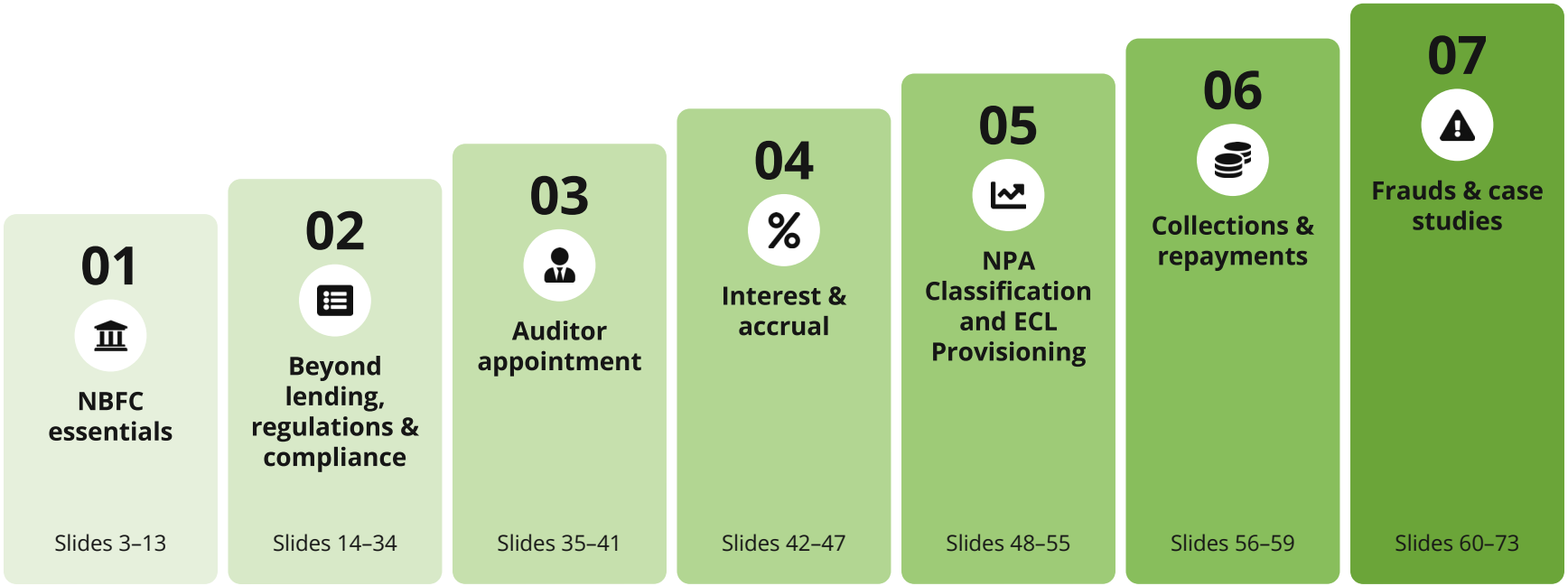
NBFCs — Beyond Lending

Financial Services, Regulation & Compliance

Adithya.V | SIRC of ICAI | 20 November 2026

Inside the Discussion



01

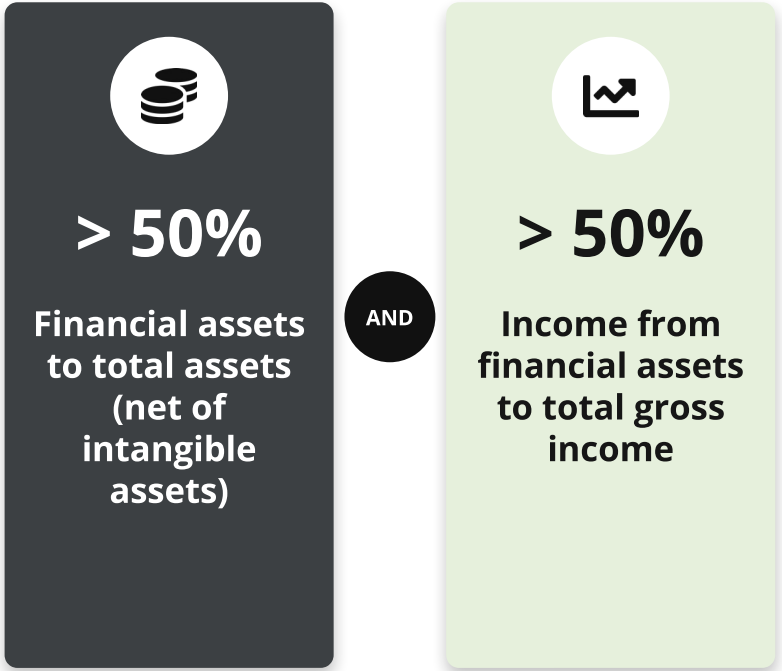
NBFC essentials

What NBFCs are, what they do, how they are regulated

What is an NBFC?

A company engaged in the business of loans and advances, acquisition of shares / securities issued by Government or local authority or other marketable securities of a like nature, leasing, hire-purchase, etc., as its principal business

- A company registered under the Companies Act, 2013 or the Companies Act, 1956
- Registered with RBI under Section 45-IA, RBI Act, 1934.
- Not a company whose principal business is agriculture, industry, trading or real estate, purchase or sale of goods (other than securities)
- Regulated under Chapter IIIB of the RBI Act, 1934
- **Only a company can be an NBFC — a proprietorship, partnership firm, Limited Liability Partnership (LLP), Co-op societies, Multi State Co-op societies cannot be a NBFC.**



Does not meet the 50-50 test but takes deposits?

Does not meet the 50-50 test

Financial assets ≤ 50% of total assets and financial income ≤ 50% of gross income

→

Not an NBFC

Principal business is non-financial: agriculture, industry, trading in goods, real estate — a non-banking non-financial company

→

Deposits: MCA's domain

Deposit acceptance and other activities of a company will be governed by the Ministry of Corporate Affairs, not RBI

What applies instead

- Companies Act, 2013, ss.73–76 and the Companies (Acceptance of Deposits) Rules, 2014
- No RBI registration or RBI deposit directions — the company is outside Chapter IIIB's NBFC regime

One licence, many avatars

Category	Full form	Key test (RBI FAQ)
ICC	**Investment and Credit Company**	Lending and investment — the default category
MFI	**NBFC – Microfinance Institution**	≥ 60% of assets in collateral-free loans to households with income ≤ ₹3 lakh
HFC	**Housing Finance Company**	≥ 60% of assets in housing finance; ≥ 50% to individuals
IFC	**Infrastructure Finance Company**	≥ 75% of total assets in infrastructure lending
IDF	**Infrastructure Debt Fund – NBFC**	Refinances infra projects after a year of commercial operations
Factor	**NBFC – Factor**	≥ 50% of assets and ≥ 50% of income from factoring
CIC	**Core Investment Company**	≥ 90% of net assets in group companies; ≥ 60% in group equity
P2P	**NBFC – Peer to Peer Lending Platform**	Online platform linking lenders and borrowers; cannot lend itself
AA	**NBFC – Account Aggregator**	Collects and shares customers' financial data, with consent
MGC	**Mortgage Guarantee Company**	≥ 90% of business or income from mortgage guarantees
SPD	**Standalone Primary Dealer**	Primary dealer in government securities
NOFHC	**Non-Operative Financial Holding Company**	Holds a bank and the group's other financial companies

