML and UL with fewer than 10 SDUs may consider implementation of the CFSS, though such implementation is not mandatory.

The objective of the CFSS would be to provide for seamless customer interface in digital offerings and transactions relating to products and services with anywhere/anytime facility, enable integration of NBFCs' functions, provide centralised database and accounting records, and be able to generate suitable Management Information Systems (MIS), both for internal purposes and regulatory reporting.

The timeframe for the implementation of CFSS by NBFCs would be as follows:

Category of NBFC	Timeframe for implementation
NBFC – Middle and upper layer with 10 or more 'fixed point service delivery units'	On or before 30 September 2025 NBFC-UL to ensure that the CFSS is implemented at least in 70 per cent of 'fixed point service delivery units' on or before 30 September 2024.

Quarterly progress report

The NBFCs are required to submit a quarterly progress report on implementation of the CFSS, along with various milestones as approved by the Board/Committee of the Board to the Senior Supervisory Manager (SSM) Office of RBI starting from quarter ending 31 March 2023.

III. Compliance Framework within an NBFC

The RBI as part of the overall guidelines under the SBR framework issued in October 2021 had observed that an independent compliance function and a strong compliance risk management framework are necessary to ensure an effective compliance culture in the organisation. Therefore, the governance guidelines introduced the mandatory requirement for appointment of Chief Compliance Officer (CCO) and having a Board approved policy laying down the roles and responsibilities of the CCO for NBFCs in the upper and middle layer.

NBFCs in the base layer shall continue to be governed under the existing guidelines prescribed under the Master Direction – Non-Banking Finance Company – Systemically Important Non-Deposit taking and Deposit taking Company (Reserve Bank) Directions, 2016 (SI-NBFC Master Directions) and the Master Direction - Non-Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016 (NSI-NBFC Master Directions), as applicable.

Pursuant to the SBR framework guidelines, the RBI provided a more detailed circular in April 2022 focusing on the scope and responsibilities

of the compliance function and role of CCO within NBFCs. A summary of some of the key requirements have been provided herewith.

- **Timelines:** NBFCs in the upper and middle layer shall be required to put in place a Board approved policy latest by 1 April 2023 and a Compliance Function which includes appointment of a CCO latest by 1 October 2023.
- **Role of BoD:** The primary responsibility of oversight over the Compliance function would rest with the BoD and Senior Management. The BoD are required to ensure that an appropriate compliance policy is put in place and implemented along with review and reporting timelines.
- **Role of senior management:** The senior management would be required to review the compliance risk which is the risk of legal and financial sanctions, material financial loss or loss of reputation an NBFC may suffer on account of failure to comply with laws, regulations, rules and codes of conduct applicable to its activities, and submit its detailed findings to the BoD at least once a year.
- **Compliance function:** The compliance function to be set up by the NBFCs should be commensurate to its scale of operations, corporate governance framework, risk profile and organisational structure. The scope of the compliance function will be to ensure strict observance to all statutory and regulatory requirements for the NBFC which would include standards of market conduct, managing conflict of interest, treating customers fairly and suitability of customer service. RBI also has laid down certain minimum responsibilities of the compliance function of an NBFC.
- **Compliance framework:** While setting up the Compliance framework in NBFCs, the RBI has also outlined some key pointers to be considered which include amongst others:
 - **Formulating a Board approved compliance policy** which includes aspects on the company's compliance culture and philosophy, structure and role of compliance function, role of the CCO, processes for identifying, assessing, monitoring, managing and reporting on compliance risk. This policy is required to be reviewed at least once a year.
 - The CCO and the compliance function should be given the **authority for access** of any information and communication with any staff member in order to carry out its responsibilities.
 - The CCO shall **not be allowed to do any dual roles** which bring conflict of interest to his/her primary role of compliance head. Staff in the compliance department are also required to primarily focus on compliance functions.
 - The compliance department shall be **subjected to internal audit** and compliance risk would be included in the risk assessment framework of the Internal audit function,

- **CCO:** The RBI has also prescribed certain guidelines around the appointment, removal and tenure of the CCO. The guidelines also state that the CCO is required to have the relevant experience and considered 'Fit and Proper' as per the MD & CEO certification and that he shall be a senior executive of the NBFC with direct reporting lines to the MD and CEO and/or BoD.

