

Regulatory Dynamics of NBFC: A Comprehensive Study On Formulation and Oversight Mechanisms

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ABSTRACT

This research paper critically examines the evolving legal and regulatory landscape of Non-Banking Financial Companies (NBFCs) in India, focusing on the Reserve Bank of India's supervisory architecture, statutory powers, and the impact of the Scale-Based Regulation (SBR) Framework introduced in 2021. It analyses the systemic risks posed by NBFCs, particularly in light of high-profile defaults such as IL&FS and DHFL, which exposed regulatory arbitrage, liquidity mismatches, and governance failures. The study explores how the RBI's regulatory responses-through master directions, prudential norms, and digital lending guidelines-have sought to fill legislative and supervisory gaps. It also examines the interplay between NBFC regulation and allied legal frameworks including the Insolvency and Bankruptcy Code, Prevention of Money Laundering Act, and SEBI Regulations. Comparative perspectives from the United States, United Kingdom, and global regulatory bodies like the Financial Stability Board (FSB) and Basel Committee are used to benchmark India's approach. Employing a doctrinal methodology, the paper identifies key challenges and policy options to ensure that NBFC oversight remains both risk-sensitive and innovation-friendly, especially in the context of fintech convergence. It advocates for a harmonised, forward-looking, and technologically integrated regulatory model for India's NBFC sector.

KEYWORDS

NBFC regulation, RBI oversight, systemic risk, Scale-Based Regulation, financial supervision.

1. INTRODUCTION

A. Background of Research

Non-Banking Financial Companies (NBFCs) have become deeply embedded in India's financial ecosystem. They account for over 20% of total credit delivery, especially to MSMEs, unbanked households, and the informal sector. Their flexibility in operations, lesser compliance burden, and sectoral focus allowed them to penetrate credit-deficient regions where banks lagged behind.¹

The 2018 collapse of IL&FS triggered systemic tremors. It exposed liquidity risks, interconnected exposures, and governance failures in shadow banking. This event changed the RBI's regulatory approach. NBFCs could no longer be treated as peripheral. They became too linked, too leveraged, and too large to

¹ Reserve Bank of India, "Financial Stability Report," July 2023.

ignore. Post-IL&FS, multiple failures followed-DHFL, SREI, Reliance Capital-each revealing fresh cracks in regulatory design.²

Earlier regulatory framework treated NBFCs with a light-touch. Capital adequacy, liquidity norms, risk controls, and board accountability were minimal for non-deposit taking NBFCs. Supervisory architecture was fragmented. Data reporting was inconsistent. Off-balance-sheet exposure went unnoticed. RBI's ability to intervene was often limited by legislative constraints and reactive enforcement.³

RBI launched the Scale-Based Regulation (SBR) Framework in 2021. It aimed to tailor regulation to systemic relevance. This included liquidity coverage norms, governance codes, risk classification, and resolution preparedness. These reforms marked a shift from uniform to differentiated oversight. The emphasis moved from compliance to resilience. NBFCs in the upper layers are now subjected to governance rules akin to commercial banks.⁴

This research arises from the urgent need to study whether India's legal-regulatory ecosystem for NBFCs is sufficient, forward-looking, and harmonised with global best practices. It examines whether the RBI has adequate statutory powers to act pre-emptively. It also investigates the risks of regulatory arbitrage, supervisory delays, and governance failures. Comparative global models-US FSOC, UK FCA-PRA regime, and FSB principles-offer benchmarking standards. Recent innovations like digital lending, AI-led credit scoring, and NBFC-fintech hybrids raise new legal challenges.⁵

The research also explores overlaps between RBI norms and laws like IBC, PMLA, FEMA, SEBI LODR, and the Consumer Protection Act. These intersections raise coordination challenges. Effective NBFC regulation now requires not just legal compliance but a re-imagination of regulatory design rooted in dynamic risk and systemic foresight.⁶

B. Research Objectives

1. To critically examine the existing legal and regulatory framework governing NBFCs in India with specific focus on RBI's statutory powers, regulatory instruments, and oversight mechanisms.
2. To analyse the structural and systemic risks posed by NBFCs within the Indian financial ecosystem and evaluate the adequacy of recent reforms like the Scale-Based Regulation (SBR) Framework.
3. To conduct a comparative assessment of India's NBFC regulation with global best practices adopted in the United States, United Kingdom, and by international bodies such as the Financial Stability Board (FSB) and Basel Committee.

C. Research Questions

1. How effective is the current legislative and regulatory framework in addressing systemic risks and governance challenges in India's NBFC sector?
2. Does the RBI possess adequate supervisory, enforcement, and resolution powers to pre-emptively regulate large NBFCs that pose systemic risks?
3. In what ways can India's NBFC regulatory regime be aligned with international standards to ensure dynamic risk-based supervision and market stability?

² Ministry of Corporate Affairs, "IL&FS Board Supersession Order," Oct. 1, 2018.

³ Reserve Bank of India Act, 1934, §§ 45IA–45MA.

⁴ Reserve Bank of India, "Scale Based Regulation for NBFCs," RBI/2021-22/112, Oct. 22, 2021.

⁵ Financial Stability Board, "Policy Framework for Strengthening Oversight and Regulation of Shadow Banking," Nov. 2013.

⁶ Financial Sector Legislative Reforms Commission, "Report," Ministry of Finance, 2013.

D. Methodology

This research adopts a doctrinal legal methodology grounded in black-letter law analysis. The study is primarily based on statutory interpretation, analysis of delegated legislation, circulars, and RBI master directions related to NBFCs. It examines relevant provisions of the Reserve Bank of India Act, 1934; Companies Act, 2013; Insolvency and Bankruptcy Code, 2016; SEBI LODR Regulations; PMLA, 2002; and allied legislations. Case laws from Indian courts and comparative foreign judgments are analysed to contextualise regulatory interventions and judicial oversight. The study further relies on official reports such as the Financial Stability Reports, IMF-FSAP assessments, FSLRC recommendations, and guidelines issued by the FSB and BCBS. This qualitative analysis is supported by reviewing peer-reviewed academic commentary, policy briefs, and institutional papers to identify doctrinal gaps, regulatory lacunae, and comparative models. The research aims to synthesise legal norms with financial regulatory theory and propose a cohesive and risk-sensitive framework for NBFC oversight in India.