Lending or credit-based models

Not mainly lending: holding (CIC, NOFHC), platforms (P2P, AA), guarantee (MGC), G-sec dealing (SPD)

Registration at a glance: who needs a CoR

Needs RBI registration (s.45-IA, RBI Act, 1934)

- Any company whose main business is lending, investing, leasing or hire-purchase (passes the 50-50 test)
- Investment & credit, microfinance, factoring, infrastructure, mortgage guarantee, P2P and AA companies
- Housing finance companies (registered under the NHB Act, regulated by RBI)
- Core investment companies with assets of ≥ 100 crore that use public funds
- Type I NBFCs with assets of ≥ ₹1,000 crore

Does not need RBI registration

- Unregistered Type I: assets under ₹1,000 crore, no public funds, no customer interface
- Core investment companies under ₹100 crore, or not using public funds
- Regulated elsewhere: insurers (IRDAI); merchant bankers, brokers, venture funds (SEBI); Nidhis (MCA); chit funds (State Governments)
- Companies that fail the 50-50 test — finance is not their main business

Public funds: wider than public deposits

Public funds include

- Public deposits
- Inter-corporate deposits
- Bank finance
- Commercial paper and debentures
- **Any funds from outside sources — directly or indirectly**

Indirect receipt

Funds received through associates and group entities that have access to public funds

2026: Type I unregistered NBFCs

No public funds

Not accessed direct or indirectly (incl. through group entities and associates), and no intention to

No customer interface

No lending, guarantees or other products to customers —including to group entities, shareholders and directors and no intention to

Assets < ₹1,000 crore

Latest audited balance sheet; aggregated across all Unregistered Type I NBFCs in the group

No overseas financial-sector investment

Investing abroad in financial services requires registration as a Type I NBFC

Result

Exempt only from:

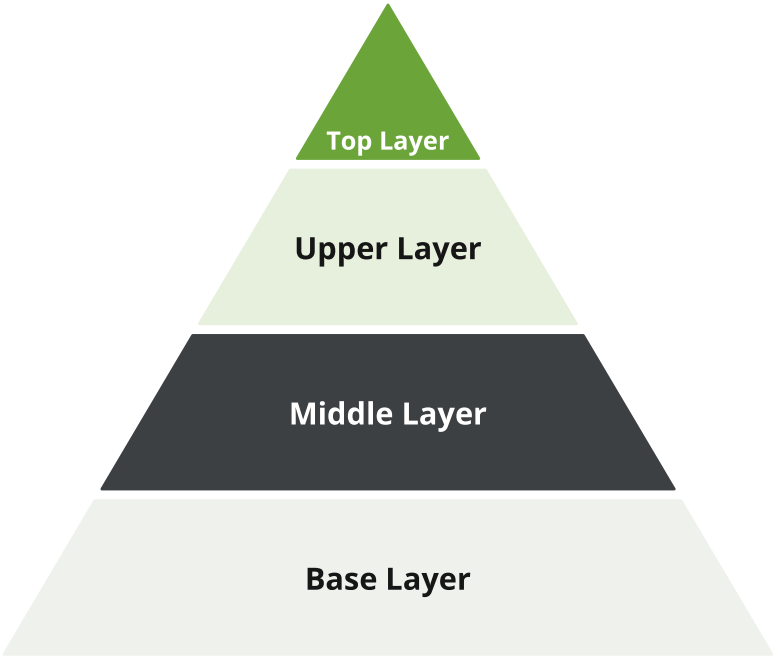
- s.45-IA - certificate of registration
- s.45-IC - transfer to reserve fund

Still an NBFC:

- Chapters IIIB and V of the RBI Act continue to apply
- RBI may issue directions specific to these entities

Scale-Based Regulation: know your layer

Layer	Who is in it
Top Layer	Ideally empty — used only if RBI identifies a substantial increase in potential systemic risk from specific NBFCs in the Upper Layer
Upper Layer	Assets ≥ ₹1 lakh crore as per the latest audited balance sheet (amended from June 2026)
Middle Layer	All deposit-takers • Non-deposit ≥ ₹1,000 crore • HFC, IFC, IDF, CIC, SPD
Base Layer	Non-deposit < ₹1,000 crore • P2P, AA, NOFHC, Type I



SBR: one group, one layer — illustration

Example 1 (para 19(1))	Assets ₹ cr	Standalone	After group test
NBFC-ICC	300	Base	**Middle**
HFC	300	Middle	Middle
NBFC-IFC	500	Middle	Middle
NBFC-MFI	100	Base	**Middle**
NBFC-P2P	50	Base	Base
Type I NBFC (with CoR)	70	Base	Base
Group total	**1,320**	**≥ ₹1,000 crore → Middle Layer**	

ICC and MFI move up to the Middle Layer. HFC and IFC are Middle Layer anyway. P2P and Type I stay in the Base Layer.

Example 2 (para 19(2))

ICC's assets are only ₹10 crore. Group total ₹1,030 crore — still above ₹1,000 crore, so the ICC and MFI remain Middle Layer.

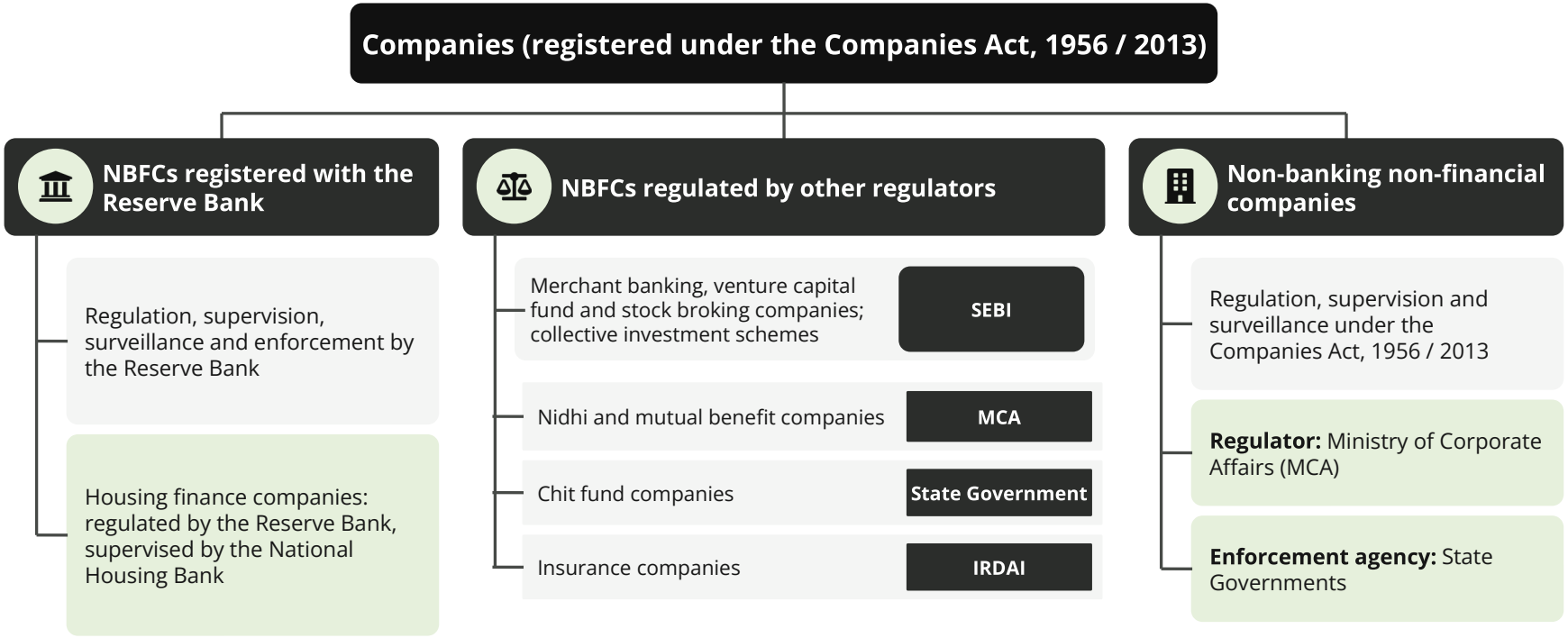
* If the group's total assets exceed ₹1,000 crore, all Base Layer NBFCs within the group move to the Middle Layer, except NBFC-P2P and Type I NBFCs

