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**Review of Regulatory Framework for HFCs and
Harmonisation of Regulations Applicable to HFCs and
NBFCs**

INTRODUCTION

With a goal of synchronizing the regulations of Housing Finance Companies (HFCs) while considering the peculiar nature of HFCs catering to the housing sector and basis the review of the extant regulations applicable to HFCs prescribed vide Master Direction – Non-Banking Financial Company – Housing Finance Company (Reserve Bank) Directions, 2021, the Reserve Bank of India (RBI) vide its circular bearing reference number DOR.FIN.REC.No. 03.10.136/2023-24 dated 15 January 2024 (Circular) is contemplating to issue the updated regulations for HFCs alongwith the certain revised regulations applicable to Non-Banking Financial Companies (NBFCs) and accordingly Master Directions – Non-Banking Financial Company – Housing Finance Company (Reserve Bank) Directions, 2021 (HFC Master Directions), Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016 (Public Deposits Master Directions) and Master Direction – Reserve Bank of India (Non-Banking Financial Company– Scale Based Regulation) Directions, 2023 (Scale Based Regulations Master Directions) shall be modified. RBI has published these guidelines for inviting comments/inputs from the stakeholders.

The key revisions proposed to be introduced are as follows:

PART A (SECTION I): GUIDELINES REGARDING ACCEPTANCE OF PUBLIC DEPOSITS

(applicable only to HFCs holding CoR to accept/ hold deposits)

a) In exercise of powers conferred under Section 29B of National Housing Bank (NHB) Act, 1987, all deposit taking HFCs shall maintain liquid assets, on an ongoing basis, to the extent of 15% of the public deposits held by them against the existing 13%, in a phased manner:

| Timeline | Unencumbered approved securities, to be held as a % of public deposits | Total liquid assets along with unencumbered approved securities to be held as a % of public deposits |
|-------------------|--|--|
| Currently | 6.50% | 13% |
| 30 September 2024 | 8.00% | 14% |
| 31 March 2025 | 10% | 15% |

- b) For alignment of safe custody regulations (in relation to liquid assets) for HFCs with those pertaining to NBFCs, it is now stipulated that the instructions contained in paragraph 33 of Public Deposits Master Directions on Safe Custody of Liquid Assets / Collection of Interest on SLR Securities shall mutatis-mutandis be applicable to deposit taking HFCs and the existing regulations on safe custody of approved securities stipulated in paragraph 40 of HFC shall stand repealed.
- c) To ensure the availability of full asset cover, at all times, in relation to public deposits accepted by the HFCs in terms of para 42.1 of HFC Master Directions, it would be imperative that concerned HFC shall inform the NHB in case the asset cover, in relation to such asset(s) is inadequate with respect to the liability on account of public deposits.
- d) For eligibility with regards to acceptance of public deposits, the concerned HFCs shall obtain minimum investment grade credit rating at least once every year, without any exceptions, as specified in paragraph 25 of HFC Master Directions and in case the credit rating being below minimum investment grade, such HFCs shall not renew existing deposits or accept fresh deposits until an investment grade credit rating is in place.

- e) The capping on aggregate public deposits held by the respective HFCs (post compliance with all prudential norms and minimum investment grade credit rating), shall stand reduced from 3 to 1.5 times of net owned fund with effect from the date of the Circular and HFCs stocking up such deposits in excess of the updated limit shall not accept fresh public deposits or renew existing deposits till such time the aggregate quantity of public deposits is below the updated limit.
- f) With effect from the date of the Circular, the public deposits accepted or renewed by HFCs shall be repayable after a period of 12 months or more but not later than 60 months, contrary to the existing position wherein the HFCs were permitted to accept or renew public deposits repayable after a period of 12 months or more but not later than 120 months from the date of acceptance or renewal of such deposits.
- g) As the regulations pertaining to opening of branches and appointment of agents to collect deposits are not prescribed for HFCs, the Circular stipulates that, similar regulations under paragraph 30 of Public Deposits Master Directions shall mutatis-mutandis be applicable to deposit taking HFCs, and necessary notification by HFCs as mandatorily required under these instructions shall be provided to NHB.
- h) As per the Circular, it is now advised that, in consonance with the restrictions imposed on the deposit taking NBFCs under paragraph 40 of the Public Deposits Master Directions, the deposit taking HFCs shall also similarly set up internal limits (separately within the limit of direct investments) approved by the board for investments in unquoted shares of another company which is not a subsidiary company or a company in the same group of the HFC and such approved limits shall form part of aggregate limits and sub-limits for exposure to capital market for such deposit taking HFCs; the only exception here is the investment in unquoted shares by an HFC in respect of investment in the equity capital of an

insurance company upto the extent specifically permitted, in writing, by RBI.