2. CONCEPTUAL FRAMEWORK AND CLASSIFICATION OF NBFCs

A. Definition and Legal Status of NBFCs

Non-Banking Financial Companies (NBFCs) are financial institutions that engage in functions akin to banks, yet fall outside the traditional banking structure. These entities mobilize public funds, offer credit facilities, and finance infrastructure, without holding a full-fledged banking license. Legally, they derive recognition under Section 45-I(c) of the Reserve Bank of India Act, 1934, which defines an NBFC as a company engaged in the business of loans and advances, acquisition of shares, debentures, bonds, securities, or leasing, hire-purchase, insurance or chit business, but does not include institutions whose principal business is related to agriculture, industrial activity, or purchase and sale of goods.⁷

The Companies Act, 2013, governs their incorporation, corporate governance, and compliance structure. However, they do not possess the authority to accept demand deposits, nor do they maintain a payment and settlement system like traditional banks. The Reserve Bank of India (RBI) mandates registration of NBFCs with minimum net owned funds (NOF) of ₹2 crores. Post-registration, NBFCs operate under the supervisory purview of the RBI, which grants them a Certificate of Registration under Section 45-IA of the RBI Act.⁸

Judicial interpretation has also shaped the legal contours of NBFCs. In *Sahara India Real Estate Corporation Ltd v. SEBI*, (2013) 1 SCC 1, the Supreme Court emphasized the need for stricter scrutiny of financial institutions operating outside the conventional banking net. The Court observed that entities which raise public money, whether under corporate or hybrid structures, must comply with prudential norms to prevent regulatory arbitrage.⁹

Unlike banks, NBFCs cannot issue cheques drawn on themselves and do not fall under deposit insurance cover provided by DICGC. Yet, they play a crucial role in credit intermediation, especially in the unbanked and underbanked sectors. This includes infrastructure finance companies, micro-finance institutions, investment companies and housing finance companies, among others. Recognising this, the RBI in recent years introduced a Scale-Based Regulation (SBR) regime to categorise NBFCs into Base, Middle, Upper and Top Layers based on size, activity, and systemic importance.¹⁰

⁷ Reserve Bank of India Act, 1934, § 45-I(c).

⁸ Id. § 45-IA.

⁹ *Sahara India Real Estate Corp. Ltd. v. SEBI*, (2013) 1 SCC 1.

¹⁰ Reserve Bank of India, "Scale Based Regulation for NBFCs," RBI/2021-22/112, Oct. 22, 2021.

Internationally, NBFCs resemble the broader category of non-bank financial intermediation (NBFI) as recognized by the Financial Stability Board (FSB) and Basel Committee on Banking Supervision (BCBS). India aligns its approach to global practices while addressing domestic concerns of financial stability, systemic risk, and customer protection.¹¹

B. Classification of NBFCs

The Reserve Bank of India classifies NBFCs on the basis of their liabilities, activities, and systemic significance. First, the traditional bifurcation is into Deposit-taking (NBFC-D) and Non-Deposit-taking (NBFC-ND) entities. While NBFC-Ds can accept public deposits within limits set by RBI, NBFC-NDs cannot. However, due to their interconnectedness with the financial system, large NBFC-NDs have been brought under tighter regulation. In 2006, the RBI introduced the category of NBFC-ND-SI or Systemically Important Non-Deposit Taking NBFCs for those with asset size of ₹500 crore and above.¹² Based on the nature of activities, the RBI further classifies NBFCs into multiple sub-categories. Loan Companies (NBFC-LC) primarily provide loans and advances. Investment Companies (NBFC-IC) deal in securities and investments. Infrastructure Finance Companies (NBFC-IFC) finance infrastructure projects and must deploy at least 75% of their total assets in infrastructure loans. Asset Finance Companies (NBFC-AFC) provide finance for physical assets such as automobiles, machinery, etc. Micro Finance Institutions (NBFC-MFI) lend to low-income borrowers and must maintain not less than 85% of their net assets as qualifying assets.¹³

Core Investment Companies (CICs) are another category. They primarily invest in group companies and hold not less than 90% of net assets in equity or debt instruments of group entities. A systemically important CIC (CIC-ND-SI) must have asset size over ₹100 crore and is subject to enhanced governance norms.¹⁴ In *RBI v. Peerless General Finance & Investment Co. Ltd.*, the Supreme Court emphasized that the classification of financial entities must align with the substance of their business rather than form, thereby supporting RBI's functional classification.¹⁵

Recognising the evolving complexity of the NBFC sector, RBI introduced a Scale-Based Regulation (SBR) framework in 2021. It stratifies NBFCs into four layers: Base Layer, Middle Layer, Upper Layer, and Top Layer. Entities in the Base Layer include NBFCs with lesser systemic risk. Middle Layer consists of deposit-taking NBFCs and large non-deposit-taking NBFCs. Upper Layer includes systemically significant NBFCs identified by RBI. The Top Layer remains empty, reserved for NBFCs with high risk features needing intensive regulation.¹⁶

¹¹ Financial Stability Board, "Global Monitoring Report on Non-Bank Financial Intermediation 2022" (Dec. 2022), <https://www.fsb.org/2022/12/global-monitoring-report-on-non-bank-financial-intermediation-2022/> (last visited on Oct. 2, 2025).

¹² Reserve Bank of India, "Master Direction - Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016", RBI/2015-16/376, Apr. 1, 2016.

¹³ Reserve Bank of India, "Master Directions - Non-Banking Financial Company – Micro Finance Institutions (NBFC-MFIs) Directions, 2022", RBI/2022-23/33, Mar. 14, 2022.

¹⁴ Reserve Bank of India, "Master Direction – Core Investment Companies (Reserve Bank) Directions, 2016", RBI/2015-16/370, Jan. 1, 2016.

¹⁵ Reserve Bank of India v. Peerless General Finance & Investment Co. Ltd., (1992) 2 SCC 343.

¹⁶ Reserve Bank of India, "Scale Based Regulation (SBR): A Revised Regulatory Framework for NBFCs", RBI/2021-22/112, Oct. 22, 2021.

This layered classification addresses regulatory arbitrage, aligns supervision with risk exposure, and reflects global trends under Financial Stability Board's recommendations on non-bank financial intermediation.¹⁷

C. Comparison with Banks and Shadow Banking

NBFCs differ from commercial banks in core regulatory and operational structures. Banks can accept demand deposits. NBFCs cannot. Banks offer full-service financial intermediation with payment systems, cheque facilities, and deposit insurance under DICGC. NBFCs remain outside this protective net. The Banking Regulation Act, 1949 governs banks. NBFCs operate under the RBI Act, 1934, subject to conditions laid out by Section 45-IA for registration and oversight.¹⁸

Banks are subjected to stricter CRAR norms, Statutory Liquidity Ratio (SLR), and Cash Reserve Ratio (CRR) obligations. NBFCs, though regulated, follow relaxed capital adequacy and exposure norms. Yet, systemically important NBFCs (NBFC-ND-SI) are now expected to maintain 15% CRAR.¹⁹ In *Industrial Credit and Investment Corporation of India v. Grapco Industries Ltd.*, the Supreme Court recognized the quasi-banking functions of NBFCs but upheld the regulatory distinction created by RBI between banks and NBFCs based on public interest.²⁰

Shadow banking refers to credit intermediation activities outside the regular banking system. NBFCs form a significant part of this space in India. Unlike unregulated informal lenders, NBFCs are formally incorporated, registered, and monitored by the RBI. However, their business model often mimics banks - borrow funds, lend to retail or infrastructure, and earn spread. This leads to concerns on regulatory arbitrage, asset-liability mismatches, and systemic vulnerabilities, especially after the IL&FS and DHFL collapses.²¹

Global regulators including the Financial Stability Board (FSB) define shadow banking or non-bank financial intermediation as activities involving maturity transformation, leverage, and liquidity creation outside banking channels. In India, the RBI has adopted a cautious but inclusive approach. It imposes prudential norms on large NBFCs, ensures regular reporting, and conducts risk-based supervision. However, unlike banks, NBFCs are not subjected to Basel III in full, nor to tight liquidity coverage ratios, though steps are underway to narrow this gap.²²

While banks are subject to direct monetary policy transmission, NBFCs experience indirect effects. Also, banks can access RBI's repo and reverse repo facilities for liquidity. NBFCs cannot. The RBI has tried to bridge this gap via special liquidity schemes and co-lending models. Yet, the core distinction lies in NBFCs being credit-driven while banks are both credit and deposit-driven institutions.²³

¹⁷ Financial Stability Board, "Strengthening Oversight and Regulation of Shadow Banking", FSB Reports, Nov. 2012, https://www.fsb.org/wp-content/uploads/r_121118.pdf (last visited on Oct. 2, 2025).