Who can legally accept deposits?

Entity	Can accept deposits?	Regulator
Banks, including co-operative banks	**Yes**	RBI
NBFCs (incl. HFCs) holding a deposit-taking CoR	**Yes — within limits**	RBI
Other NBFCs, including CICs	**No public deposits**	RBI
Companies under the Companies (Acceptance of Deposits) Rules, 2014	**Yes — up to limits**	MCA
Co-operative credit societies	**From members only**	Registrar of Co-op Societies
Chit funds	**Subscriptions only; no public deposits**	State Governments
Proprietorships, partnerships, other unincorporated bodies	**No — prohibited**	RBI Act, s.45S

Deposit (s.45-I(bb)): any money received as deposit or loan, except share capital, bank and FI loans, trade advances, money-lender receipts and chit subscriptions. **Public deposit** excludes further items, e.g. inter-company money and promoter loans.

Regulators of Non-Banking Companies



02

Beyond lending, Regulations and compliance

Co-lending, digital lending, distribution — and what an NBFC must keep doing

Co-lending

Two lenders. One loan. One EMI.

Bank
₹8 lakh (80%)

NBFC
₹2 lakh (20%)

→

Borrower
One ₹10 lakh loan

Who does what

- NBFC finds the customer, checks KYC and credit, and collects the EMIs
- Bank puts in most of the money, at a lower cost
- Each keeps its part of the loan — and its risk — in its own books

Why do it?

- Bank reaches small towns it cannot serve
- NBFC lends more with less capital
- Borrower gets a lower, blended rate

Point	Current rule (Co-Lending Directions, 2025 — in force from 1 Jan 2026)
Which loans?	**Any loan — priority and non-priority sector**
Minimum share kept	**Each lender at least 10%**
Who can partner?	**Bank + NBFC, NBFC + NBFC, and All-India FIs**

A co-lent loan, step by step

1

Sign up

Bank and NBFC sign a Board-approved agreement: who puts in what share

2

Find and check

NBFC finds the borrower and does KYC and the credit check

3

Pay out

Both put in their share; money goes to the borrower's account

4

One rate

Borrower sees one blended interest rate in the Key Fact Statement

5

Collect

Borrower pays one EMI; it is split between the lenders in the agreed ratio

Example: ₹10 lakh loan to a small business

Bank gives ₹8 lakh at 9%; NBFC gives ₹2 lakh at 14%.

Borrower pays one rate: 0.8 × 9% + 0.2 × 14% = 10%

If the borrower stops paying

Both lenders mark the loan overdue / NPA in the same way and tell each other by the next working day. The NBFC may agree to cover losses up to 5%.

Digital lending, simply put

The whole loan happens online — apply, get checked, approved, paid and repay — all through an app.

Borrower	→	The app	→	Fintech partner	→	NBFC
Who: The person taking the loan **Must:** Sees the full cost before signing; can cancel within the cooling-off period		**Who:** Where the borrower applies **Must:** Must show which NBFC is giving the loan		**Who:** Works for the NBFC: finds customers, helps check them, collects EMIs **Must:** Paid by the NBFC; never handles the loan money		**Who:** The real lender — its money, its decision **Must:** Answerable to RBI for everything the app and fintech do

the NBFC can hand over the work to an app or fintech — but never the responsibility.

Digital lending: Rules

Rule	What it means	Problem it stops
1. Money goes straight	Loan is paid directly into the borrower's bank account; EMIs go directly to the NBFC	Fintechs were holding borrowers' money
2. Show the full cost first	A Key Fact Statement shows the all-in yearly cost (APR) before signing	Hidden charges
3. Free exit	Borrower can cancel within the cooling-off period (at least 1 day) by returning the money plus interest for those days	Loans taken on impulse
4. Respect privacy	App cannot read contacts, photos or call logs; data kept in India	Harassment of family and friends
5. Only listed apps	Every app is reported to RBI and shown in a public list	Fake loan apps
6. Limited guarantees	A fintech can promise to cover losses only up to 5% of the loans	Risk hidden behind guarantees

Selling other companies' products

Think of a shop counter: the NBFC sells an insurer's or fund house's product to its own customers and earns a commission. The product — and its risk — stay with that company.

₹5 lakh car loan
Customer borrows from the NBFC

→

Motor insurance offered
An insurer's policy, sold by the NBFC

→

Premium to insurer
The insurer carries the risk

→

Commission to NBFC
NBFC's income for selling

Who gives permission

- Insurance — IRDAI (as corporate agent or broker)
- Mutual funds — SEBI / AMFI rules
- Pension (NPS) — PFRDA (Pension Fund Regulatory and Development Authority)

What went wrong

- Insurance forced as a condition of the loan
- Premium added to the loan without asking
- Staff pushed products for commission
- Customers unsure whose product they bought

Selling others' products: the new rules

Do

- Sell only products regulated by IRDAI, SEBI or PFRDA — as an agent
- Take separate, clear consent from the customer
- Sell only what suits the customer
- Make it clear whose product it is

Don't

- Make the loan depend on buying the product
- Use pre-ticked boxes or misleading screens
- Let staff take incentives from the insurer or fund house
- Take on any of the product's risk

Starts

1 Jan 2027

RBI (NBFCs – Undertaking of Financial Services) Second Amendment Directions, 2026 and RBI (NBFCs – Responsible Business Conduct) Second Amendment Directions, 2026 — both issued 15 June 2026

Net owned fund and capital adequacy

Net Owned Fund (NOF)

Owned fund = paid-up equity + free reserves (-) accumulated losses (-) deferred revenue expenditure (-) intangible assets

NOF = owned fund (-) investments in shares of subsidiaries, group companies and other NBFCs (-) loans / deposits to subsidiaries and group companies above 10% of owned fund

Minimum NOF

₹10 cr	ICC, MFI, Factor (existing: by 31 Mar 2027)
₹20 cr	Housing finance companies
₹300 cr	IFC and IDF-NBFC
₹2 cr	P2P, AA, Type I
₹100 cr	To issue credit cards