IV. Large exposure framework

The RBI had prescribed a Large Exposure Framework (LEF) for NBFCs in the upper layer as per the SBR framework circular dated 22 October 2021. LEF aims at addressing credit risk concentration in NBFCs by setting out how to identify large exposures, refine the criteria for grouping of connected counterparties and put in place reporting norms for large exposures.



The LEF has put in place single counterparty and group of connected counterparty limits for lending by NBFCs. The LEF limits have been summarised as below:

(as percentage of eligible capital base)

	NBFC-UL (Other than infrastructure finance company)	NBFC – UL (Infrastructure finance company)
Single Counterparty	<ul style="list-style-type: none">• 20 per cent• Additional 5 per cent with board approval• Additional 5 per cent if exposure towards infrastructure loan/investment (Single counterparty limit shall not exceed 25 per cent in any case)	<ul style="list-style-type: none">• 25 per cent• Additional 5 per cent with board approval
Group of connected counterparties	<ul style="list-style-type: none">• 25 per cent• Additional 10 per cent if exposure towards infrastructure loan/investment	<ul style="list-style-type: none">• 35 per cent

An exposure to a counterparty shall constitute both on and off-balance sheet exposures. Additionally, the current exposure ceiling limits were capped at 15 per cent for single borrower and 40 per cent in case of group borrower and therefore, the new guidelines especially with respect to group borrower limits would require NBFC-ULs to put in place an effective mechanism to bring down existing exposures to below 25 per cent in case of non-IFC companies.

Eligible capital base

Eligible capital base is the Tier 1 capital as defined in the SI-NBFC Master Directions. In addition, profits accrued during the year would be considered in Tier I capital for the purpose of LEF after making necessary adjustments as per the other guidelines applicable to NBFC-UL.

Determining group of connected counterparties

Group of connected parties has been defined within the LEF circular for NBFCs in the upper layer released in April 2022. There are two primary relationships which have been defined for identification of the connection:

- a. Control relationship
- b. Economic interdependence.

While there is detailed guidance on identification of the parties which would be covered under the group of connected parties, there are also specific exemptions for sovereign exposures and NBFC-ULs exposure to group entities (that is deducted from owned funds for calculation of Net Owned Funds (NOF)). While determining group of connected parties, RBI has also exempted an NBFC-ULs investment in the equity capital of an insurance company to the extent specifically permitted in writing by the regulator.

Under the LEF, the NBFC-ULs would need to frame a board approved policy to determine the existence of a group of connected counterparties. This policy, as well as the periodic assessment for completeness checks would be subject to supervisory checks.

Adjustments to be made to the exposures before the LEF limits are calculated

The RBI has permitted exposures to be offset with credit risk transfer instruments as permitted within the LEF guidelines. These include:

- Cash margin/caution money/security deposit against which right to set off is available, held as collateral against the advances;
- Central government guaranteed claims which attract 0 per cent risk weight for capital computation;
- State government guaranteed claims which attract 20 per cent risk weight for capital computation;
- Certain corporate bonds held in the current category and hedged by Credit Default Swap (CDS)

Breach of the LEF limits

Any breach of large exposure limits should have occurred only under exceptional conditions beyond the control of NBFC-UL, and it shall be reported to RBI (Department of Supervision, Central Office) immediately and rapidly rectified. In addition, NBFC-UL cannot undertake any further exposure (at the entity or group level, as the case may be) until the exposure is brought down within the limit.

Additional applicable reporting to RBI

RBI requires the NBFC-UL to report its large exposures (i.e. exposure values to a single counterparty or group of connected counterparties equal to or above 10 per cent of the NBFC-UL's eligible capital base) to the RBI. The LEF reporting shall cover the following exposures:

- All exposures, meeting the definition of large exposures
- All other exposures, without offsetting the credit risk transfer instruments, are equal to or above 10 percent of the NBFC-UL's eligible capital base.
- All exempted exposures with values equal to or more than 10 percent of the NBFC-UL's eligible capital base
- 10 largest exposures irrespective of the values of these exposures.

Effective date

These guidelines are applicable from 1 October 2022, with effect from which the currently applicable credit concentration norms in respect of single/group of borrowers contained in SI-NBFC Master Directions shall no longer be applicable to NBFC-UL.