¹⁸ Reserve Bank of India Act, 1934, § 45-IA.

¹⁹ Reserve Bank of India, "Master Direction – Non-Banking Financial Company – Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016," RBI/2015-16/376, Apr. 1, 2016.

²⁰ *Industrial Credit and Investment Corporation of India v. Grapco Industries Ltd.*, (1999) 4 SCC 710.

²¹ Ministry of Finance, "Report of the Committee on the Development of Housing Finance Securitisation Market in India," July 2019.

²² Financial Stability Board, "Global Monitoring Report on Non-Bank Financial Intermediation 2022," Dec. 2022, <https://www.fsb.org> (last visited on Oct. 2, 2025).

²³ Reserve Bank of India, "Discussion Paper on Revised Regulatory Framework for NBFCs - A Scale-Based Approach," Jan. 2021.

3. LEGISLATIVE AND REGULATORY FRAMEWORK GOVERNING NBFCs

A. Primary Legislation

NBFCs operate under a dual legal regime. The Reserve Bank of India Act, 1934 provides for financial regulation. The Companies Act, 2013 governs incorporation and corporate conduct. The RBI Act ensures macroprudential oversight, while the Companies Act regulates internal governance. Together they form the primary legislative architecture.

The RBI derives its powers to regulate NBFCs under Chapter IIIB of the RBI Act. Section 45-IA mandates prior registration for NBFCs before undertaking business. It also prescribes net owned fund requirements. Section 45-IB and 45-IC introduce liquidity and reserve obligations. These statutory measures aim to insulate the NBFC sector from financial instability. The objective is to strike balance between credit expansion and depositor protection.²⁴

The Companies Act, 2013 regulates the form and functioning of NBFCs as corporate entities. It prescribes the minimum number of directors, board independence, audit committees, annual financial disclosures, and penal consequences for fraud or non-compliance. It mandates that all NBFCs be incorporated as companies limited by shares. The Companies Act ensures that NBFCs adhere to corporate governance principles similar to listed entities, even when they are unlisted.²⁵

A. Reserve Bank of India Act, 1934 (Chapter IIIB)

Chapter IIIB (Sections 45-IA to 45-IE) empowers the RBI to register, regulate, inspect, direct, and penalize NBFCs. Section 45-IA makes RBI registration mandatory for NBFCs with NOF of ₹2 crore. It also gives RBI discretion to reject or cancel registration. RBI can also impose terms and conditions while granting the certificate.²⁶

Section 45-IB requires maintenance of a percentage of liabilities as liquid assets. Section 45-IC mandates NBFCs to create a reserve fund, transferring 20% of net profit annually before declaring any dividend. This strengthens capital buffers. RBI has powers under Sections 45JA and 45J to issue binding directions on accounting standards, prudential norms, risk exposure, asset classification, and provisioning. Section 45L allows the RBI to inspect books and records of NBFCs.²⁷

In *Peerless General Finance and Investment Co. Ltd. v. RBI*, the Supreme Court upheld the RBI's powers to regulate NBFCs by treating them as financial institutions even if they didn't accept public deposits. The Court held that RBI's proactive oversight is essential to ensure financial soundness.²⁸

RBI has also used these powers to introduce important guidelines like the Prudential Norms Directions (2007), Fair Practices Code, and more recently, the Scale-Based Regulation Framework (2021). These instruments, though delegated legislation, derive authority from Chapter IIIB of the Act. In the aftermath of the IL&FS default, RBI enhanced its regulatory lens, tightening norms for liquidity risk management, ALM disclosures, and governance.²⁹

²⁴ Reserve Bank of India Act, 1934, § 45-IA, 45-IB, 45-IC.

²⁵ Companies Act, 2013, §§ 3, 12, 149–172.

²⁶ Id. § 45-IA.

²⁷ Id. §§ 45JA, 45J, 45L.

²⁸ *Peerless General Finance and Investment Co. Ltd. v. Reserve Bank of India*, (1992) 2 SCC 343.

²⁹ Reserve Bank of India, "Scale Based Regulation (SBR): A Revised Regulatory Framework for NBFCs," RBI/2021-22/112, Oct. 22, 2021.

B. Companies Act, 2013 (Incorporation, Governance)

NBFCs must be companies under the Companies Act, 2013. Most are private or public limited companies limited by shares. Section 3 of the Companies Act provides for incorporation of such companies. Section 12 mandates them to maintain a registered office. Sections 149 to 172 govern the composition, independence, and functioning of the board of directors. NBFCs must appoint independent directors and form audit committees under Section 177 when they fall into the prescribed thresholds.³⁰

The Companies Act also prescribes transparency through Section 134 (financial statement disclosures), Section 138 (internal audit), and Section 143 (statutory audit). Section 447 penalises fraud, and Section 248 empowers the Registrar of Companies to strike off NBFCs that default regulatory filings. These provisions prevent shell companies from misusing the NBFC label.

In *Union of India v. Deloitte Haskins and Sells LLP*, the Supreme Court emphasized that financial intermediaries like NBFCs must maintain high standards of governance and disclosure, especially in public interest. The ruling reinforced the auditor's liability and stressed directors' fiduciary obligations.³¹

NBFCs registered under the Companies Act must also comply with various SEBI regulations (if listed), IBC norms (if insolvent), and PMLA (if handling high-value transactions). The Companies Act provides the structural framework; RBI overlays regulatory depth.

C. Delegated Legislation and RBI Master Directions

RBI regulates NBFCs not only through the parent legislation but also through delegated legislation. These delegated legislations take the form of Master Directions, Notifications, Circulars, and Guidelines. They are issued under the authority granted by Chapter IIIB of the RBI Act, 1934, particularly Sections 45JA and 45L. These Master Directions consolidate earlier fragmented instructions into a unified legal instrument. They provide clarity, compliance structure, and consistent supervision to NBFCs.³²

The Master Direction on NBFC-ND-SI and NBFC-D (Reserve Bank) Directions, 2016 is a key document. It outlines prudential norms on income recognition, asset classification, provisioning, capital adequacy, and exposure limits. The Direction prescribes a minimum Capital to Risk-Weighted Assets Ratio (CRAR) of 15%, concentration norms for lending and investment exposure, and asset-liability management requirements. It also mandates quarterly returns to be filed with the RBI, ensuring real-time surveillance.³³

The RBI issued another significant document-the Master Direction – Non-Banking Financial Company – Housing Finance Company (Reserve Bank) Directions, 2021. It applies to HFCs following the transfer of their regulatory oversight from NHB to RBI. It includes additional guidelines on liquidity coverage ratio, public disclosures, governance requirements, and risk assessment systems. This change came after the Finance Act, 2019 amended the National Housing Bank Act, curbing NHB's powers and shifting regulation to RBI.³⁴

Delegated legislation also includes the Fair Practices Code introduced in 2006 and revised multiple times. It applies to all NBFCs. It directs entities to maintain transparency in interest rates, recovery methods, and grievance redressal mechanisms. It also mandates disclosures during loan sanction, EMI terms, and

³⁰ Companies Act, 2013, §§ 134, 138, 143, 447, 248.