Capital adequacy (CRAR)

CRAR = (Tier 1 + Tier 2) ÷ risk-weighted assets

- Middle Layer and above: CRAR ≥ 15%, Tier 1 ≥ 10%
- Upper Layer: also CET1 ≥ 9%
- Gold-loan NBFCs (any layer): CRAR ≥ 15%, Tier 1 ≥ 12%
- Base Layer: no CRAR — leverage (outside liabilities ÷ owned fund) ≤ 7
- Tier 2 never more than 100% of Tier 1
- Not applicable to P2P, AA, NOFHC and Type I NBFCs

Risk weights range from 0% (cash, government securities) to 125% (consumer credit)

CRAR (1): minimums and capital

Type of entity	Minimum
Gold-loan NBFCs, any layer (6(1))	**CRAR 15%; Tier 1 12%**
Middle Layer and above (6(2)–(3))	**CRAR 15%; Tier 1 10%**
Upper Layer (6(4))	**Also CET1 9%**
Top Layer (6(5))	**Higher charge set by RBI**
Base Layer (17)	**Leverage ≤ 7 at all times**
P2P, AA, NOFHC, Type I (3(6))	**Not applicable**

CET1 (para 7): equity, share premium, capital and statutory reserves, free reserves, retained earnings, eligible quarterly profits; revaluation reserve at 55% discount less group / NBFC investments above 10%

Tier 1 — Base (gold-loan) and Middle Layer (para 10): owned fund less group / NBFC investments above 10%, plus perpetual debt up to 15% of Tier 1 (none for Base Layer)

Tier 1 — Upper Layer (para 11): CET1 + compulsorily convertible preference shares + perpetual debt up to 15%

Tier 2 (para 13): revaluation reserve at 55% discount; general provisions up to 1.25% of RWA; hybrid debt; subordinated debt (discounted 20% a year in the last 5 years, capped at 50% of Tier 1); excess perpetual debt

Ind AS NBFCs (para 16): unrealised fair-value gains excluded; 12-month ECL in Tier 2; lifetime ECL reduces RWA; impairment reserve not counted

CRAR (2): risk-weighted assets

Risk weight	Assets (para 18(1))
0%	Cash, bank balances and bank FDs/CDs; approved and Central Government securities; loans against own deposits; staff loans; advance tax (net)
20%	Public sector bank bonds; State Government guaranteed claims not in default over 90 days
50% / 75%	High-quality infrastructure loans, once 5% / 2% of project debt is repaid
100%	Corporate shares, debentures, CP, MF units; ICDs; other secured loans; bills; leased and other assets
125%	Consumer credit (excl. housing, education, vehicle, gold, microfinance) and credit card receivables

Off-balance sheet (Reg. 18(3)–(11))

Amount × credit conversion factor × risk weight

- 100%: financial and other guarantees, asset sales with recourse, forward commitments
- 50%: share/debenture underwriting obligations, other contingent liabilities, lines over 1 year
- 20%: lines up to 1 year; 0%: unconditionally cancellable

ICAAP (para 54)

Middle Layer and above: Board-approved internal capital assessment

Compliance at a glance

Governance

Board policies, CCO, CRO and committees

Reporting

Returns to RBI, FIU-IND and credit bureaus

Fair practices

KFS, interest, charges, recovery

Grievance redress

Internal Ombudsman for specified NBFCs

KYC & AML

Customer due diligence; PMLA reporting

Fraud, IT & outsourcing

Fraud reporting, cyber, vendor oversight

Governance: who owns compliance

Roles

Board

Approves policies; owns risk appetite and conduct

Audit Committee

Oversees audit, auditors and internal controls

Chief Compliance Officer

Middle and Upper Layer; independent, fixed tenure

Chief Risk Officer

Middle and Upper Layer; independent of business

Principal Officer and Designated Director

PMLA reporting; registered with FIU-IND

Grievance officer / IO

Complaints; Internal Ombudsman where applicable

Board-approved policies

- Credit / loan policy and delegation
- Fair Practices Code and interest-rate model
- KYC and AML
- Fraud risk management
- Outsourcing; IT and cyber security
- ECL / provisioning and write-off
- Compliance and grievance redressal
- Statutory auditor appointment (published on website)

Customer conduct for NBFCs

Key Facts Statement

All retail and MSME term loans: KFS with all-in APR before signing

Interest and charges

Interest from actual disbursement; penal charges, not penal interest, never capitalised

Prepayment

No foreclosure charges on floating-rate loans to individuals (non-business)

Recovery

No harassment; trained agents; calls only between 9 am and 6 pm

Release of documents

Original property papers within 30 days of closure, or ₹5,000 a day

Grievance redress

Nodal officer; Internal Ombudsman review before rejection

KYC, AML and credit information

KYC

- Board-approved KYC policy; customer due diligence on onboarding
- Beneficial owner identified for entities
- Risk categorisation; periodic update: high 2, medium 8, low 10 years
- Records uploaded to CKYCR; V-CIP for remote onboarding

Anti-money laundering

- Principal Officer and Designated Director registered with FIU-IND
- STR within 7 working days; CTR monthly
- Screening against UN (United nations Security Council) and UAPA (Unlawful activities Prevention Act) sanctions lists
- Records kept for at least 5 years

Credit information

- Member of all four credit bureaus
- Data reported fortnightly, within 7 days
- Customers told of adverse action (SMA or default)
- Compensation of ₹100 a day if a complaint is not resolved in 30 days

The reporting calendar

RBI return (CIMS portal)	When	Who files
DNBS01 / DNBS02 – financial parameters	Quarterly	01: ML, UL 02: BL
DNBS03 – prudential parameters (Capital adequacy, provisioning etc.,)	Quarterly	ML, UL
DNBS04A / 04B – liquidity (ALM, Interest rate sensitivity)	Quarterly / monthly	ML, UL; BL ICC, MFI, Factor ≥ ₹500 cr
DNBS08 / 09 – CRILC (₹5 cr+ borrowers; SMA-0)	Monthly / weekly	ML, UL; BL ICC, MFI, Factor ≥ ₹500 cr
DNBS13 – Overseas investment	Quarterly (NIL if none)	All NBFCs
DNBS10 – Statutory Auditor Certificate	5 working days after audit report; by 31 Dec	All — filed by the auditor
Form A – auditor appointment	Within 1 month of appointment	All NBFCs
FMR / FMR-4 – frauds; robbery and theft	Within 14 days / quarterly	All NBFCs

Outside CIMS

Credit bureaus (all four): fortnightly — 15th and month-end

FIU-IND: STR within 7 working days; CTR by the 15th of next month

Cyber incidents: RBI within 6 hours of detection

ROC: AOC-4 and MGT-7 after the AGM

Fraud, technology and outsourcing

Fraud risk management

- Board policy; fraud risk unit within risk management
- Early warning signals and red-flagged accounts
- Show-cause notice with at least 21 days before declaring fraud
- Fraud returns to RBI within 14 days; report to police

Technology & cyber

- IT Strategy Committee and CISO
- Cyber incidents to RBI within 6 hours
- Business continuity and DR tested
- IS audit of core systems and access rights

Outsourcing & data

- Core functions (sanction, strategic and compliance functions, internal audit decisions) not outsourced
- Vendor due diligence and RBI access in contracts
- Recovery agents and DLAs remain the NBFC's responsibility
- DPDP Act duties: consent, security, breach notice

Internal audit: who, how and limits

Who must follow RBI's rules

- All deposit-taking NBFCs
- Non-deposit NBFCs with assets ≥ ₹5,000 crore
- All deposit-taking HFCs; non-deposit HFCs ≥ ₹5,000 crore

Everyone else

- Companies Act s.138: internal auditor if listed, or above the size limits in Rule 13

Can it be outsourced?

