RBI UPDATES

1. Multiple NBFCs in a Group: Classification in Middle Layer

On **October 11, 2022**, RBI vide Notification No. **DOR.CRE.REC.No.78/03.10.001/2022-23**, issued a notification on Multiple NBFCs in a Group: Classification in Middle Layer.

This Guidelines for classification shall be effective from October 01, 2022.

The Notification refers para 1 of the Annex to the Circular on "Scale Based Regulation (SBR): A Revised Regulatory Framework for NBFCs" issued on October 22, 2021 delineating the four-layered regulatory structure for NBFCs under Scale Based Regulatory Framework. The details of NBFCs populating various layers are as below:

Base Layer: The Base Layer shall comprise of (a) non-deposit taking NBFCs below the asset size of ₹1000 crore and (b) NBFCs undertaking the following activities- (i) NBFC-Peer to Peer Lending Platform (NBFC-P2P), (ii) NBFC-Account Aggregator (NBFC-AA), (iii) Non-Operative Financial Holding Company (NOFHC) and (iv) NBFCs not availing public funds and not having any customer interface.

Middle Layer: The Middle Layer shall consist of (a) all deposit taking NBFCs (NBFC-Ds), irrespective of asset size, (b) non-deposit taking NBFCs with asset size of ₹1000 crore and above and (c) NBFCs undertaking the following activities (i) Standalone Primary Dealers (SPDs), (ii) Infrastructure Debt Fund - Non-Banking Financial Companies (IDF-NBFCs), (iii) Core Investment Companies (CICs), (iv) Housing Finance Companies (HFCs) and (v) Infrastructure Finance Companies (NBFC-IFCs).

Upper Layer: The Upper Layer shall comprise of those NBFCs which are specifically identified by the Reserve Bank as warranting enhanced regulatory requirement based on a set of parameters and scoring methodology as provided in the Appendix to the said circular. The top ten eligible NBFCs in terms of their asset size shall always reside in the upper layer, irrespective of any other factor.

Top Layer: The Top Layer will ideally remain empty. This layer can get populated if the Reserve Bank is of the opinion that there is a substantial increase in the potential systemic risk from specific NBFCs in the Upper Layer. Such NBFCs shall move to the Top Layer from the Upper Layer.

Categorization of NBFCs carrying out a specific activity As the regulatory structure envisages scale based as well as activity-based regulation, the following prescriptions shall apply in respect of the NBFCs

a. NBFC-P2P, NBFC-AA, NOFHC and NBFCs without public funds and customer interface will always remain in the **Base Layer** of the regulatory structure.
b. NBFC-D, CIC, IFC and HFC will be included in Middle Layer or the Upper Layer (and not in the Base layer), as the case may be. SPD and IDF-NBFC will always remain in the **Middle Layer**.

c. The remaining NBFCs, viz., Investment and Credit Companies (NBFC-ICC), Micro Finance Institution (NBFC-MFI), NBFC-Factors and Mortgage Guarantee Companies (NBFC-MGC) could lie in **any of the layers** of the regulatory structure depending on the parameters of the scale based regulatory framework.
d. Government-owned NBFCs shall be placed in the **Base Layer or Middle Layer,** as the case may be. They will not be placed in the Upper Layer till further notice.

Para 16 of the Master Direction - NBFC- Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions 2016 reads on Multiple Bank as follows:

Multiple NBFCs

Applicable NBFCs that are part of a corporate group or are floated by a common set of promoters shall not be viewed on a standalone basis. The total assets of the NBFCs in a group including deposit-taking NBFCs, if any, shall be aggregated to determine if such consolidation falls within the asset sizes of the two categories i.e., those with asset size of below ₹500 crores and those with asset size of ₹500 crore and above. Regulations as applicable to the two categories shall be applicable to each of the non-deposit-taking NBFCs within the group. For this purpose, Statutory Auditors are required to certify the asset size of all the NBFCs in the Group. However, NBFC-D, within the group, if any, shall be governed under the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Direction, 2016, and Prudential Norms and other Directions as applicable to deposit-taking NBFCs

In line with the existing policy on the consolidation of assets of the NBFCs in a Group, the total assets of **all the NBFCs in a Group** shall be consolidated to determine the threshold for their classification in the Middle Layer.