³¹ *Union of India v. Deloitte Haskins and Sells LLP*, (2023) 4 SCC 21.

³² Reserve Bank of India Act, 1934, §§ 45JA, 45L.

³³ Reserve Bank of India, "Master Direction - NBFC-ND-SI and NBFC-D Directions," RBI/2015-16/376, Apr. 1, 2016.

³⁴ Reserve Bank of India, "Master Direction – HFC (Reserve Bank) Directions, 2021," RBI/2021-22/84, Feb. 17, 2021.

borrower obligations. In *Muthoot Finance Ltd. v. RBI*, the Court upheld RBI's delegated authority to impose such norms to prevent coercive recovery practices and protect customer rights.³⁵

The RBI's Master Direction on Know Your Customer (KYC), last updated in 2023, binds NBFCs to carry out due diligence under the PMLA, 2002. NBFCs must maintain identity and address proofs, report suspicious transactions, and comply with FATF guidelines. This aligns Indian NBFC compliance with international AML-CFT standards.³⁶

The RBI also issued Master Directions on Scale-Based Regulation (SBR) in 2021. These directions are layered. They prescribe graded norms depending on the systemic significance of the NBFC-Base, Middle, Upper, and Top layers. The stricter the layer, the heavier the compliance burden. For example, NBFCs in the Upper Layer must follow mandatory core banking solutions, governance norms, and enhanced credit risk controls. This scale-based regulation is a response to past failures like IL&FS and DHFL. It ensures that large NBFCs operate with banking-like risk management without being banks.³⁷

RBI also issues ad hoc circulars to respond to market dynamics. For instance, the circular on co-lending with banks issued in November 2020 enables NBFCs to expand their credit delivery using a risk-sharing model. Another is the circular on digital lending issued in 2022, which imposes transparency and data protection requirements on NBFCs engaged in app-based or online lending. These circulars are legally binding under RBI's delegated powers.³⁸

Such delegated legislations serve two ends-regulatory nimbleness and legal certainty. They are vital to update policy without amending statutes each time. The RBI consults stakeholders through working groups and discussion papers before issuing them. Despite being non-parliamentary instruments, courts have repeatedly held them to be valid provided they stay within the parent Act's scope. In *BSNL v. TRAI*, the Court reiterated that such subordinate legislation, when traceable to statutory power, has the force of law.³⁹

D. Statutory Powers of RBI over NBFCs

The Reserve Bank of India has wide statutory powers over NBFCs under Chapter IIIB of the RBI Act, 1934. Section 45-IA makes registration compulsory. RBI can grant, suspend or cancel the Certificate of Registration. It can impose conditions while granting it. NBFCs must maintain minimum net owned funds. If they breach guidelines or engage in prejudicial conduct, RBI can revoke the registration.⁴⁰

Section 45-IB empowers RBI to enforce liquidity obligations. It mandates maintenance of a certain portion of liabilities in approved securities. Section 45-IC requires creation of a statutory reserve fund. NBFCs must transfer 20% of net profits before dividends. RBI can penalize defaults. This ensures capital preservation and shields against financial shocks.⁴¹

Under Section 45JA, RBI can determine the policy, accounting standards, and prudential norms for NBFCs. It includes norms on provisioning, income recognition, capital adequacy, and exposure limits.

³⁵ *Muthoot Finance Ltd. v. Reserve Bank of India*, WP(C) 13225/2020 (Delhi HC).

³⁶ Reserve Bank of India, "Master Direction – Know Your Customer (KYC) Direction," RBI/DBR/2015-16/18, last updated Jan. 2, 2023.

³⁷ Reserve Bank of India, "Scale Based Regulation (SBR): Revised Regulatory Framework," RBI/2021-22/112, Oct. 22, 2021.

³⁸ Reserve Bank of India, "Guidelines on Digital Lending," RBI/2022-23/111, Sept. 2, 2022.

³⁹ *Bharat Sanchar Nigam Ltd. v. Telecom Regulatory Authority of India*, (2014) 3 SCC 222.

⁴⁰ Reserve Bank of India Act, 1934, § 45-IA.

⁴¹ Id. §§ 45-IB, 45-IC.

Section 45J gives RBI power to issue general directions in public interest. This enables dynamic regulation without amending the parent Act. Section 45L authorizes inspection of books. RBI officers can demand information, examine records, and verify solvency.⁴²

In *Reserve Bank of India v. Peerless General Finance & Investment Co. Ltd.*, the Supreme Court upheld RBI's discretion to regulate NBFCs even where their activities fell within a legal grey zone. The Court ruled that RBI's preventive regulation serves both depositor safety and monetary stability. RBI's directions under Chapter IIIB have legal force equivalent to delegated legislation.⁴³

Section 45MA provides for penal action. RBI can fine NBFCs for non-compliance or impose monetary penalties. It can also prohibit acceptance of deposits or bar specific business practices. Under Section 45MB, RBI can supersede the board of an NBFC in the interest of public or financial stability. It can appoint administrators or file for winding-up. These powers were rarely used earlier but became active post-IL&FS crisis.⁴⁴

The 2018 default by Infrastructure Leasing & Financial Services (IL&FS) was a regulatory turning point. RBI exercised its inspection powers and flagged systemic risks. This led to the government superseding the IL&FS board under Section 241 of Companies Act, and RBI imposing stricter norms under its delegated authority. Post-IL&FS, RBI enhanced powers under Section 45NC to monitor group exposure, related party transactions and leverage ratios.⁴⁵

Section 45Q grants overriding effect to Chapter IIIB over other laws. If any provision under another Act contradicts RBI directions under Chapter IIIB, the latter prevails. This ensures RBI's supremacy in regulating NBFCs. This clause was upheld in *Subrata Roy Sahara v. Union of India*, where the Court stressed the binding nature of RBI's directions on all NBFCs including hybrid corporate entities.⁴⁶

E. Other Applicable Laws

The Insolvency and Bankruptcy Code, 2016 (IBC) governs the insolvency and liquidation of financial service providers, including certain categories of NBFCs. Initially, NBFCs were excluded from the corporate insolvency resolution process (CIRP). But the Ministry of Corporate Affairs, through a notification dated November 2019, brought systemically important NBFCs (asset size ₹500 crore and above) within IBC's fold, under the Financial Service Provider Rules, 2019. The resolution of DHFL was the first case where CIRP was applied to an NBFC. The National Company Law Tribunal (NCLT) admitted DHFL's insolvency under Section 227 of the Code. The RBI acted as the appropriate financial sector regulator and appointed an administrator. The process culminated with Piramal Capital acquiring DHFL's assets. This set a precedent for regulatory coordination between RBI and the Insolvency and Bankruptcy Board of India (IBBI).⁴⁷

The Supreme Court in *Jaypee Kensington Boulevard Apartments Welfare Assn. v. NBCC (India) Ltd.*, (2021) 1 SCC 494, upheld that sectoral regulators like RBI retain jurisdiction even during insolvency. The RBI's consent is mandatory under the FSP Rules before CIRP can be initiated against an NBFC. This creates dual oversight and limits misuse of IBC against regulated financial firms.⁴⁸

⁴² Id. §§ 45JA, 45J, 45L.