No — the internal audit function cannot be outsourced (para 39)

Experts, even ex-employees, may be hired on contract only if:

- the Board / Audit Committee is satisfied the skill is not in-house
- conflicts of interest are handled
- the in-house audit team owns every report

Must comply with

- Board-approved internal audit policy and risk-based audit plan
- Risk assessment of every activity and location, at least yearly
- Head of Internal Audit: should be appointed for a minimum of 3 years
- Audit Committee meets the Head alone every quarter
- Auditors' pay not linked to business results

Branches: what the rules allow

General rule

Most NBFCs can open branches without RBI approval — unless specifically restricted

Deposit-taking NBFCs

NOF ≤ ₹50 crore or rating below AA: branches and agents only in the home State.
NOF > ₹50 crore and rating AA or above: anywhere in India.

Branches abroad

Not allowed as a general policy. Representative offices abroad need prior RBI approval — only liaison, market study and research; no funding or credit lines.

Closing a branch

Three months' public notice in a national and a local-language newspaper, with arrangements for depositors.
Deposit-taking NBFC should send RBI a copy within 7 days.

Gold-loan branches

Safe storage and security for pledged gold at every branch.

What a branch can do

Any business the NBFC itself is allowed to do — lending, collections, distribution as agent; deposits only by deposit-taking NBFCs within their area.

Change in control, shareholding or directors

1. Takeover or control

- **Prior approval:** any takeover or acquisition of control, direct or indirect
- **Applies** even if the management does not change
- **'Control':** as defined in SEBI Substantial Acquisition of shares and takeover Regulations, reg. 2(1)(e)

2. Shareholding 26% or more

- **Prior approval:** any acquisition or transfer resulting in ≥ 26% of paid-up equity
- **Progressive** purchases are added up
- **No approval:** 26% crossed by court-approved buyback or capital reduction - inform RBI within 1 month

3. Directors: more than 30%

- **Prior approval:** change in management resulting in change of more than 30% of directors
- **Excluded:** independent directors; re-election on retirement by rotation
- **T**he test is 'more than 30%', not 'one-third' or '≥ 30%'

HOW THE PRIOR WRITTEN APPROVAL IS OBTAINED (same for all three):

NBFC applies on PRAVAAH (buyer details, source of funds, declarations) → RBI grants prior written approval → Public notice ≥ 30 days before transfer (national + vernacular paper) → Complete the transfer

Restrictions on dividends and on lending

Dividend: eligibility and ceiling

- **Capital:** met CRAR, Tier 1 and leverage in each of the last 3 years
- **Net NPA:** below 6% in each of the last 3 years
- **Other:** reserve fund under s.45-IC complied with; no RBI bar on dividends
- **Payout ceiling** (dividend ÷ audited net profit): 50% most NBFCs • 60% CIC • no ceiling for Type I
- **Relaxation:** missed a test in an earlier year → up to 10% payout, if capital is met and NNPA < 4% at year-end
- **Deduct** exceptional profits and profit overstated per audit qualification
- **Report** to RBI within a fortnight of declaration

Lending: what is restricted

- **Listed shares** (NBFCs ≥ ₹100 cr): 50% LTV at all times; shortfall cured in 7 working days
- **IPO funding:** up to ₹1 crore per borrower
- **Gold:** no loans to buy gold or against bullion/primary gold; LTV 85% / 80% / 75% (≤ ₹2.5 lakh / ≤ ₹5 lakh / above)
- **Related parties** incl. directors (from 1 Apr 2026): Board/committee approval above ₹1 cr BL, ₹5 cr ML, ₹10 cr UL

IT general controls (ITGC) in NBFCs

What is ITGC?

Controls over the IT environment that make the system's data reliable: who can access it, how changes are made, and how it is run and backed up.

Is it mandatory?

Yes. Every RBI-registered NBFC must follow RBI's Cybersecurity and Technology Directions, 2026 (31 July 2026). How much is required depends on size and layer.

NBFC	What it needs
Base Layer below ₹ 500 cr, and CICs	Basic controls: access, backup, cyber incident reporting
Base Layer ₹ 500 cr and above	Plus an IT Strategy Committee, a CIO and a yearly IS audit
Middle and Upper Layer	Full framework: IT committees, CISO, regular security testing and DR drills

For everyone: report a cyber incident to RBI within 6 hours.

03

Auditor appointment

Eligibility, independence, tenure and reporting

Eligibility: what your firm needs

NBFC asset size	Full-time partners	of which FCA	CISA / ISA	Audit experience	Professional staff
Above ₹15,000 crore	5	4	2	15 years	18
₹1,000 – 15,000 crore	3	2	1	8 years	12
Up to ₹1,000 crore	2	1	Not mandatory	6 years	8

- Partners need at least one year's continuous association; above ₹1,000 crore, two partners need ten years
- Firm must not be debarred by NFRA, ICAI, RBI or any other regulator
- Computer-assisted audit tools preferred for NBFCs above ₹1,000 crore
- If a partner is a director in any NBFC, the firm cannot audit that group

Independence and mandate limits

No concurrent auditor

The NBFC's concurrent auditor cannot be its statutory auditor

One-year cooling-off

After non-audit work for the NBFC or its group

Network counts as one

Common partners or the same network are treated as one firm

Cap: 8 NBFCs a year

Also 4 banks and 8 UCBs, regardless of asset size

Large exposures

Audits of large borrowers of the NBFC weigh on independence

Report concerns

Audit Committee monitors; concerns go to RBI supervisors

Tenure, joint audit and coverage

3 yrs
Continuous term, if eligible each year

6 yrs
Before the same firm can return

₹15,000 cr
Assets that require a joint audit

15%
Minimum share of gross advances covered by branch visits

- Joint auditors: no common partners, not in the same network; work split agreed before the audit
- Branch visits: at least the top 20 branches (or top 20% if under 100 branches), by advances
- Removal before three years: NBFC informs RBI within a month, with reasons
- NBFC reports serious audit lapses to RBI within two months of the audit

Appointment, step by step

1

Board policy

Approved and published on the NBFC's website

2

Shortlist

At least two firms for each vacancy

3

Form B

Each firm certifies its eligibility

4

Verify

NBFC checks eligibility before appointing

5

Appoint

Board / Audit Committee, then members

6

Form A

Filed with RBI within one month

Reporting requirements for auditors

	Report	Covers	To / when
1	**Main audit report**	True and fair view; KAMs where applicable; IFC	Members
2	**CARO 2020, clause 3(xvi)**	RBI registration, business without CoR, CIC status	Members
3	**Report to the Board**	Matters under RBI Auditor's Report Directions, 2026	Board of Directors
4	**DNBS10 certificate (SAC)**	CoR eligibility and NOF, filed on CIMS	RBI: 5 working days, by 31 December
5	**Exception report**	Qualifications or non-compliance with RBI rules	RBI supervisory office