Next steps

NBFCs within each of the layers of the SBR framework, should take note of the provisions applicable to them and draw up broad guidelines for implementation. This includes putting in place a board approved compliance policy, setting up a compliance function, identifying existing officers that can take up the role of a CCO or recruiting such officers, developing a plan for implementation of the CFSS, etc.



CHAPTER 8

Regulatory updates



MCA issues amendments to the Companies (Appointment and Qualifications of Directors) Rules, 2014

Rule 8 of the Companies (Appointment and Qualifications of Directors) Rules, 2014 specifies that every person who has been appointed to hold an office of a director is required to furnish to the company a consent in writing to act as such, on or before the appointment, in Form DIR-2. Rule 10 of the said Rules explains provisions with respect to the allotment of a Director Identification Number (DIN). Additionally Rule 6 mentions the compliances required by a person who is eligible and willing to be appointed as an independent director of a company.

On 1 June 2022, the Ministry of Corporate Affairs (MCA) issued the Companies (Appointment and Qualifications of Directors) Amendment Rules, 2022, inserting new provisos to Rule 8 and Rule 10(1) respectively. As per the amendments, if the person seeking appointment as a director or an independent director is a national of a country which shares land border with India, then a necessary security clearance from the Ministry of Home Affairs, Government of India would also be attached along with the consent. The Rules also clarify that no application filed by such person for allotment of DIN would be generated unless the mentioned security clearance has been attached

along with the application. The consequent amendments to Form DIR-2 has also been issued.

On 10 June 2022, MCA amended Rule 6, inserting a new sub-rule Rule 6(5), which provides that any individual whose name has been removed from the databank of independent directors requirement to be maintained in accordance with the Companies (Creation and Maintenance of Databank of Independent Directors) Rules, 2019 may apply for restoration of his/her name on payment of the prescribed fees, subject to the following conditions:

- The name shall be shown in a separate restored category for a period of one year from the date of restoration within which, the person shall be required to pass the online proficiency self-assessment test and thereafter his/her name shall be included in the databank, and
- In case the person fails to pass the online proficiency self-assessment test within one year from the date of restoration, his/her name shall be removed from the data bank, and he/she shall be required to apply afresh for inclusion of his/her name in the databank.

Effective date: The amendments to Rule 8, Rule 10 and DIR-2 is applicable from 1 June 2022 and amendments to Rule 6 are applicable from 10 June 2022.

(Source: MCA notification no. G.S.R 410 (E) dated 1 June 2022 and G.S.R 439 (E) dated 10 June 2022)

Companies (Removal of Name of Companies from the Register of Companies) Amendment Rules, 2022

Rule 4 of the Companies (Removal of Name of Companies from the Register of Companies) Rules, 2016, specifies that a company in order to remove its name from the register of companies, must file an application to the Registrar of Companies (RoC) in Form No. STK-2 in accordance with section 248(2)¹ of the Companies Act, 2013 (2013 Act).

On 9 June 2022, MCA issued the Companies (Removal of Names of Companies from the Register of Companies) Amendment Rules, 2022, inserting a new sub-rule Rule 4(4) which provides that:

- If the RoC on examination of the application made in Form No. STK-2, finds it necessary to call for further information or finds the application defective or incomplete in any respect, he/she shall inform the applicant to remove such defects and re-submit the application within 15 days from the date of such information.
- After the company has re-submitted the application, if the RoC finds that it is still defective or incomplete in any respect, he/she shall give further time of 15 days to remove such defects or complete the application.

The Rules have also issued the revised formats of Form No. STK-1, STK-5 and STK-5A respectively.

Effective date: The amendments are applicable from 9 June 2022.

(Source: MCA notification no. G.S.R. 436 (E) dated 9 June 2022, The Companies (Removal of Names of Companies from the Register of Companies) Amendments Rules, 2022)



1. Section 248(2) of the 2013 Act states that a company may, after extinguishing all its liabilities, by a special resolution or consent of 75 per cent members in terms of paid-up share capital, file an application in the prescribed manner to RoC for removing the name of the company from the RoC.