⁴³ *Reserve Bank of India v. Peerless General Finance & Investment Co. Ltd.*, (1992) 2 SCC 343.

⁴⁴ Reserve Bank of India Act, 1934, §§ 45MA, 45MB.

⁴⁵ Ministry of Corporate Affairs, "Order of Supersession of IL&FS Board," Oct. 1, 2018.

⁴⁶ *Subrata Roy Sahara v. Union of India*, (2014) 8 SCC 470.

⁴⁷ Ministry of Corporate Affairs, Notification No. S.O. 4139(E), Nov. 15, 2019.

⁴⁸ *Jaypee Kensington Boulevard Apartments Welfare Assn. v. NBCC (India) Ltd.*, (2021) 1 SCC 494.

The Prevention of Money Laundering Act, 2002 (PMLA) applies to NBFCs as reporting entities. Section 2(1)(sa) of the Act includes NBFCs under the definition of “financial institutions.” They are obligated to maintain transaction records, conduct enhanced due diligence for high-risk clients, and report suspicious transactions to the Financial Intelligence Unit (FIU-IND). The RBI also enforces these norms through its KYC Master Directions. Failure to comply exposes NBFCs to penal action under Sections 12 and 13 of the Act. In *Enforcement Directorate v. M/s. Shiv Vani Oil and Gas Exploration Services Ltd.*, the Delhi High Court upheld attachment of assets of a financial firm for non-compliance with PMLA reporting obligations.⁴⁹

Listed NBFCs fall within the domain of the Securities and Exchange Board of India (SEBI). SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 mandate listed NBFCs to maintain robust corporate governance, disclose financial results quarterly, and report material events promptly. NBFCs issuing debentures are also governed by SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021. They must appoint debenture trustees, maintain security cover, and adhere to disclosure frameworks. SEBI has also prescribed stewardship codes for institutional investors, including NBFCs managing mutual fund arms or insurance-based products. Non-compliance invites penalties under Section 15HA of the SEBI Act, 1992.⁵⁰

In *SEBI v. Sahara India Real Estate Corp. Ltd.*, the Supreme Court reaffirmed that even hybrid financial entities like Sahara’s housing schemes must comply with SEBI disclosure norms if they raise funds from public or quasi-public sources. NBFCs are often structured to raise debentures or structured obligations. Hence SEBI oversight supplements RBI regulation.⁵¹

Foreign Exchange Management Act, 1999 (FEMA) governs NBFCs with foreign investments. The Consolidated FDI Policy permits 100% foreign direct investment under the automatic route in most NBFC sectors. However, such NBFCs must comply with minimum capitalisation norms and cannot engage in activities prohibited by FDI guidelines. FEMA Regulations, particularly the Foreign Exchange Management (Transfer or Issue of Security by Persons Resident Outside India) Regulations, 2017, require NBFCs with foreign shareholders to file Form FC-GPR, maintain reporting obligations and adhere to downstream investment conditions. Non-compliance results in compounding or penal actions under Sections 13 and 15 of FEMA.⁵²

The Consumer Protection Act, 2019 applies to NBFCs insofar as they offer loans, credit, or financial products to individuals. Consumers can file complaints before District, State or National Consumer Commissions for unfair trade practices, charging hidden fees, or coercive recovery. In *National Insurance Co. Ltd. v. Harsolia Motors*, the Supreme Court ruled that commercial transactions may not always fall outside consumer law if the complainant is a consumer of services and not a commercial re-seller. NBFC customers, especially in microfinance or housing loans, often qualify as consumers. RBI also requires NBFCs to put in place grievance redress mechanisms, ombudsman linkages and disclose contact details clearly on all customer documents.⁵³

NBFCs must also comply with anti-money laundering norms that emerge from FATF standards. India being a member jurisdiction, domestic financial entities including NBFCs must implement AML-CFT

⁴⁹ *Enforcement Directorate v. M/s. Shiv Vani Oil and Gas Exploration Services Ltd.*, 2019 SCC OnLine Del 7844.

⁵⁰ Securities and Exchange Board of India, SEBI (LODR) Regulations, 2015; SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021.

⁵¹ *SEBI v. Sahara India Real Estate Corp. Ltd.*, (2013) 1 SCC 1.

⁵² Reserve Bank of India, Consolidated FDI Policy, 2020; FEMA (TISPRO) Regulations, 2017.

⁵³ *National Insurance Co. Ltd. v. Harsolia Motors*, (2007) 13 SCC 306.

controls. These include appointment of Principal Officer, periodic internal audits, STR generation, and customer risk grading. RBI's Circular DNBS(PD).CC.No.336/03.10.042/2013-14 requires NBFCs to establish AML policy frameworks. Any NBFC found aiding in layering or structuring illicit transactions risks cancellation of registration and prosecution under PMLA.⁵⁴

4. Regulatory Oversight and Supervisory Mechanisms

A. RBI's Supervisory Architecture

The Department of Supervision under RBI oversees NBFCs. Earlier this role was discharged by the Department of Non-Banking Supervision (DNBS). Post-2019, RBI consolidated supervision of banks and NBFCs under a unified vertical. This move followed IL&FS default and the need to adopt integrated risk-based oversight. The supervisory framework now blends microprudential monitoring with systemic risk assessment.⁵⁵

RBI uses both onsite and offsite surveillance tools. NBFCs are required to submit statutory returns periodically. These include NBS-1, NBS-2, ALM statements, and capital adequacy reports. These are analysed using automated platforms like OSMOS. RBI classifies NBFCs into supervisory buckets based on their size, complexity, and interconnectedness. These buckets determine the frequency and intensity of inspection.⁵⁶

The supervision is guided by a CAMELS-like model: Capital adequacy, Asset quality, Management, Earnings, Liquidity, and Systems. RBI also conducts special thematic inspections, stress testing, and early warning signal (EWS) frameworks. It has powers under Sections 45L and 45MA of the RBI Act to call records, inspect books, and penalise violations.⁵⁷