PART A (SECTION II): OTHER INSTRUCTIONS (APPLICABLE TO HFCS AS STATED IN RELEVANT PARAGRAPHS)

To allow the HFCs shall hedge the risks arising out of their operations like in case of NBFCs and to diversify their activities into certain fee-based activities without risk participation, a review of certain existing HFC regulations has been put forth, summarised as follows:

- i) The HFCs may continue to participate in permitted currency derivatives in over-the-counter (OTC) market for hedging the inherent exposures, subject to adherence to following pertinent instructions as issued by RBI: (i) the HFCs may participate in currency futures exchanges and (ii) all non-deposit taking HFCs with asset size of INR 100 crores and above can participate in currency options exchanges. The participation by HFCs in either case shall, at all times, be subject to the guidelines issued in the matter by the Foreign Exchange Department of RBI and requisite disclosures in balance sheet compliant with the guidelines issued by SEBI.
- j) The HFCs may continue to participate in Forward Rate Agreements and Interest Rate Swaps in OTC market for hedging the inherent underlying exposures, subject to adherence to following pertinent instructions as issued by RBI: (i) participation in the designated Interest Rate Futures (IRF) exchanges recognized by SEBI, as clients, subject to adherence to instructions contained in Rupee Interest Rate Derivatives (Reserve Bank) Directions, 2019 dated 26 June 2019 (RIRD Directions) and (ii) non-deposit taking HFCs with asset size of INR 1000 crores and above are permitted to participate in the interest rate futures market permitted on recognized stock exchanges, as trading members, provided that instructions contained in the RIRD Directions have been adhered to.

- k) The HFCs are allowed to take part in credit default swap (CDS) market only as users and purchase of credit protection shall only be to hedge their credit risk on corporate bonds held by them, they shall not sell of the credit protection and not enter into short positions in the contracts pertaining to CDS. The HFCs shall be permitted to exit their CDS positions (existing) by unwinding them with the original counterparty or by assigning them in favour of buyer of the underlying bond or by assigning the contract to any other qualified participant in the market through novation (only in case of events such as winding-up or mergers/acquisitions). Further, the HFCs shall additionally also comply with the pertinent guidelines as provided in Annexure XIV of Scale Based Regulations Master Directions.
- l) Issue of Co-branded Credit Cards:
- (i) The HFCs are selectively permitted to issue co-branded credit cards with scheduled commercial banks, without sharing any risks, with prior approval of RBI, for a starting period of 2 years along with a review thereafter.
- (ii) The HFCs which fulfil the eligibility requirements and comply with the stipulations detailed in Annexure XVII of Scale Based Regulations Master Directions, are eligible to apply for issuing co-branded credit cards, provided that such HFCs, at all times, also adhere to the instructions prescribed in *Master Direction - Credit Card and Debit Card - Issuance and Conduct Directions, 2022* (to the extent applicable to such HFCs).
- m) As per the Circular, the HFCs shall conclude the respective balance sheets within 3 months from the pertaining date, and in case any HFC anticipates an extension of the date (in compliance with the provisions of Companies Act, 2013), it shall take an approval from NHB prior to approaching Registrar of Companies (RoC) for the same and upon grant of extension of time by NHB and RoC, the HFC shall submit a proforma balance sheet (unaudited) as on 31st of March of that year along with the returns due on the said date, to NHB.
- n) The Audit Committee shall ensure that information system audit is now conducted as per the periodicity prescribed in Master Direction on Information Technology Governance, Risk, Controls and Assurance Practices dated 7 November 2023, instead of the periodicity stipulated earlier in paragraph 50.1.2 of the HFC Master Directions.
- o) To compute the new owned fund (NOF), investment made by HFC in entities of the same group, either directly or indirectly, including but not limited through an alternative investment fund (AIF), shall be treated as the same, provided the funds in the AIF have come from HFC to the extent of 50% or more or where the beneficial owner (holding the power to make or influence decisions in the trust and being the recipient of benefits arising out of the activities of the trust) in the case of AIF (trust) is the HFC and 50% of the funds in the trust have come from the HFC itself.
- p) For the sole purpose of ensuring that the walkway of financial data of a customer consolidated by NBFC-Account Aggregator (AA) as defined in para 3(1)(ix) of Master Direction - Non-Banking Financial Company - Account Aggregator (Reserve Bank) Directions, 2016, is fortified/protected, authorised and seamlessly unified, it has been opted by RBI to have in place a set of core technical specifications for the participants of the AA ecosystem; accordingly, Reserve Bank Information Technology Private Limited (ReBIT) has framed certain specifications published the same on its website (www.rebit.org.in) and now the HFCs acting either as 'financial information provider' or 'financial information user' shall, at all times, adopt the technical specifications published by ReBIT.

