

Comments on the Draft Amendment Directions Non-Banking Financial Companies – Registration, Exemptions and Framework for Scale Based Regulation, dated 10 April 2026

On 10 April 2026, the Reserve Bank of India released the “[Draft - Reserve Bank of India \(Non-Banking Financial Companies – Registration, Exemptions and Framework for Scale Based Regulation\) Second Amendment Directions, 2026](#)” (hereafter “**Draft Amendments**”). The Draft Amendments provide a new methodology to classify Non-Banking Financial Companies (NBFCs) in the Upper Layer of the [scale-based regulatory framework](#), thereby determining which NBFCs will be subject to more stringent regulations and supervision.

In this response, we present our comments to the Draft Amendments, set out across two sections.

1) Section-1 provides specific input into the changes introduced in the draft, whereunder we contrast the existing regulations and the flexibility it affords to the RBI vis-à-vis the proposed changes, which limit the degrees of freedom for the RBI, while simultaneously increasing the capacity of the NBFCs to skirt the regulations.

2) Section-2 suggests an alternate scoring mechanism, in line with global best practices.

Section-1: RBI limiting its own regulatory flexibility

The proposed amendment materially weakens the conceptual foundations of the [Scale Based Regulatory \(“SBR”\) framework](#) by replacing a risk-sensitive identification methodology with a blunt asset-size threshold. Under the existing framework, RBI identifies NBFCs for the Upper Layer (“NBFC-UL”) through a combination of quantitative and qualitative criteria, including leverage, interconnectedness, liability profile, complexity, and supervisory judgment. The draft amendment discards this architecture and instead provides that every NBFC with assets above ₹1 lakh crore will automatically fall within the Upper Layer, while all others will remain outside it.

This approach assumes that systemic importance can be adequately proxied through size alone. However, the logic underlying the SBR framework is precisely the opposite, i.e., systemic risk is multidimensional. Financial instability may arise not only from scale, but also from concentrated funding structures, interconnected liabilities, complexity of operations, market dependence, correlated exposures, and behavioural contagion during stress events. The existing framework recognizes this by preserving multiple channels through which supervisory assessment may operate. The amendment removes these dimensions and substitutes them with a single mechanical criterion. In doing so, the amendment reduces RBI’s supervisory “degrees of freedom” while simultaneously increasing those available to regulated entities.

Under the present framework, RBI may identify risk across several variables — size, leverage, interconnectedness, liability composition, group structure, and supervisory inputs. This multiplicity provides flexibility to respond adaptively to evolving market conditions and emerging forms of systemic vulnerability. By contrast, once classification depends solely on a ₹1 lakh crore asset threshold, regulated entities are given a much narrower and more predictable target around which to optimize their operations. This predictability creates substantial scope for regulatory gaming.

Institutions approaching the threshold may restructure balance sheets to remain marginally below it, possibly through securitisation of receivables near reporting dates, accelerated sell-downs of loan

portfolios, increased reliance on originate-to-distribute models, migration of exposures into off-balance-sheet structures, or shifting specific activities into affiliated entities. To be sure, the existing framework already addresses certain forms of group-level arbitrage by requiring consolidation of assets across NBFCs within a group for purposes of classification into the Middle Layer. However, the proposed amendment still creates incentives to reorganize activities through legal and operational arrangements that may reduce measured on-balance-sheet asset size without correspondingly reducing underlying interconnectedness, funding dependence, or contagion potential.

For instance, a large NBFC group nearing the threshold may increasingly rely on co-lending structures, servicing arrangements, special purpose vehicles, or distribution partnerships that permit economic exposure and market presence to expand without a proportionate increase in reported balance-sheet assets. Similarly, an institution may reduce retained assets through securitisation while continuing to remain exposed through credit enhancements, servicing obligations, liquidity support arrangements, or reputational dependence. Such strategies may formally comply with the threshold requirement while preserving many of the same systemic transmission channels that the Upper Layer framework is intended to monitor.

The concern is not merely evasion of regulation, but the possibility that the amendment may inadvertently incentivize more opaque and fragile institutional structures. A regime that focuses overwhelmingly on measured asset size encourages institutions to optimize toward appearances of smaller scale rather than genuine reduction of systemic risk. This may increase reliance on indirect funding arrangements, intra-group operational dependencies, and off-balance-sheet mechanisms that are harder to supervise and more vulnerable during periods of market stress.

This is especially significant because financial contagion frequently operates through channels that exceed formal balance-sheet interconnectedness. Episodes such as the post-IL&FS and DHFL liquidity disruptions demonstrated that stress could spread through market sentiment, funding withdrawals, reassessment of sectoral risk, and correlated investor responses even where direct exposures are limited. If institutions are encouraged to converge toward similar threshold-management strategies, the resulting system may become more susceptible to such contagion dynamics. In periods of stress, markets may suddenly discover that formally separate or apparently smaller entities remain economically interdependent through shared funding sources, servicing relationships, guarantees, or investor perceptions.

The strength of the existing framework lies in its preservation of supervisory flexibility and multidimensional assessment. The proposed amendment relinquishes that flexibility in favour of a simpler but significantly narrower rule. In effect, it trades away RBI's own degrees of supervisory freedom while increasing the strategic degrees of freedom available to regulated entities to structure themselves around the perimeter of regulation. Therefore, we submit that the RBI reconsiders adopting a single-parameter classification criterion, in-lieu of a parametric one.

Section-2: Improving the Existing Parametric Framework

While the existing parametric methodology is significantly preferable to a single-threshold classification approach, the framework itself may still be improved to better identify systemically significant NBFCs. A risk-based approach to proportionality requires RBI to consistently apply a set of risk-based parameters, for instance – size, leverage, interconnectedness and arrive at a consolidated assessment of systemic significance, rather than relying excessively on any one metric. The present framework already moves meaningfully in this direction by incorporating multiple quantitative and qualitative dimensions. However, several important indicators of systemic vulnerability remain either

absent, insufficiently specified, or relegated to qualitative assessment despite being capable of objective measurement.

In particular, the framework may benefit from a stronger incorporation of liquidity and maturity mismatch indicators, substitutability metrics, and counterparty analysis. Indicators such as liquidity coverage across different time horizons, callable debt as a fraction of total debt, asset-backed funding dependence, and asset-liability duration gaps are critical in understanding vulnerability to liquidity shocks and contagion dynamics. Similarly, indicators like “segment and geography wise concentration of assets,” the “extent of BC operations”, “assets being serviced after securitisation or direct assignment”, and the “strength, nature, and number of counterparties” connected to an NBFC are all capable of providing measurable insight into systemic significance beyond mere balance-sheet size.

Finally, the weighting methodology itself may warrant reconsideration. As previously noted, several international methodologies “assign uniform but arbitrary weights” across categories such as size, interconnectedness, and complexity, often without empirical justification. RBI may therefore consider undertaking empirical analysis of historical episodes of institutional distress and contagion in order to derive statistically grounded weights (subject to periodic reviews) for different indicators or alternatively deploy both statistically derived weights and equal-weight approaches simultaneously. Such an approach would preserve the flexibility and multidimensionality of the present architecture while making the identification framework more transparent, empirically grounded, and adaptive to evolving forms of systemic risk. We discuss these approaches in detail in Section C.2. of our [position paper on Regulatory and Supervisory Approaches for NBFCs](#).

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