Where misstatement hides

ECL & staging

Judgement-heavy; often a key audit matter

Asset classification

Late NPA tagging, restructuring, evergreening

Interest & fees

Effective interest rate, income on stressed loans

IT systems

DPD and interest logic sits in the software

Related parties

Group lending, connected borrowers

Liquidity

Asset-liability gaps; going concern

04

Interest calculation & accrual

Recognition, a worked example, recurring errors

How interest income is recognised

Accounting (Ind AS 109)

- Effective interest rate (EIR) method
- Processing fees and direct sourcing costs spread over the loan's life
- Accrued daily on the reducing balance
- Stage 3 loans: interest on the net amount after ECL

Regulation (RBI)

- Interest only from the date of cheque handover/ date of funds reaching the borrower
- No interest for days the loan was not outstanding
- Penal charges are charges, not interest — never capitalised
- All-in cost disclosed upfront in the Key Fact Statement

EIR: a worked example

Loan terms	
Loan amount	₹1,00,000
Contract rate	18% p.a., reducing, 12 months
EMI	₹9,168
Processing fee	₹2,000 (net disbursal ₹98,000)
Total income over the loan	₹12,016

Income booked in month 1 – AS

₹3,500 Fee taken upfront + contract interest

Income booked in month 1 – Ind AS

₹1,500 Contract interest, fee ignored

₹1,800 EIR method — correct (Including interest)

Front-loading fees overstates profit in a growing book

Common errors in income recognition

1. **Interest from sanction date**
   Instead of the day funds reached the borrower/date of cheque handover

2. **Full-month interest**
   Charged though the loan ran only part of the month

3. **Advance EMIs ignored**
   Interest still charged on the full amount

4. **Fees booked upfront**
   Not spread through the EIR

5. **Accrual on bad loans**
   Income kept running on NPAs and Stage 3 at gross

6. **Penal charges capitalised**
   Interest charged on penalties

7. **Rate master errors**
   System rate differs from sanction letter or reset

8. **Day-count mix-ups**
   360 vs 365 days; leap years; moratorium periods

Case: pricing as a red flag

REGULATOR *RBI action against four NBFCs, 17 October 2024*

What happened

- Fresh lending stopped from 21 October 2024
- Deviations in income recognition and asset classification norms
- Collections and servicing allowed to continue

How it stayed hidden

- Deviations sat inside income recognition and asset classification
- Evergreening masked real overdue status
- Core financial services outsourced, weakening oversight

What the auditor should test

- Board-approved pricing policy and actual yields by product
- Overdue status vs income recognition, account by account
- Fresh loans to borrowers who were overdue
- Fees and charges against the Key Fact Statement

Audit procedures for interest

1. **Recompute for all loans**
   Rate × outstanding × days, from the loan book

2. **Reconcile accrual to ledger**
   Loan system interest = general ledger interest

3. **Test the rate master**
   System rates vs sanction letters, KFS, resets

4. **Test EIR**
   Fees and costs included; release on prepayment

5. **Check bad-loan income**
   No accrual on NPAs; Stage 3 on net amount

6. **Yield analysis**
   Income ÷ average loans, by product and month

7. **System logic**
   Changes to interest code approved and tested

8. **Refunds and complaints**
   Excess interest refunds; RBI directions; provisions

05

NPA Classification and ECL Provisioning

How the number is built, where it goes wrong, how to audit it

Ind AS 109: three stages

Stage 1	Stage 2	Stage 3
Trigger Performing	**Trigger** Significant increase in credit risk	**Trigger** Credit-impaired
Provision 12-month ECL	**Provision** Lifetime ECL	**Provision** Lifetime ECL
Income Interest on gross amount	**Income** Interest on gross amount	**Income** Interest on net amount (after ECL)

Backstops in the standard: more than 30 days overdue presumes a significant increase in risk; more than 90 days presumes default. Both are rebuttable — but only with evidence.

How the number is built

ECL = PD × LGD × EAD discounted, and weighted across economic scenarios

PD — Probability of default: from the NBFC's own repayment history, by product and vintage

LGD — Loss given default: after collateral, recoveries, costs and time to recover

EAD — Exposure at default: principal, accrued interest, undrawn limits

Scenarios — Base, upside, downside economic outlooks, with weights

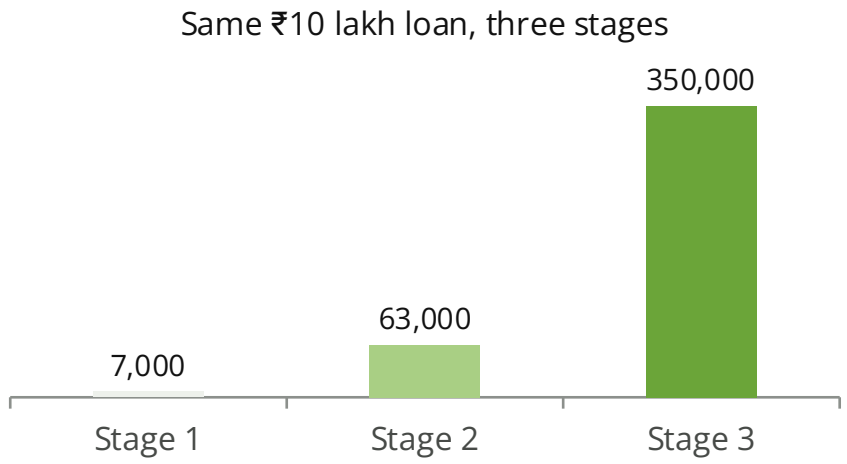


Illustration: LGD 35%; PD 2% (12-month), 18% (lifetime), 100% (impaired); no discounting

NPA classification and provisioning

Standard	SMA-1	SMA-2	NPA
not overdue	overdue > 30 days	overdue > 60 days	overdue > 90 days

Category	When	Minimum provision
Standard	Not overdue > 90 days	0.25% BL • 0.40% ML • UL 0.25%–2% by segment
Sub-standard	NPA ≤ 12 months	10% of outstanding
Doubtful – up to 1 yr	Sub-standard > 12 months	100% of unsecured portion + 20% of secured
Doubtful – 1 to 3 yrs	In doubtful for 1–3 years	100% of unsecured portion + 30% of secured
Doubtful – over 3 yrs	In doubtful for over 3 years	100% of unsecured portion + 50% of secured
Loss	Identified as uncollectible	Write off, or 100% provision

- 90-day norm applies to all NBFCs from 31 Mar 2026 (Base Layer glide path 150 → 120 → 90 days ended)
- Borrower-wise: one NPA facility makes all the borrower's facilities NPA
- Overdue flagged in the day-end process on the due date
- Upgrade only when the entire arrears of interest and principal are paid
- Income on NPA only on realisation; reverse unrealised income
- Ind AS: these are a floor — any shortfall goes to an Impairment Reserve

ECL vs IRACP: which provision is booked?