PART B (SECTION III): GUIDELINES REGARDING ACCEPTANCE OF PUBLIC DEPOSITS (APPLICABLE ONLY TO NBFCs HOLDING COR TO ACCEPT/HOLD DEPOSITS)

- q) RBI has now advised that NBFCs shall devise a suitable system of acknowledging the receipt of duly completed form of nomination, cancellation and/or variation of the nomination under the terms of Rule 2(9) of the Banking Companies (Nomination) Rules, 1985. Such acknowledgement shall be provided to all customers regardless of the demand being made by the customers, and the NBFCs shall introduce the practice of recording on the face of the passbooks/ receipts the position regarding availment of nomination facility with the legend "nomination registered" also indicating the name of the nominee in the passbook/ receipt.
- r) It has been now decided by RBI that under Chapter V of the Public Deposits Master Directions for a non-banking financial company not being a problem 'non-banking financial company', for meeting certain critical expenses, subject to the satisfaction of the NBFC concerned about such circumstances and prior to expiry of 3 months from the date of acceptance of such deposits without any interest: (i) 'tiny deposits' may be paid prematurely to individual depositors, at the request of the depositor and (ii) in case of other public deposits, not more than 50% of amount of the principal sum of deposit or INR 5,00,000, whichever is lower, may be paid prematurely to individual depositors, at the request of the depositors.
- s) As per paragraph 17 of Public Deposits Master Directions, NBFCs were mandatorily required to inform the details of maturity of the deposit to the depositor at least 2 months prior to the date of maturity of the deposit, and RBI has now stipulated that the timelines be reduced to a period of 14 days prior to the date of maturity.

- t) In relation to paragraph 29 of Public Deposits Master Directions, it is advised by RBI as per the Circular that NBFCs may maintain the particulars of the deposits, as required under paragraph 29 of Public Deposits Master Directions, on centralized computer database, provided the authenticated details of such public deposits are provided to the respective branches, updating the information on quarterly basis every year (which shall reach the concerned branch before the 10th day of the next quarter).
- u) The provisions of paragraph 33(5) of the Public Deposits Master Directions, which dealt with NBFCs' requirement to maintain liquid assets under Section 45-IB of the RBI Act, have now been withdrawn by RBI under the said Circular, since approved securities are now being maintained only in dematerialized form.

PART B (SECTION III): OTHER INSTRUCTIONS (APPLICABLE TO NBFCs AS STATED IN RELEVANT PARAGRAPHS)

- v) RBI has further also advised that the Audit Committee of applicable NBFCs shall ensure that an Information System Audit is conducted as per the periodicity prescribed as per the IS Audit Policy (approved by the Audit Committee of the Board) which is put in place as per the provisions of paragraph 30 of the Master Direction on Information Technology Governance, Risk, Controls and Assurance Practices dated 7 November 2023, as amended from time to time.

CONCLUDING REMARKS

The intention behind the proposed guidelines appears to be conscious and significant step toward building and adopting a uniform regulatory framework as well as prudential norms for housing finance NBFCs and other NBFCs and appears to be aimed towards promoting stability and compliance within the financial ecosystem. Furthermore, on adoption of the regulatory framework the HFCs achieve a go ahead from RBI to hedge the risks ascending out of their operations

similar to the NBFCs and the HFCs also get permitted to diversify their activities in various fee-based functions without risk participation identical to the scenario of NBFCs, subject to compliance to regulatory norms.

While one can argue that by adopting this approach, the cost of capital for purchasing homes may further increase, the underlying intention behind the approach is to bring the deposit taking HFCs along with all non-banking finance sector players on a level playing field. With these proposals, RBI is looking to emphasize and address the need of the hour for having a balanced approach and ensuring the interests of depositors at large along with ensuring healthy and stable

financial institutions and avoid further crisis debacles involving financial companies. In addition, the customers of the HFCs may also benefit indirectly from increased financial stability and compliance with the robust standards, encouraging a more safeguarded lending environment, and this step towards uniform regulatory parameters guarantees a level playing field among different categories of NBFCs while nurturing transparency in the prudential landscape.

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