If the consolidated asset size of the Group is ₹1000 crore and above, then each Investment and Credit Company (NBFC-ICC), Micro Finance Institution (NBFC-MFI), NBFC-Factor and Mortgage Guarantee Company (NBFC-MGC) lying in the Group shall be classified as an NBFC in the **Middle Layer** and consequently, regulations as applicable to the Middle Layer shall be applicable to them.

The Statutory Auditors are required to certify the asset size (as on March 31) of all the NBFCs in the Group every year. The certificate shall be furnished to the Department of Supervision of the Reserve Bank under whose jurisdiction the NBFCs are registered.

Provisions contained in this circular will not be applicable for classifying an NBFC in the Upper Layer.

The link for Notification is mentioned below:
https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=12400&Mode=0

2. RBI Bulletin- October 2022

On **October 17, 2022,** RBI vide Press Release No. **RBI/2022-23/1055** issued its monthly bulletin for the month of October 2022. The Bulletin includes one Speech, five Articles, and Current Statistics.

Five Articles includes on the following topics:

1. State of the Economy
2. Estimation of Green GDP for India
3. 'Bigtechs' in the Financial Domain: Balancing Competition and Stability
4. Market Returns and Flows to Debt Mutual Funds
5. Financial Liabilities of Household Sector in India – An Assessment

A Speech on "Fintech as a Force Multiplier"- By Mr. Shaktikanta Das

The link for the Press Release is mentioned below:
https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=54553

3. Keynote address- Internationalization of the Rupee: Is it time to shift gears?

On **October 20, 2022**, Keynote address was delivered by Shri T Rabi Sankar, Deputy Governor, Reserve Bank of India at the Annual Day event of the Foreign Exchange Dealers Association of India (FEDAI at Mumbai.

The synopsis of the talk on the "Case for Rupee as an international currency" is as below

An international currency is one that is freely available to non-residents, essentially to settle cross-border transactions. It is an expression of external credibility in the currency as well as in the economy. All truly international currencies belong to large, advanced economies. Their use for international transactions confers substantial economic privileges to the host countries. In the case of the Dollar, the 'exorbitant' privileges include immunity from BoP crises as the USA can pay for its external deficits with its own currency. The dominance of its financial institutions, markets and policies in the global economy, the protection for its businesses from currency risk, the seigniorage that accrues to it, all of these flow from its status as the preeminent reserve currency.

Clearly, one or only a few countries can enjoy such privileges at any given point of time in history. And the preconditions - size of the economy and a dominant share of global GDP, globally dominant businesses, extraordinary military capabilities etc. limit the prospects of owning an international currency to any but the largest few economies. If that is the case, why am I talking of internationalisation of the Rupee? I would like to clarify this point by drawing a distinction between the status of 'Rupee as an international currency' and the process of 'internationalisation' of the Rupee. Rupee as an international currency, with all its attendant privileges that we saw USD enjoys, is a state that lies well into the future. It is not achievable by financial regulation alone, as the preconditions we listed for dollar dominance clearly illustrate.

Therefore, the status of Rupee as an international currency is not what we are discussing here today.

But we can make tangible progress towards internationalisation of the Rupee. This is a process that involves increasing use of the Rupee in cross-border transactions. Broadly, the process involves promoting Rupee for import and export trade and then other current account transactions followed by its use in capital account transactions. These are all transactions between residents in India and non-residents. Use of Rupee for transactions between non-residents would be a decisive vote of confidence in Rupee's internationalization, but that is a step that belongs to the final stages of Rupee internationalization, and not a priority at this stage.

Why do I think the internationalization of the Rupee is a desirable objective of public policy?