1 ECL under Ind AS 109

Board-approved model; Stage 1, 2, 3; forward-looking

Charged to P&L

2 IRACP floor

RBI percentages by asset class and age (slide 42)

Used only to compare

3 Compare the two

ECL ≥ IRACP: nothing more to do

ECL < IRACP: Create an Impairment Reserve

From profit after tax

Example

ECL: ₹80 lakh • IRACP: ₹100 lakh

P&L impairment: ₹80 lakh

Impairment Reserve: ₹20 lakh, debited directly to reserves

Reserve: not capital; withdrawal needs RBI approval

Provide more than ECL?

Not as a P&L provision — the allowance must be an unbiased estimate

Allowed only as: a justified overlay, or an appropriation to a reserve

Overlays and RBI guardrails

Overlay: Audit Committee approval; documented, quantified, time-bound

Default: 90 days past due

SICR: not deferred beyond 60 days

The RBI layer on top of Ind AS

Board-approved policy

Staging, definition of default and cure rules approved by the Board

Side-by-side disclosure

ECL compared with RBI provisioning norms in the notes

Impairment Reserve

If ECL is lower, the gap is moved from profit to a reserve — not capital

No easy release

Withdrawal from the reserve needs RBI permission

Stress not hidden

Restructured and evergreened loans cannot be cured on paper

Supervisory scrutiny

RBI inspections compare reported and assessed provisions

Where ECL goes wrong

1. **Wrong overdue data**
   Stale or manually overridden days-past-due

2. **Mechanical cures**
   One payment moves a loan back to Stage 1

3. **Thin history**
   PD from a young, fast-growing book

4. **Optimistic LGD**
   Ignores recovery costs, time, collateral haircuts

5. **Stale collateral**
   Property or gold valued years ago

6. **Convenient overlays**
   Added or released to smooth profit

7. **Missing exposures**
   Undrawn limits and accrued interest left out

8. **No back-testing**
   Model never compared with actual losses

Audit procedures for ECL

1. **Understand the model**
   Policy, governance, who approves changes (SA 315)

2. **Test the data**
   Reconcile loan book to ledger; recompute overdue days

3. **Re-perform staging**
   Full population, including cures and restructures

4. **Challenge parameters**
   Back-test PD and LGD against actual outcomes

5. **Test scenarios**
   Source, weights and changes from last year

6. **Probe overlays**
   Rationale, approval, reversal in later periods

7. **Use an expert**
   Model specialist where complexity needs it (SA 620)

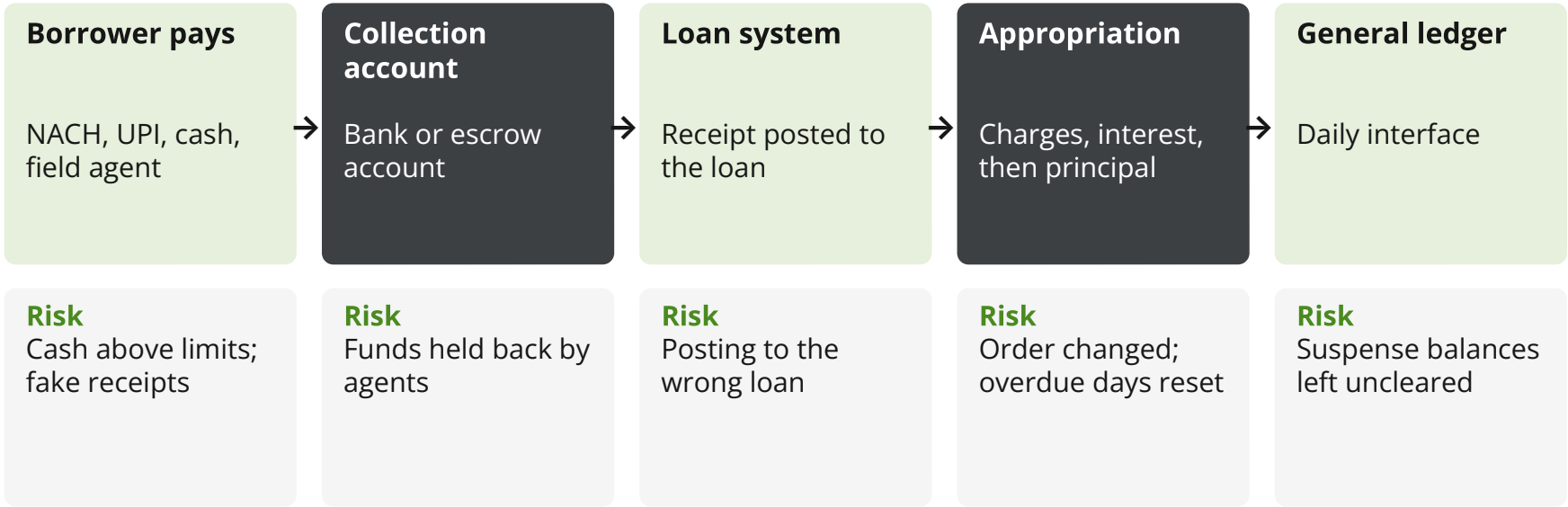
8. **Stand back**
   Management bias, IRACP comparison, disclosures (SA 540)

06

Collections & repayments

From the borrower's payment to the ledger

From EMI to ledger



Where collections go wrong

Processing errors

- Receipts parked in suspense and never applied
- Wrong appropriation order
- Bounced NACH not reversed in the loan account
- Part-prepayments not reducing EMI or tenure
- Co-lending collections split wrongly

Cash and agent risks

- Cash collected but deposited late, or not at all
- Teeming and lading between borrowers
- Fake or duplicate receipt books
- Cash beyond income-tax limits
- Overdue days reset by manual override

Audit procedures for collections

1. **Three-way reconciliation**
   Bank credits, loan system receipts, ledger
2. **Age the suspense**
   Unapplied and unidentified receipts, by age
3. **Who paid?**
   Repayments from accounts other than the borrower's
4. **Receipt book control**
   Issued, used, cancelled — all accounted for
5. **Surprise cash counts**
   At branches and with field collectors
6. **Borrower confirmations**
   Sample balances, especially 'regular' payers
7. **NACH bounce file**
   Bounces matched to overdue status
8. **Overrides log**
   Manual overdue-day and appropriation changes

07

Frauds in NBFCs & case studies

Employees, management and borrowers

Who commits fraud, and how



Employees

- Ghost loans using recycled KYC
- Spurious gold with valuer collusion
- Cash collections pocketed
- Unauthorised waivers and restructuring



Management

- Evergreening through third parties
- Parallel books and fictitious loans
- Funds diverted to promoter entities
- Bad loans kept 'standard' on paper



Borrowers

- Fake identity, income or bank statements
- Fake gold or forged title deeds
- Same collateral pledged twice
- Loan stacking across many lenders

Employee frauds

Common schemes

- Loans in names of unaware customers
- Valuer passes spurious gold
- Field staff keep cash collections
- Teeming and lading to hide shortfalls
- Unauthorised waivers or restructures
- Customer data sold to outsiders

Red flags

- Loans sharing a phone, address or account
- Loans that never miss an EMI, paid in cash
- Gold packets not re-tested since pledge
- Same staff sanction, disburse and collect
- Staff who never take leave
- Spike in waivers near month-end