MCA issues report of the Insolvency Law Committee

The Insolvency Law Committee (the committee) was formed to make recommendations to the Government on issues arising in the implementation of the Insolvency and Bankruptcy Code, 2016 (the Code), as well as on the recommendations received from various stakeholders.

With an aim to strengthen the insolvency framework, the committee issued its fifth report to provide recommendations in respect of the Corporate Insolvency Resolution Process (CIRP) and liquidation processes. Some of the key recommendations proposed include:

- **Mandating reliance on Information Utilities (IUs) for certain Financial Creditors:** An application for initiating a CIRP under Sections 7, 9 and 10 of the Code depends largely on the evidence of default committed by a corporate debtor. In order to prove default, financial and operational creditors are allowed to rely on various kinds of documents. In order to streamline the CIRP admission process and reduce delays, the committee decided that financial creditors that are financial institutions, and such other financial creditors as may be prescribed by the Central Government, should be required to submit only IU authenticated records to establish default for the purposes of admission of a Section 7 application. In cases,

where such IU authenticated records are not available, and for all other financial creditors, current options of relying on different documents for establishing default may remain available.

- **Curbing submission of unsolicited resolution plan and revision of resolution plans:** During the CIRP, the resolution professional is required to publish an invitation for Expression of Interests (Eols) calling prospective resolution applicants to submit their Eols. After the Eols are submitted, the resolution professional issues a Request for Resolution Plan (RFRP) which provides the deadline for submitting the resolution plan(s). However, it was observed that on certain occasions, additional resolution plans are submitted after the deadline prescribed in the RFRP. Thus, the committee decided that the regulations should lay down a mechanism for reviewing late submissions of (or revisions to) resolution plans.
- **Timeline for approval or rejection of resolution plan:** The approval of a resolution plan by the adjudicating authority is the last step in the CIRP. However, the committee noted that there are significant delays in the approval or rejection of resolution plans by the adjudicating authority. Thus, it has been proposed that amendments should be made to Section 31 of the Code to provide that the

adjudicating authority has to approve or reject a resolution plan within 30 days of receiving it. Further, where the adjudicating authority has not passed an order of either approving or rejecting a resolution plan within such 30-day time-period, it may be required to record reasons in writing for the same.

- **Mandatory stakeholder consultation by the liquidator:** Section 35(2) of the Code currently empowers a liquidator to consult stakeholders. It was brought to the committee's notice that conducting such consultation may be made mandatory to ensure a comprehensive oversight over the liquidator. Accordingly, the committee concluded that Section 35(2) may be suitably amended to provide that a liquidator must mandatorily consult with the Stakeholders Consultation Committee (SCC) so as to ensure that the SCC is able to provide commercial inputs on the functions of the liquidator as well as conduct an oversight over the liquidator.
- **Contribution by secured creditors:** During liquidation proceedings, a secured creditor has an option to realise its security interest under Section 52, rather than relinquishing it to the liquidation estate for distribution in terms of Section 53(1) of the Code. Where a secured creditor realises their security interest, an amount pertaining to CIRP costs is required

to be deducted from the proceeds of the realisation. Accordingly, it was suggested to the committee that Section 52 should be amended to require secured creditors who choose to realise their security interest outside the liquidation process to contribute towards workmen's dues and repay the liquidator for any expenses incurred for preserving and protecting their security interest. Thereby, the committee has proposed that in case of such creditors, the amount payable towards the workmen's dues as well as the expenses incurred for preserving and protecting the security interest shall be deducted from the proceeds of such realisation.

(Source: Report of the Insolvency Law Committee, May 2022)

MCA issued amendments to NFRA Rules

Rule 13 of the National Financial Reporting Authority (NFRA) Rules, 2018 stated that if a company or any officer of a company or an auditor or any other person contravenes any of the provisions of these Rules, the company and every officer of the company who is in default, or the auditor or such other person shall be punishable as per the provisions of section 450² of the 2013 Act.

On 17 June 2022, MCA issued the NFRA Amendment Rules, 2022. The amended Rules substituted Rule 13 to state that anyone who contravenes any of the provisions of these Rules, shall be punishable with a **fine not exceeding INR5,000**, and where the contravention is a continuing one, with a **further fine not exceeding INR500** for every day after the first day during which the contravention continues.

Effective date: The amendments are applicable from 17 June 2022.