A. Scale-Based Regulation (SBR) Framework (2021)

The SBR framework was introduced in October 2021 through RBI Circular RBI/2021-22/112. It aims to address proportionality in supervision. All NBFCs are classified into four layers - Base Layer, Middle Layer, Upper Layer, and Top Layer. Each layer attracts a different regulatory intensity depending on systemic footprint.⁵⁸ Base Layer includes NBFCs with lower risk. These face light-touch norms but must maintain NOF, board constitution, and minimum disclosures. Middle Layer includes deposit-taking NBFCs and large non-deposit-taking ones with asset size above ₹1,000 crore. These must follow prudential norms, board independence, risk management systems and CRAR of 15%.⁵⁹

Upper Layer consists of NBFCs specifically identified by RBI from among the top 50 NBFCs in terms of asset size. These entities face enhanced governance norms like mandatory core banking solution (CBS), appointment of Chief Compliance Officer (CCO), enhanced disclosure under Ind-AS, and robust internal audit systems. These NBFCs must follow Large Exposure Framework and declaration of systemic exposures quarterly.⁶⁰ The Top Layer remains empty for now. It is a supervisory buffer for NBFCs that may pose extreme systemic risks in future. RBI has reserved the right to move any NBFC to Top Layer if

⁵⁴ Reserve Bank of India, Circular DNBS(PD).CC.No.336/03.10.042/2013-14, Feb. 28, 2014.

⁵⁵ Reserve Bank of India, "RBI Annual Report 2019-20," Supervisory and Regulatory Functions, May 2020.

⁵⁶ Reserve Bank of India, "COSMOS Returns," <https://cosmos.rbi.org.in> (last visited on Oct. 2, 2025).

⁵⁷ Reserve Bank of India Act, 1934, §§ 45L, 45MA.

⁵⁸ Reserve Bank of India, "Scale Based Regulation (SBR): Revised Regulatory Framework," RBI/2021-22/112, Oct. 22, 2021.

⁵⁹ Id.

⁶⁰ Reserve Bank of India, "Revised Regulatory Framework for NBFCs in the Upper Layer," RBI Press Release, Jan. 2022.

it shows elevated risk despite compliance. The SBR is India's first forward-looking NBFC regulatory tool, aligning with FSB's recommendations on proportionality in non-bank supervision.⁶¹

B. Fit and Proper Criteria for Promoters and Directors

RBI mandates NBFCs to ensure promoters and directors are "fit and proper." Guidelines were formalised in the 2006 Circular DNBS(PD).CC.No.96. These criteria were later incorporated in the Master Directions. The framework requires scrutiny of integrity, track record, financial soundness, and absence of criminal background.⁶² NBFCs must obtain declarations from directors about non-disqualification under Section 164 of the Companies Act. They must also submit quarterly compliance certificates to RBI. In case of resignation, NBFCs must inform RBI within 7 days. For senior appointments like CEO or MD, RBI's prior approval may be necessary depending on the NBFC category.⁶³

The Supreme Court in *Union of India v. R. Gandhi*, highlighted that financial regulators must ensure institutional independence and integrity in quasi-judicial or financial decision-making roles. This principle applies to NBFCs where promoters play central roles in governance. Hence, fit and proper tests are crucial for investor protection and financial hygiene.⁶⁴ RBI also mandates succession planning. NBFCs must maintain a policy on onboarding of independent directors. In Upper Layer NBFCs, the appointment of independent directors must be validated by the Nomination and Remuneration Committee. These criteria ensure governance doesn't get compromised by family control or opaque board composition.⁶⁵

C. Technology-Driven Supervision and Digital Lending Guidelines

RBI has gradually adopted RegTech and SupTech solutions for real-time supervision. NBFCs must file returns through COSMOS portal. RBI is developing the Integrated Compliance Management and Tracking System (ICMTS) which will allow supervisory tracking, resolution of red flags, and standardisation of compliance filings.⁶⁶ NBFCs also participate in the Central Repository of Information on Large Credits (CRILC). Any borrower with exposure above ₹5 crore must be reported. This helps detect evergreening, fraud, and exposure concentration. Data from CRILC, FIU-IND, and CERSAI is integrated into RBI's surveillance framework.⁶⁷

In 2022, RBI released the Guidelines on Digital Lending through apps and platforms. These guidelines were triggered by consumer complaints, data theft, high interest rates, and coercive recovery. NBFCs must now display digital lending partners on websites, ensure KYC of digital borrowers, and restrict automatic increase of credit limit without consent.⁶⁸

Disbursement and repayment must flow directly between bank accounts of the borrower and NBFC. Lending Service Providers (LSPs) cannot hold funds. NBFCs must also appoint grievance redress officers and audit their algorithms annually. These rules apply to NBFCs using AI/ML or outsourcing to fintech startups. In *People's Union for Civil Liberties v. Union of India*, the Supreme Court stressed that right to

⁶¹ Financial Stability Board, "Principles for Non-Bank Financial Intermediation," July 2017.

⁶² Reserve Bank of India, "Fit and Proper Criteria for Directors of NBFCs," DNBS(PD). CC.No.96/03.05.002/2006-07, May 2006.

⁶³ Companies Act, 2013, § 164.

⁶⁴ *Union of India v. R. Gandhi*, (2010) 11 SCC 1.

⁶⁵ Reserve Bank of India, "Corporate Governance Directions for NBFCs," RBI Circular DNBR.PD.008/03.10.119/2016-17, June 2017.

⁶⁶ Reserve Bank of India, "SupTech Initiatives," Financial Stability Report, July 2022.

⁶⁷ Reserve Bank of India, "CRILC Reporting Guidelines," <https://www.rbi.org.in> (last visited on Oct. 2, 2025).

⁶⁸ Reserve Bank of India, "Guidelines on Digital Lending," RBI/2022-23/111, Sept. 2, 2022.

privacy includes financial privacy. RBI's digital lending norms uphold this doctrine by enforcing consent-based data sharing and limiting digital surveillance.⁶⁹

5. REGULATORY CHALLENGES AND SYSTEMIC RISK CONCERNS

Regulatory arbitrage remains a serious issue. NBFCs often operate in spaces that banks are barred from. Their lighter prudential norms allow them to take higher credit risks. This creates gaps in supervisory parity. For example, while banks must comply with Basel III norms, many NBFCs follow a simplified CRAR model. The absence of uniform capital treatment across lending entities increases contagion risk when credit cycles reverse.⁷⁰

Liquidity mismatches pose a recurring threat. NBFCs fund long-term assets through short-term borrowings. Asset-liability mismatches were a key reason behind the collapse of IL&FS in 2018 and DHFL in 2019. These firms lacked sufficient liquidity buffers to manage redemptions. RBI has responded with LCR norms and ALM disclosures, but monitoring remains difficult due to dynamic liability profiles.⁷¹ Shadow banking nature of NBFCs leads to systemic opacity. Several NBFCs function through complex group structures and SPVs. Transactions often happen off-balance sheet. In *SEBI v. Sahara India Real Estate Corp. Ltd.*, the Supreme Court warned against opaque fund-raising by NBFC-like entities that escape investor scrutiny. Interconnected exposures between NBFCs and banks further deepen systemic links.⁷² Credit concentration in real estate and infrastructure heightens risk. A majority of NBFCs lend disproportionately to a few high-value sectors. This leads to sectoral stress in downturns. RBI has introduced exposure ceilings and sectoral lending caps. However, large NBFCs still account for significant housing and builder loans, particularly through co-lending partnerships with banks.⁷³