Some of the advantages are fairly obvious, as explained below:

i. Use of the Rupee in cross-border transactions mitigates currency risk for Indian business. Protection from currency volatility not only reduces cost of doing business, it also enables better growth of the business, improving the chances for Indian business to grow globally.
ii. It reduces the need for holding foreign exchange reserves. While reserves help manage exchange rate volatility and project external stability, they impose a cost on the economy. For example, there is a general agreement that India's reserves are borrowed funds. Banks and corporate incur external debt at market rates which are then invested in Government securities issued by advanced economies (AEs). The rate at which external debt is incurred is substantially higher than the return on reserves. Assuming an interest differential of 2%, on a Reserve base of say USD 600 billion, the cost of reserves would work out to USD 12 billion, annually. This cost represents a transfer of income from India to AEs. Reducing the requirement of reserves would save some of this this loss of income.
iii. Reducing dependence on foreign currency makes India less vulnerable to external shocks. For example, during phases of monetary tightening in US and strengthening dollar, excessive foreign currency liabilities of domestic business results in a de facto domestic tightening. The 'Taper Tantrum' episode in 2013 and the currency volatility experienced by most emerging market economies (EMEs) in recent months exemplify such risks. Reduced exposure to currency risk would substantially mitigate the pain of reversal of capital flows.
iv. As the use of Rupee becomes significant, the bargaining power of Indian business would improve adding weight to the Indian economy, enhancing India's global stature and respect.

How do we go about the process of internationalisation of the Rupee? We have, in fact, taken the initial steps. Enabling external commercial borrowings in Rupees (especially Masala Bonds) was one step. Though invoicing export and import in Rupees was long permitted, it was being resorted to for limited uses. The July 2022 Scheme of RBI permitting Rupee settlement of external trade created a more comprehensive framework, including the flexibility of investing surplus Rupees in Indian bond markets. We are receiving encouraging response from countries to participate in Rupee-based trading. The Asian Clearing Union is also exploring a scheme of using domestic currencies for settlement. An arrangement, bilateral or among trading blocs, which offers importers of each country the choice to pay in domestic currency is likely to be favoured by all countries, and therefore, is worth exploring.

As increased use of Rupee in cross-border transactions requires a unified global market in Rupee both in interest rates and currencies. Such unification would not only improve depth and liquidity of our markets, but they would also facilitate uniform pricing across borders. Accordingly, Reserve Bank has also been putting in place enabling conditions by way of linking the domestic Rupee interest rates and currency markets with offshore Rupee markets by enabling domestic banks to operate in the offshore markets. Concomitantly, Primary Dealers (PDs) have been allowed market making in forex markets to improve market liquidity. Further steps in this direction are enhancing transparency of global Rupee markets through a comprehensive Reporting framework. A desirable outcome would be if market-makers like banks and PDs centralize their global Rupee book in India. Among other benefits, this would improve risk management for Indian and global firms alike and enhance the global role for India's financial sector.

We have so far discussed the advantages. Let us know and consider the risks.

i. India is a capital deficient country, and hence needs foreign capital to fund its growth. If a substantial portion of its trade is in Rupee, non-residents would hold Rupee balances in India which would be used to acquire Indian assets. Large holdings of such financial assets could heighten vulnerability to external shocks, managing which would necessitate more effective policy tools.
ii. A reduced role for convertible currencies in external transactions could lead to reduced reserve accretion. At the same time, however, the need for reserves would also reduce to the extent the trade deficit is funded in Rupees.
iii. Non-resident holdings of Rupees could exacerbate pass-through of external stimulus to domestic financial markets, increasing volatility. For instance, a global risk-off phase could lead non-residents to convert their Rupee holdings and move out of India.

These risks are real, but they are unavoidable if India is to progress to be an economic superpower. Macroeconomic policy would need to measure up to such risks. Internationalisation would make domestic monetary policy more challenging but the alternative of compromising on growth by playing it safe is clearly not an optimal choice. We need to calibrate our moves to the evolving size of our economy, particularly the size of the external sector and to our appetite for risk in framing policy for external trade and capital flows. But the direction is clear.

The link for the Key Note Address is mentioned below:
https://rbi.org.in/scripts/FS_Speeches.aspx?Id=1331&fn=5

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