(Source: MCA notification no. G.S.R. 456 (E), NFRA Amendment Rules, 2022 dated 17 June 2022)

Extension of facility for conducting Annual and other meetings of unitholders of REITs and InvITs through Video Conferencing (VC) or Other Audio-Visual means (OAVM)

Recently, MCA, vide circular dated 5 May 2022 had extended the facility of holding Annual General Meeting (AGM) and Extraordinary General

Meetings (EGMs) through VC/OAVM till 31 December 2022. In line with this, the Securities and Exchange Board of India (SEBI), had also been receiving several representations from the stakeholders of Real Estate Investment Trusts (REITs) and Infrastructure Investment Trusts (InvITs) regarding the extension of aforesaid facilities.

Accordingly, SEBI, through its circular dated 3 June 2022 has extended the facility for conducting annual meeting and other meetings of unitholders of REITs and InvITs through VC/OAVM till **31 December 2022** (Earlier: 30 June 2022).

(Source: SEBI circular no. SEBI/HO/DDHS/DDHS_Div2/P/ CIR/2022/079 dated 3 June 2022)

SEBI issues a consultation paper on introducing a framework for schemes of arrangement for entities that have listed only debt securities/Non-Convertible Redeemable Preference Shares (NCRPS)

Chapter XV of the 2013 Act deals with compromises, arrangements and amalgamations by any entity, desirous of entering into a compromise or arrangement with its members or creditors. Currently, for schemes of arrangement involving merger, amalgamation, etc., certain safeguards are available in the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (Listing Regulations) to protect the interest of investors of the entities with listed specified securities (equity shares and convertible

securities). However, no separate framework is prescribed for entities with only listed debt securities/NCRPS under SEBI (Issue and listing of Non-Convertible Securities) Regulations, 2021 (NCS Regulations).

Considering this, SEBI issued a consultation paper to include specific provision in the Listing Regulations, with regard to the schemes of arrangement under Chapter XV of the 2013 Act for entities that have listed only debt securities/ NCRPS.

Some of the key proposals provided by the consultation paper are:

- **No-Objection Letter:** Listed entity to file a draft scheme of arrangement with stock exchange(s) for obtaining a No-Objection Letter (NOL). The stock exchange(s) would in turn, forward the draft scheme received from the listed entity along with NOL to SEBI. SEBI should provide comments on the draft scheme to the stock exchange(s), pursuant to which the stock exchange(s) would issue the NOL to the listed entity, incorporating the comments received from SEBI. While processing the draft scheme, SEBI may seek clarifications on the draft scheme from the listed entity, stock exchanges and also an opinion from certain experts (including practicing company secretaries, practicing chartered accountants, etc.).

- **Time for processing filed schemes:** The proposed period for processing schemes filed by entities that have listed only debt securities NCRPS and have raised money only by way of a private placement of debt securities/NCRPS is proposed to be co-terminus with the filing period of schemes filed with any Court or Tribunal. The entities that have listed debt securities/ NCRPS' by way of a public issue, however, shall comply with the stipulations as to filing and processing in a manner similar to that of schemes filed by entities with listed specified securities before any Court or Tribunal.

- **Validity of the NOL:** The validity of the NOL would be six months from the date of issuance. Upon receipt of NOL from the stock exchange(s), the listed entity must ensure that the same is submitted immediately, but not later than two working days from such receipt to the Court or Tribunal to avoid any delay.

(Source: SEBI consultation paper on introducing framework for schemes of arrangement for entities that have listed only debt securities / NCRPS dated 3 June 2022)

2. Section 450 of the 2013 Act states that if a company or any officer of a company or any other person contravenes any of the provisions of this Act or the Rules made thereunder, and for which no penalty or punishment is provided elsewhere in this Act, the company and every officer of the company who is in default or such other person shall be liable to a penalty of ten thousand rupees, and in case of continuing contravention, with a further penalty of one thousand rupees for each day after the first during which the contravention continues, subject to a maximum of two lakh rupees in case of a company and fifty thousand rupees in case of an officer who is in default or any other person.