Corporate governance failures amplify vulnerabilities. Board oversight, auditor independence, and related party transactions are weak in some NBFCs. The case of SREI Infrastructure Finance Ltd., placed under administration in 2021, showed how governance lapses can escalate into solvency crises. RBI has tightened rules on independent directors, statutory audits, and promoter fit-and-proper assessments.⁷⁴ Regulatory perimeter remains fragmented. Smaller NBFCs are under light supervision. Many remain outside CRILC reporting or SBR upper layer criteria. Fintech-NBFC models using digital lending apps often escape robust regulatory coverage. RBI's 2022 digital lending guidelines were a partial response, yet enforcement is still catching up.⁷⁵

Market perception of implicit government support distorts risk pricing. Investors often assume that large NBFCs will be rescued if they fail. This leads to moral hazard. It weakens market discipline. Credit ratings become inflated. The default by IL&FS, once rated AAA, showed the dangers of blind faith in systemic bailouts.⁷⁶

⁶⁹ *People's Union for Civil Liberties v. Union of India*, (1997) 1 SCC 301.

⁷⁰ Reserve Bank of India, "Report on Trend and Progress of Banking in India 2021-22," Dec. 2022.

⁷¹ Reserve Bank of India, "Liquidity Risk Management Framework for NBFCs," RBI/2019-20/88, Nov. 2019.

⁷² *SEBI v. Sahara India Real Estate Corp. Ltd.*, (2013) 1 SCC 1.

⁷³ Reserve Bank of India, "Discussion Paper on Rationalisation of Sectoral Exposure Limits for NBFCs," Jan. 2021.

⁷⁴ Reserve Bank of India, "Press Release on Supersession of SREI Boards," Oct. 4, 2021.

⁷⁵ Reserve Bank of India, "Guidelines on Digital Lending," RBI/2022-23/111, Sept. 2, 2022.

⁷⁶ Ministry of Corporate Affairs, "IL&FS Board Supersession Order," Oct. 1, 2018.

6. COMPARATIVE ANALYSIS WITH GLOBAL REGULATORY REGIMES

A. United States

Non-bank financial institutions in the US are regulated through a layered federal-state structure. The Dodd-Frank Wall Street Reform and Consumer Protection Act, 2010 was a pivotal response to the 2008 financial crisis. It established the Financial Stability Oversight Council (FSOC) to identify and supervise systemically important financial institutions (SIFIs), even if they are not banks. This includes insurance firms, asset managers, and mortgage companies.⁷⁷

The Office of Financial Research (OFR) supports FSOC through data gathering and systemic risk analysis. The Federal Reserve, as central bank, exercises oversight on financial holding companies, including NBFC-like entities. Non-bank entities designated as SIFIs must comply with enhanced prudential norms like capital buffers, resolution plans, and liquidity risk frameworks. FSOC can recommend stricter regulation or break-up of firms that pose a systemic threat.⁷⁸

The US also applies the Volcker Rule under the Dodd-Frank Act. It restricts proprietary trading and exposure to hedge funds by NBFC-like firms affiliated with banks. Consumer protection is handled by the Consumer Financial Protection Bureau (CFPB), which oversees payday lenders, mortgage brokers, and fintechs. The Securities and Exchange Commission (SEC) and Commodity Futures Trading Commission (CFTC) regulate securities-based NBFCs such as investment advisers and clearinghouses.⁷⁹

In *MetLife, Inc. v. Financial Stability Oversight Council*, the court struck down FSOC's designation of MetLife as a SIFI, stating the process lacked transparency. It exposed legal gaps in systemic regulation of NBFCs and sparked policy debate. India's NBFC regulation lacks such judicial scrutiny on systemic labelling but adopts a similar tiered approach through SBR.⁸⁰

A. United Kingdom

The UK follows a twin-peaks model. Prudential Regulation Authority (PRA) under the Bank of England supervises prudential aspects, while Financial Conduct Authority (FCA) oversees conduct. Non-bank lenders, leasing companies, credit intermediaries, and e-money institutions fall under this dual regulatory model. The Financial Services and Markets Act 2000 (FSMA) empowers both regulators to license, monitor, and penalize firms engaging in regulated activities.⁸¹

FCA mandates NBFC-like entities to follow the Senior Managers and Certification Regime (SMCR), which imposes personal accountability. It requires mapping responsibilities to individuals and enforcing fitness and propriety tests. The PRA applies Basel norms to systemically relevant institutions, even if not banks. PRA also assesses resolution preparedness through living wills and bail-in frameworks.⁸²

Peer-to-peer lenders and fintech credit firms must comply with FCA's consumer credit sourcebook (CONC). It outlines rules on affordability checks, interest caps, marketing conduct, and complaints redress. The UK was among the first to regulate buy-now-pay-later models to protect borrowers. In *FCA v. Avacade Ltd.*, the High Court held directors liable for misleading investment products and banned them from offering unregulated financial advice, showing firm enforcement.⁸³ The UK also maintains the

⁷⁷ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

⁷⁸ Financial Stability Oversight Council (FSOC), "Annual Report 2022," U.S. Treasury Department, <https://home.treasury.gov> (last visited on Oct. 2, 2025).

⁷⁹ Consumer Financial Protection Bureau, "Supervision and Examination Manual," (2022).

⁸⁰ *MetLife, Inc. v. Fin. Stability Oversight Council*, 177 F. Supp. 3d 219 (D.D.C. 2016).

⁸¹ Financial Services and Markets Act 2000 (UK).

⁸² Bank of England, "PRA Rulebook: CRR Firms," 2022.

⁸³ *Financial Conduct Authority v. Avacade Ltd.*, [2020] EWHC 1673 (Ch).

Financial Services Compensation Scheme (FSCS), covering certain NBFC clients in case of institutional failure. India lacks such protection for NBFC borrowers or depositors. RBI's light-touch regime contrasts with UK's high accountability-based model.⁸⁴

B. International Standards

Globally, the Financial Stability Board (FSB) plays a critical role in shaping NBFC regulation. It coined the term "non-bank financial intermediation" to replace "shadow banking." Its 2013 policy framework set out five principles: oversight, risk monitoring, data collection, regulation proportionality, and inter-agency cooperation. FSB requires national regulators to map entities engaged in credit intermediation and assess their leverage, maturity transformation, and liquidity risks.⁸⁵

The Basel Committee on Banking Supervision (BCBS) has published specific guidance on credit risk and capital standards for non-bank lenders, especially those owned by financial conglomerates. These norms suggest application of countercyclical capital buffers and group-wide exposure norms for NBFCs engaged in systemic lending. India's SBR mirrors this layered risk-based philosophy but leaves out certain advanced metrics such as leverage ratio and liquidity coverage ratio in full scope.⁸⁶

International Organisation of Securities Commissions (IOSCO) regulates investment-based NBFCs like asset management companies and hedge funds. Its reports warn against regulatory blind spots where firms operate across multiple financial sectors without consolidated supervision. Cross-border NBFCs face host-home supervisory gaps. India addresses this partly through MoUs between RBI and other central banks or foreign regulators, but not yet under a comprehensive cross-jurisdictional licensing regime.⁸⁷

