



Enhanced Corporate Governance compliances for NBFCs under

RBI (NBFC-Scale Based Regulations) Directions, 2023

Section 45 IA of Reserve Bank of India Act, 1934 (RBI Act) governs the functioning of NBFCs so much so that any company carrying on the activities of an NBFC has to obtain a certificate of registration issued by RBI. Sections 45JA, 45K, 45L and 45M of the RBI Act empower Reserve Bank of India to determine policies and issue directions for efficient working of NBFCs. Accordingly, RBI vide its notification dated 19th October 2023 issued Master Direction - Reserve Bank of India – NBFC (Scale Based Regulations) Directions, 2023(SBR). The SBR has superseded the Non-Banking Financial Company–Non-Systemically Important Non-Deposit taking (Reserve Bank) Directions, 2016 and Non-Banking Financial Company–Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016. SBR classifies NBFCs based on the nature of business, asset size, need for enhanced monitoring certain NBFCs and intensive monitoring of systemically risky NBFCs.

Role of KMP restricted

In terms of Regulation 97 of SBR, Key Managerial Personnel (KMP) as defined in Section 2(51) of the Companies Act, 2013 in NBFC- Middle Level (ML)/ NBFC- Upper Level (UL) shall not hold any office (including directorships) in any other NBFC- ML or NBFC UL, except that of the office of director in a subsidiary or in a NBFC-BL (Base Level). If a KMP is already holding any position otherwise than what is stated as exempted above, he or she has to demit such office within two years from 01st October 2022 i.e., on or before 30th September, 2024.

In other words, a KMP of a holding company being a NBFC-ML or NBFC-UL, can hold office of only a (non-executive) director in a subsidiary. Yet another exception for such KMP is that of holding office of a director in NBFC-BL which need not be a subsidiary.

The sub-section (3) Section 203 of the Companies Act, 2013 provides that a Whole-time Key Managerial Personnel (WKMP) can hold office in more than one company except such company being its subsidiary company at the same time. The said condition is relaxed only in the case of a Managing Director who is allowed to occupy the office of Managing Director in one other company, which need not be a subsidiary. Hence, the reference to KMP in regulation 97 of SBR has the same meaning as it is in Section 2(51) and Section 203 of the Act, as the case may be.

The expression Whole-time Key Managerial Personnel (WKMP) used in Section 203 is same as KMP defined in Section 2(51) of the Act, except that the differentiation is only to make the appointment of KMP (known as WKMP) compulsory for such select companies prescribed under Section 203(1) read with Rules 8 and 8A of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014. To reiterate a WKMP is no different from KMP defined under Section 2(51) of the Act.

The restriction that Regulation 97 of SBR, imposes is on a KMP holding office in a NBFC-UL / NBFC ML, such that such KMP shall not hold “any office” including directorships in



any other NBFC-ML/ MBFC-UL, unless that of a director in the subsidiary of NBFC or as a director in a NBFC-BL.

The office of a director permitted to be held by a KMP in NBFC-UL / NBFC-ML in a subsidiary is that of a non-executive directorship only. This could be understood by the fact that the whole-time directorship will fall within the definition of KMP.

In terms of Section 1(4)(e) of the Act, the Act will apply to a company governed by any special Act for the time being in force only to the extent of the provisions of the special act are not in consistent with the provisions of the Act. Accordingly, in respect of NBFCs, the RBI Act and any Rules, Regulations, Directions notified by RBI from time to time shall have precedence over the Act, in respect of such provisions of the Act which conflicts with the provisions of such Rules, Regulations, Directions notified by RBI.

Hence by virtue of the said provisions under Section 1(4)(e) of the Act, the blanket ban on holding of such any other office by a KMP of NBFC-ML/UL shall prevail upon the provisions of the Section 203(3) of the Act.

Thus, based on the above discussion, KMPs of NBFC- ML, NBFC-UL cannot take advantage of 203(3) of the Act. If any such positions are held by KMPs of NBFC- ML, NBFC-UL on or after 01st October, 2022, they are supposed to vacate the office of KMP held even if it were to be in a subsidiary company, on or before 30th September 2024.

Independent Directors- Conflict Avoidance and Restrictions:

In terms of Regulation 98 an Independent Director (ID) can be on the Board of only three NBFC-UL or NBFC-ML. However, this is subject to the respective NBFCs on whose Board such ID serves should verify whether such ID holding office in other two NBFCs do not conflict with its business. IDs who holds office of ID in more than three NBFC-UL or NBFC-ML have to restrict their holding of such office as aforesaid on or before 30th September, 2024. Directorships held in NBFC-BL is not counted for the said limit of three.

Compensation Policy for KMP and Senior Management (SM)

A Board approved compensation policy is mandated with guidelines for fixing the fixed and variable pay which is to be aligned with the risk profile of the KMP or SM (this term has the same meaning as defined in Companies Act, 2013). The guidelines propose a higher variable pay at higher levels of responsibility. Further, variable pay can be deferred in both cash and non-cash components as decided by the Board of Directors of NBFC. Guaranteed Bonus from now on cannot be paid to KMP or SM. KMP and SM engaged in financial control, risk management, compliance and internal audit can be compensated in a manner that is independent of the business areas they oversee. Accordingly, such personnel may have higher proportion of fixed compensation and reasonable proportion of compensation may be in the form of variable pay.

Framing of Internal Guidelines on Corporate Governance

NBFCs are required to frame their internal guidelines on corporate governance with the approval of the Board of Directors, enhancing the scope of the guidelines without



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sacrificing the spirit underlying the guidelines as specified in Chapter XI of SBR. The CG guidelines have to be published on the company's website, if any, for the information of various stakeholders.