SEBI issues revised format of security cover certificate, monitoring and revision in timelines

In terms of Regulation 54, read with regulation 56(1)(d) of the Listing Regulations, listed entities are required to disclose security cover to stock exchange(s) and debenture trustee(s), in a prescribed format. Thus, in line with the above specified amendments, SEBI, vide a circular dated 19 May 2022 has introduced the revised format of security cover certificate, monitoring, and revision in timelines. The circular would be applicable to issuers who have listed and/or propose to list non-convertible securities, securitised debt instruments, security receipts, municipal debt securities, or commercial paper to all recognised stock exchange(s) and debenture trustee(s) registered with SEBI.

The revised format has been prepared to provide a holistic picture of all the borrowings and the status of encumbrance on the assets of the listed entity.

Effective date: The provisions mentioned in Part A and B of the circular with respect to ‘revised format of the security cover’ and ‘monitoring of covenants’ would be applicable with effect from 1 October 2022. Other provisions of the circular would come into effect with an immediate effect.

(Source: SEBI circular no. SEBI/HO/MIRSD/CRADT/CIR/P/2022/67 dated 19 May 2022)

ICAI issues Technical Guide on financial statements of Non-Corporate entities

On 9 June 2022, The Institute of the Chartered Accountants of India (ICAI) through its Accounting Standards Board (ASB) has issued a Technical Guide on financial statements for Non-Corporate entities. The objective of this Technical Guide is to deal with applicability of Accounting Standards (AS) to the non-corporate entities and to prescribe format of the financial statements for the non-corporate entities. It has been clarified that Limited Liability Partnerships (LLPs) form of entities are scoped out of this Technical Guide.

Meaning of Non-Corporate entities

All business or professional entities, other than the companies incorporated under the 2013 Act and Limited Liability Partnerships incorporated under Limited Liability Partnership Act are considered to be non-corporate entities. Entities for business, commercial or other economic and social activities can be established under variety of structures and the most common structures are as follows:

- a. Sole proprietorship firms
- b. Hindu Undivided Family
- c. Partnership Firms
 - i. Registered Partnership Firms
 - ii. Unregistered Partnership Firms

- d. Association of Persons
 - i. Partnership firms not covered above
 - ii. Body of Individuals
 - iii. Resident Welfare Association
- e. Society registered under any law for the time being in force
- f. Trust (private or public) registered or unregistered under any law for the time being in force
- g. Statutory Corporations, autonomous bodies and authorities
- h. Any form of organisation that is engaged fully or partially in any business or professional activities unless their activities are fully charitable in nature.

Applicability of the technical guide

This Technical Guide is relevant for the purpose of preparation of the financial statements of the above mentioned non-corporate entities unless any formats/principles are specifically prescribed by the relevant Statute or Regulator or any Authority.

Key considerations

- **Applicability of AS:** The AS issued by ICAI as on 1 April 2020 are applicable to non-corporate entities. However, for the purpose of their applicability, entities have been classified into four levels, viz., Level I, Level II, Level III and Level IV. The criteria for entities to be classified as Level I, II, III and IV have been provided in

the Annexure 1 of the Technical Guide and applicability of AS and exemptions/relaxations to such entities are given in Annexure 2.

- **Format:** The Technical Guide highlights that in the absence of specific formats for the preparation of financial statements for non-corporate entities (such as Schedule III of the 2013 Act which is applicable for corporate entities), there is currently a diversity in presentation of financial statements by non-corporate entities. Accordingly, the format for preparation of financial statements for non-corporate entities has been prescribed in the Technical Guide. The format is largely based on format provided by Schedule III- Division I (financial statements for a company required to comply with the Companies (Accounting Standards) Rules, 2006) with certain modifications and excludes items which are not relevant for non-corporate entities such as:

- i. Share capital details
- ii. Details of ageing schedule of trade receivables and payables
- iii. Details of cost of goods sold required instead of details of cost of material consumed, purchase of stock in trade, etc.
- iv. Disclosure of ratios
- v. Additional regulatory information not applicable, etc.

(Source: ICAI Technical Guide on Financial Statements of Non-Corporate Entities, June 2022)

ICAI issued an Exposure Draft of Guidance Note on CARO 2020 (Revised 2022 Edition)

The Auditing and Assurance Standards Board (AASB) of the ICAI had issued the Guidance Note on the Companies (Auditor's Report) Order, 2020 (CARO 2020) in July 2020 to provide detailed guidance to auditors on the reporting requirements of CARO 2020.