The International Monetary Fund (IMF) in its Financial Sector Assessment Program (FSAP) has periodically reviewed India's NBFC sector. The 2017 FSAP noted that while RBI had taken significant steps post-IL&FS, supervision needed to become more dynamic and data-integrated. IMF also recommended harmonizing NBFC norms with banks to prevent credit transmission gaps during crises.⁸⁸

G20 discussions post-COVID emphasized strengthening digital NBFC oversight. Regulatory perimeters should capture algorithm-based lending, embedded finance models, and unlicensed intermediaries. India's 2022 digital lending guidelines reflect this global shift but lack enforcement capacity and real-time data analytics, making global convergence still aspirational.⁸⁹

7. RECENT REFORMS AND POLICY DEVELOPMENTS IN INDIA

The Scale-Based Regulation (SBR) Framework was introduced in 2021. It marked a structural shift from a one-size-fits-all approach. RBI classified NBFCs into four regulatory layers. The move brought proportionality. Regulatory expectations now match systemic importance. Upper layer NBFCs face tougher capital, governance, and disclosure norms. This framework aligns with FSB recommendations on non-bank intermediation.⁹⁰ The introduction of Liquidity Coverage Ratio (LCR) norms for NBFCs in 2020 was significant. RBI mandated phased compliance for all deposit-taking and large non-deposit-taking

⁸⁴ Financial Services Compensation Scheme, "Guide to FSCS Protection," 2023.

⁸⁵ Financial Stability Board, "Strengthening Oversight and Regulation of Shadow Banking," Nov. 2013.

⁸⁶ Basel Committee on Banking Supervision, "Supervisory Framework for Measuring and Controlling Large Exposures," Apr. 2014.

⁸⁷ International Organization of Securities Commissions, "Thematic Review of Implementation of FSB Shadow Banking Recommendations," Dec. 2016.

⁸⁸ International Monetary Fund, "India: Financial Sector Assessment Program," IMF Country Report No. 17/390, Dec. 2017.

⁸⁹ G20 Italy, "Presidency Note on Non-Bank Financial Intermediation," July 2021.

⁹⁰ Reserve Bank of India, "Scale Based Regulation for NBFCs," RBI/2021-22/112, Oct. 22, 2021.

NBFCs. These entities must maintain high-quality liquid assets to cover 30-day net outflows. It addressed liquidity mismatches post-IL&FS crisis.⁹¹

Digital lending guidelines issued in 2022 targeted growing fintech-NBFC activity. RBI restricted balance sheet lending through unregulated digital platforms. Lending Service Providers (LSPs) must now be disclosed. Disbursements and repayments must route directly between borrower and lender. Consent-based data policies were mandated to prevent misuse and protect borrower privacy.⁹²

RBI also revised governance norms. Independent directors are now mandatory in upper layer NBFCs. Audit committee, nomination committee, and risk committee requirements have been standardised. CEO-CFO separation, tenure caps for auditors, and board evaluations became part of compliance structure. These reforms follow weaknesses seen in DHFL, SREI and Reliance Capital.⁹³ Co-lending models between banks and NBFCs were institutionalised. In 2020, RBI issued guidelines allowing co-origination of loans. Risk-sharing arrangements and interest rate structuring were clarified. It enhances credit flow to priority sectors like MSMEs and housing. NBFCs now access cheaper funds while banks extend their outreach.⁹⁴

Aadhaar e-KYC access was restored for regulated NBFCs in 2022. After Supreme Court's ruling in Justice K.S. Puttaswamy v. Union of India, the Aadhaar Act was amended. Entities regulated by RBI with net worth over ₹100 crore can now use Aadhaar for customer onboarding, subject to UIDAI approval. It strengthens digital inclusion with privacy safeguards.⁹⁵

8. CONCLUSION

NBFCs have evolved into a critical arm of India's credit system. Their regulatory framework, however, continues to adapt reactively rather than proactively. The RBI has strengthened oversight using tools like SBR, LCR, and digital lending norms. Yet fragmented supervision, delayed risk detection, and patchy enforcement remain serious gaps.⁹⁶ Liquidity mismatches, weak corporate governance, and excessive credit concentration to risky sectors expose systemic fault lines. Regulatory arbitrage persists. Small NBFCs often operate under light scrutiny. Their links with fintechs, digital platforms, and informal lending channels demand deeper perimeter surveillance. RBI's current inspection model still lacks full integration of real-time data analytics and behavioural risk indicators.⁹⁷

The SBR framework is a strong step toward proportional regulation. But unlike global regimes, it lacks forward-looking stress testing or automatic resolution mechanisms. Judicial review of regulatory decisions, unlike in the US or UK, remains limited. Consumer protection mechanisms outside courts are underdeveloped for NBFC clients. RBI's ombudsman scheme for NBFCs remains underutilized.⁹⁸

Digital transformation offers both opportunity and regulatory risk. Data consent, AI-based lending, and digital KYC are now standard. But enforcement of algorithmic fairness, transparency, and grievance redress mechanisms is inconsistent. Fintech-NBFC hybrids must face harmonised oversight, without

⁹¹ Reserve Bank of India, "Liquidity Risk Management for NBFCs," RBI/2019-20/88, Nov. 4, 2019.

⁹² Reserve Bank of India, "Guidelines on Digital Lending," RBI/2022-23/111, Sept. 2, 2022.

⁹³ Reserve Bank of India, "Corporate Governance for NBFCs in Upper Layer," Jan. 2022.

⁹⁴ Reserve Bank of India, "Co-Lending by Banks and NBFCs to Priority Sector," RBI/2020-21/63, Nov. 5, 2020.

⁹⁵ Justice K.S. Puttaswamy v. Union of India, (2019) 1 SCC 1.

⁹⁶ Reserve Bank of India, "Scale Based Regulation for NBFCs," RBI/2021-22/112, Oct. 22, 2021.

⁹⁷ Reserve Bank of India, "Financial Stability Report," July 2023.

⁹⁸ Consumer Education and Protection Department, "RBI Integrated Ombudsman Scheme for NBFCs," 2022.

stifling innovation or creating entry barriers.⁹⁹ Legal alignment between RBI, SEBI, IBBI, and FIU-IND is vital. Regulatory sandboxes, MoUs and inter-agency coordination need expansion. Dispute resolution models like arbitration for NBFC clients can reduce litigation. India needs a consolidated NBFC Code or reform under the Financial Sector Legislative Reforms Commission (FSLRC) approach.¹⁰⁰

The future of NBFC regulation lies in embedding technology-led supervision, harmonising with global benchmarks, and moving toward risk-sensitive but innovation-friendly lawmaking. Financial inclusion must coexist with systemic resilience.

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⁹⁹ Reserve Bank of India, “Guidelines on Digital Lending,” RBI/2022-23/111, Sept. 2, 2022.

¹⁰⁰ Financial Sector Legislative Reforms Commission (FSLRC), “Report,” Ministry of Finance, 2013.



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