NBFC Prudential Norms - Insights from Mehta & Mehta

Non-Banking Financial Companies (NBFCs) are a crucial part of India's financial system, enabling last-mile credit delivery to sectors and borrowers underserved by traditional banks. In Mehta & Mehta's recent Saturday Knowledge-Sharing Webinar, experts decoded **Prudential Norms** and **Scale-Based Regulation (SBR)** under the RBI framework.

1. Why Prudential Norms Matter

NBFCs today manage **₹48+ lakh crore** in assets, with more than 9,200 registered entities classified across different regulatory layers.

They play a **systemically important role** because:

Financial Inclusion: Provide credit to rural households, small businesses, and first-time borrowers.

Access to Public Funds: Borrow from banks, mutual funds, and issue bonds, making their stability vital.

Systemic Risk: Failure of a large NBFC can disrupt the entire financial system, as seen in past crises.

Callout:
"Prudential norms are like a seatbelt you may not notice them daily, but they save lives when the road gets bumpy."

2. Evolution of NBFC Regulation

From "One-Size-Fits-All" to Scale-Based Regulation

Earlier, NBFCs operated under a relatively **uniform framework**. With their rapid growth, RBI introduced **Scale-Based Regulation (SBR)** (effective 1 Oct 2022), classifying NBFCs into **four layers**:

Base Layer – Small NBFCs (asset size < ₹1,000 Cr), P2P lenders, Account Aggregators, NOFHCs.

Middle Layer – All deposit-taking NBFCs + large non-deposit taking NBFCs (> ₹1,000 Cr), CICs, HFCs, IDFs.

Upper Layer – Top 10 NBFCs by asset size + others flagged by RBI based on systemic risk score.

Top Layer – Remains empty unless an NBFC is identified as posing **extreme systemic risk**.

Compliance intensity increases as you move up the layers — ensuring proportional risk-based supervision

3. Core Prudential Norms (IRACP Framework)

The IRACP framework rests on **three pillars**:

a) Income Recognition

Recognize income only when **actually realized** (NPAs require reversal of unrealized interest).

Dividend recognized post-AGM declaration; interest on bonds accrues only if payments are regular.

b) Asset Classification

Standard, Substandard, Doubtful, Loss categories based on repayment status.

NPA Norms are being tightened from 180 → 150 → 120 → 90 days overdue (phased till FY26).

Special Mention Accounts (SMA-0/1/2):

SMA-0: Early warning (up to 30 days overdue)

SMA-1: Moderate stress (31–60 days)

SMA-2: High risk (61–90 days, close to NPA)

c) Provisioning Requirements

Set aside **15%–100%** based on asset classification.

0.4% buffer even for standard assets – ensuring financial strength against potential losses.

4. Capital Adequacy & Leverage

Minimum CRAR: 15% for NBFCs (Base Layer and above).

Leverage Ratio: Max 7x (Base Layer) – prevents over-borrowing.

Tier 1 Capital: Core equity capital + retained earnings (excludes intangibles & unrealized gains).

Why It Matters:
Rating agencies, lenders, and investors track these ratios to assess solvency and borrowing capacity.

5. Strengthened Governance & Disclosures

Upper Layer NBFCs face **stricter requirements**:

Risk Management Committee: Mandatory for large NBFCs.

Auditor Rotation & Enhanced Disclosures: Ensuring independence and transparency.

Real-Time Reporting to RBI: Including **weekly SMA-0 default reporting**.

Insight:
Finance and compliance teams must work hand-in-hand approvals, board policies, and committee notings cannot be siloed.

6. Key Questions & Insights from Participants

CRR/ESOP Reserves: Clarified treatment for CRAR calculation.

Collateral Valuation: Must be done periodically (annually or more frequently for liquid securities).

Securitization Risk Weights: Explained treatment under CRAR computation.

NOF Breach: Does not automatically cancel license, but triggers regulatory scrutiny.

Dividend Declaration: Tied to maintaining acceptable debt-equity and CRAR levels.

Conclusion

Prudential norms are **not just compliance checklists** they are **risk shields** for NBFCs and the financial system.

To access the webinar recording and other resources, visit the YouTube channel: *"Decoding Corporate Laws with Mehta & Mehta"*