In view of the recent amendments made in the 2013 Act (including amendments to the Schedule III), ICAI, in June 2022 has released an Exposure Draft (ED) of the Guidance Note on CARO 2020 (Revised 2022 Edition). Some of the key changes suggested include:

- **Applicability:** For evaluating applicability of the CARO 2020 to companies following IGAAP (both AS and Ind AS entities), total income would now be considered as a criteria instead of total revenue
- **Clause (iii) - Reporting on loans, investments, guarantees, securities and advances in nature of loan:** Changes in reporting format have been introduced in the disclosures relating to granting of loans and advances, regularity of repayment of the principal and interests for loans granted, etc.
- **Clause (ix) - Reporting on repayment and usage of borrowings:** With respect to loans raised by the company against pledge of securities held in its subsidiaries, associates and joint ventures, companies would now be required to disclose the carrying amount of the securities pledged in the financial statements (including cross reference to the relevant note in the financial statements)
- **Clause (xix) - Reporting on financial position:** As per the existing set of requirements, auditors, based on review of liquidity ratios of the company, were required to report on whether material uncertainty exists as on the date of the audit report. However, now instead of review of liquidity ratios, auditors would need to form an opinion based on the financial ratios disclosed by the company.

(Source: ICAI Exposure Draft of Guidance Note on CARO 2020 (Revised 2022 Edition))

IRDAI prescribes the accounting of premium, claims and related expenses on estimation basis

At present, the Insurance Regulatory and Development Authority of India (IRDAI) (Preparation of Financial Statements and Auditors Report of Insurance Companies) Regulations, 2002 provides the following guidelines for recognition of premium:

- Premium shall be recognised as an income over the contract period or the period of risk, whichever is appropriate
- Premium received in advance is the premium where the period of inception of the risk is outside the accounting period and is to be shown under current liabilities
- 'Unallocated premium' includes premium deposit and premium which has been received but for which risk has not commenced. It is to be shown under current liabilities.

IRDAI observed that while some of the reinsurers are accounting for the premium on an 'actual' basis, some others are doing so on an 'estimation' basis. The premium is accounted

on estimation basis by the reinsurers due to the following reasons:

- Lag or delay in receiving the statement of accounts from the insurer(s),
- Alignment of accounting practices with parent organisation.

Given that a significant part of the premium is being accounted on an estimation basis, IRDAI, vide circular dated 15 June 2022, has prescribed the guidelines with respect to accounting and disclosures of premium recognised on an estimation basis in the annual report. As per the prescribed guidelines, the Foreign Reinsurers Branch (FRBs)/reinsurers shall ensure that in the annual financial statements no premium is accrued/accounted on an estimate basis at least upto third quarter of each financial year. However, for the fourth quarter ending on 31 March, where the statement of accounts has not been received in time, the premium, losses and related expenses may be accounted on an estimation basis, subject to the conditions as specified by the IRDAI.

(Source: IRDAI circular no. IRDA/F&A/CIR/MISC/123/6/2022 dated 15 June 2022)

First Notes



MCA issues narrow scope amendments to Indian Accounting Standards

5 May 2022

In view of the recent amendments to IFRS, and in order to keep the Ind AS converged with IFRS1, the Ministry of Corporate Affairs (MCA) issued certain amendments to Ind AS2 vide a notification dated 23 March 2022 (2022 amendments). These amendments have been issued in the areas mentioned below:

- Ind AS 16, Property, Plant and Equipment - Accounting for proceeds before intended use
- Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets - Determining costs to fulfil a contract
- Ind AS 103, Business Combinations - Reference to the Conceptual Framework for Financial Reporting
- Annual improvements to Ind AS (2021)
 - Ind AS 101, First-time adoption of Indian Accounting Standards
 - Ind AS 109, Financial Instruments
 - Ind AS 41, Agriculture

This issue of first notes provides an overview of the 2022 amendments.



KPMG in India has scheduled a webinar on Thursday, 7 July 2022 from 4pm to 5pm to discuss key financial reporting and regulatory matters that are expected to be relevant for stakeholders for the quarter ended 30 June 2022.



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Introducing



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