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Regulatory Alert

August 20, 2020

Reserve Bank of India announces New Guidelines for Core Investment Companies

On August 13, 2020[1], the Reserve Bank of India ('RBI') has notified revised guidelines for Core Investment Companies ('CICs') tightening provisions around leveraging at multiple levels, strengthening corporate governance, disclosure norms and risk management

The revised guidelines are based on the recommendation of the Working Group ('**WG**') constituted by the RBI with an intention to monitor the complex group structures and inter-connectedness of CICs within financial systems and strengthen the corporate governance framework for these entities. The revised CIC guidelines provide the following:

Change in nomenclature

- A Systemically Important CIC[2], will henceforth be termed as a CIC. A CIC, which is not required to be registered in terms of existing criteria, will be termed as 'Unregistered CIC' instead of 'exempted CIC'.
- Accordingly, the following CICs shall not be required to be registered with RBI and will be termed as 'Unregistered CIC' as per the amended nomenclature definition:
  a) CICs with an asset size of less than INR 100 crore, irrespective of whether accessing public funds or not; and
  b) CICs with an asset size of INR 100 crore and above and not accessing public funds.

Definition of Adjusted Net Worth ('ANW') / deduction of group exposure

- While computing ANW of CICs, the amount representing any direct or indirect capital contribution made by one CIC into another must be deducted if such amount exceeds 10

[1] *Notification No. DoR (NBFC) (PD) CC. No. 117/03.10.001/2020-21 dated August 13, 2020*

[2] *'Systemically Important Core Investment Company (CIC-ND-SI)' means a core investment company having total assets of not less than INR 100 crore either individually or in aggregate along with other CICs in the Group and which raises or holds public funds*

per cent of the Owned Funds[3] of the investing CIC.

- However, in case of existing CICs, where the investment made by one CIC in another is already in excess of 10 per cent of the Owned Funds of the investing CIC, then the CIC need not deduct the excess investment from Owned Funds for computation of its ANW till March 31, 2023.

Group Structure

- To address the complexity in group structures and existence of multiple CICs within a group, the RBI has restricted the number of layers of CICs within a group to two. It has also been declared by RBI that if a CIC makes any direct/ indirect equity investment in another CIC, it will be deemed as a layer for the investing CIC.

Risk Management

- A Group Risk Management Committee ('**GRMC**') is required to be constituted by the parent CIC in the group. However, in case there is no identifiable parent CIC in the group, the CIC with the largest asset size is required to constitute the GRMC. The GRMC shall consist of at least five members, out of them, two (including the Chairperson) shall be independent directors. The GRMC shall be responsible for analysing the various activities including analysing material risks to which corporate group, its subsidiaries and businesses exposed to, identification of potential intra-group conflict of interest, assessing periodic independent formal review of the group structure and internal controls, etc.

- All CICs with asset size of more than INR 5,000 crores shall appoint a Chief Risk Officer who shall be responsible for identification, measurement, and mitigation of risks within the CIC.

- CICs are now mandated to file a quarterly statement of deviation certified by the Chief Executive Officer/ Chief Financial Officer, indicating any deviations with regard to use of proceeds in any funding obtained from the details stated in application or sanction letter or offer letter for such funding.

Corporate Governance and Disclosure Requirements

- CICs are required to follow corporate governance requirements as stated under the Companies Act, 2013 ('the Companies Act').

- The disclosure requirements provide for maintaining a functional website, *inter alia,* containing basic information about CIC and its group, disclosure about group entities not disclosed in the consolidated financials, disclosures with respect to components of ANW, investment in other CICs, off balance sheet exposure, details of investments, maturity pattern of assets and liabilities, business ratios, concentration of non-performing assets, overseas assets.

- The revised guidelines call for implementing a stricter policy for appointment of directors by ascertaining the 'fit and proper' status of directors on continuous basis. The 'fit and proper' status guidelines of RBI, *inter alia,* prescribe carrying out due diligence exercise for determining the suitability of a person to be appointed as a director, based on his qualification, expertise, track record and integrity, obtaining annual declaration from directors in case there is any change in the details furnished at the time of appointment, and constitution of Nomination Committee for scrutinizing the directors' declarations.

Other amendments

- CICs shall prepare consolidated financial statement as per provisions of the Companies Act to provide a clear view of the financials of the group.

- CICs implementing Indian Accounting Standards shall adhere to the guidelines prescribed[4] by RBI on Implementation of Indian Accounting Standards which provide for governance framework for preparation of financial statements, computation of 'owned funds', 'net owned funds' and other regulatory ratios, etc.

[3] *"Owned Fund" means paid up equity capital, preference shares which are compulsorily convertible into equity, free reserves, balance in share premium account and capital reserves representing surplus arising out of sale proceeds of asset, excluding reserves created by revaluation of asset, as reduced by accumulated loss balance, book value of intangible assets and deferred revenue expenditure, if any*

[4] *Circular DOR (NBFC). CC. PD No.109/22.10.106/2019-20 dated March 13, 2020*

- CICs can invest in money market instruments, including mutual funds which make investments in money market instruments/ debt instruments with a maturity of up to one year.
- All CICs shall adhere to the guidelines prescribed by RBI on Submission of Data to Credit Information Companies[5].

Dhruva Comments

- CIC was a welcome change for corporates since it provided flexibility of holding structures for operating companies without the need for registration as an NBFC, leading to savings from cumbersome compliances. However, over time, it has been found that multiple layers of CICs led to multiple gearing and over-leveraging at a group level, thereby, increasing the risk exposure and inter-connectedness within the financial system.
- Experts have been seeking review of CIC guidelines ever since defaults by Infrastructure Leasing and Financial Services Ltd (IL&FS), a large systemically important CIC. RBI, through the revised guidelines, seeks to regulate the issues in CIC structures and mitigate the related risks for the CICs, their groups as well as for the financial system. These guidelines are expected to have a far-reaching impact on strengthening the entire regulatory and governance framework for CICs. However, few other recommendations of the report of WG on setting up of committees such as audit committee, nomination and remuneration committee have not been incorporated in the guidelines.
- While the revised guidelines will be applicable from August 13, 2020, existing entities have been given time till March 31, 2023 to reorganize their business structures and ensure compliance with the revised guidelines. Any move to reduce the number of layers will need to factor the attendant tax consequences, given the significant underlying values that might be involved. We believe that the restriction on the number of layers should drive large groups to eliminate any additional layers, through mergers and other forms of corporate reorganisations.
- At present, only about 70 CICs are registered with the RBI. While it appears that the revised guidelines apply only to the registered CICs, one can expect increased scrutiny by the RBI as well as the Registrar of Companies, particularly on multi-layered structures in case of other CICs as well. Under the Companies Act, 2013, unregistered CICs are restricted from having more than 2 layers of subsidiaries. However, the revised RBI guidelines are more restrictive as they cover even less than 50% shareholding as a layer.
- The setting up of the GRMC and the quarterly statement of deviation should help in setting higher standards of governance and disclosures by the CICs.

[5] *Para 100 and 101 of Master Direction Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016*

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