Management frauds

Common schemes

- New loans via third parties repay old ones
- Loans to shell companies linked to promoters
- Fictitious borrowers kept in a separate system
- Board restrictions bypassed for 'special' loans
- Overdue status suppressed to avoid provisions
- Group exposure split to dodge limits

Red flags

- Large corporate loans with thin documentation
- Borrowers sharing addresses or directors
- Loan funds flowing back to group entities
- Loans approved by e-mail, outside the system
- More than one loan system, or manual ledgers
- Sudden growth in one product or branch

Borrower frauds

Common schemes

- Fake identity or forged KYC
- Doctored salary slips and bank statements
- Spurious gold or forged property papers
- Same asset pledged to two lenders
- Loans taken from many apps at once
- Loan used for a purpose other than stated

Red flags

- Income documents that don't match bureau data
- Default on the first or second EMI
- Many recent enquiries on the credit report
- Collateral value far above local norms
- Disbursal account opened just before the loan
- Clusters of loans via the same agent

Detecting fraud: Audit procedures

Technique	Audit Procedures	Potential fraud identified
Rule-based data tests	Run fixed tests on the whole loan book	Duplicate borrowers, evergreening, hidden NPAs
Link analysis	Join borrowers by phone, address, bank account, directors (MCA data)	Connected and shell borrowers
Fund-flow tracing	Follow large disbursals through bank statements	Diversion, round-tripping
Early-default analysis	First or second EMI missed, by agent or branch	Borrower and agent rings
Surprise checks	Cash counts, gold re-testing, field visits	Theft, fake gold, ghost borrowers
External confirmations	Borrowers, co-lenders, banks (SA 505)	Fictitious balances
Complaints and tips	Whistle-blower and customer complaints by branch	Staff misconduct

Case 1: DHFL — what happened

MANAGEMENT *Dewan Housing Finance Corporation — forensic audit by Grant Thornton; CBI cases*

Jan 2019
Cobrapost alleges ₹31,000 crore siphoned via shell companies

20 Nov 2019
RBI supersedes the Board; administrator appointed

Dec 2019
First finance company admitted to insolvency (IBC)

Aug 2020
Final forensic report on the 'Bandra Book'

Jun 2021
NCLT approves Piramal's resolution plan

How it was done

- 2.6 lakh fake home loans (2007–19) in a non-existent branch: ₹14,046 crore
- ₹11,756 crore routed to 91 'Bandra Book' entities
- KYC copied from customers who had already repaid
- Approved by e-mail; no collateral
- Separate software ran the fake book
- Fake receipts posted as principal; fictitious interest
- PMAY subsidy of ~₹1,887 crore claimed on fake loans

Case 1: DHFL — detect and prevent

Red flags that were visible

- A branch with loans but no premises, staff or costs
- Regular EMIs with no bank trail
- A cluster of borrowers on lower rates
- Common addresses across 'retail' borrowers
- Loans approved by e-mail
- More than one loan system

How the auditor detects it

- Match the branch list with rent, payroll and asset registers
- De-duplicate new loans against closed-loan KYC
- Test who paid each EMI, from which account
- Trace disbursals to beneficiary accounts; look for clusters
- Reconcile every system and data partition to the ledger and bank
- Confirm balances directly with sampled borrowers

How management prevents it

- One system of record; all partitions visible to IT audit
- Approvals only inside the system, with maker-checker
- Access logs on back-end changes reviewed monthly
- Subsidy claims reconciled to loan data
- Internal audit reporting to the Audit Committee
- Protected whistle-blower channel

Case 2: IL&FS — what happened

MANAGEMENT *IL&FS Financial Services (IFIN) — SFIO investigation and chargesheet*

2017 — Whistle-blower raises concerns; reportedly not acted on

Jun 2018 — Group company ITNL defaults on about ₹450 crore

4 Sep 2018 — Default on ₹1,000 crore SIDBI loan

1 Oct 2018 — NCLT lets Government replace the Board; group debt about ₹91,000 crore

2019 — SFIO chargesheet on IFIN: evergreening, auditor collusion alleged

How it was done

- 88 cases of evergreening in five years
- ₹2,985 crore lent to group companies in three years to Mar 2018 to stop defaults
- ₹1,630 crore sent to ITNL through eight group companies with negative net worth
- Routing used to get around RBI concentration limits
- ₹125 crore lent to Unitech, paid on to Siva Ventures, which cleared ₹80 crore of IFIN dues
- RBI observation on negative net owned fund and CRAR below regulatory requirements not disclosed in the audited financial statements

Case 2: IL&FS — detect and prevent

Red flags that were visible

- Fresh loans to borrowers with negative net worth
- Overdue cleared within days of a new disbursal
- Third-party loans with no clear purpose
- Group exposure close to limits
- RBI findings not disclosed
- Ignored whistle-blower complaint

How the auditor detects it

- Match new disbursals to old dues cleared within 30 days
- Trace where the money went, from bank statements
- Recompute group exposure, including indirect routes
- Read RBI inspection reports and management replies
- Review the whistle-blower register (CARO 3(xi)(c))
- Escalate and document - knowing is not enough

How management prevents it

- Limits on group exposure counting indirect lending
- Independent credit committee for group loans
- Restructured and refinanced loans flagged automatically
- Early-warning signals and red-flagged accounts
- Whistle-blowers report to the Audit Committee

Case 3: IIFL Finance — what happened

OPERATIONS

RBI action on IIFL Finance's gold loan business — control failures, not a fraud finding

31 Mar 2023
Reference date of RBI inspection

4 Mar 2024
RBI bars new gold loans; servicing continues

23 Apr 2024
RBI special audit begins

Aug 2024
Gold loan book falls from ₹26,081 crore to ₹12,162 crore

19 Sep 2024
Restrictions lifted after remedial action

How it was done

- Serious deviations in testing gold purity and net weight, at sanction and at auction
- Loan-to-value ratio breaches (RBI cap: 75%)
- Cash disbursed and collected far above the statutory limit
- Standard auction process not followed
- Charges to customers not transparent
- Company said it disbursed and collected cash up to ₹2 lakh

Case 3: IIFL — detect and prevent

Red flags that were visible

- Auction recoveries below loan balances
- Weight at auction below weight at pledge
- High share of cash disbursals and collections
- Loans close to or above the 75% cap
- Customer complaints about charges

How the auditor detects it

- Re-test a sample of gold packets with an independent appraiser
- Compare pledge weight and purity with auction records
- Recompute loan-to-value on the sanction date
- Extract cash transactions of ₹20,000 or more
- Test auction steps: notice, reserve price, surplus refunded
- Recompute charges against the Key Fact Statement

How management prevents it

- Photographs and weight of every packet captured in the system
- Dual custody; seals checked on every movement
- Cash limits hard-coded in the loan system
- Board-approved auction policy, followed and logged
- Surprise packet audits by internal audit

From samples to the full population

Traditional

- Pick 25–60 loan files
- Rely on the system's overdue report
- Test at year-end only
- Findings depend on luck of the sample

Data-led

- Take the entire loan book
- Recompute overdue days yourself
- Run tests quarterly or continuously
- Sample only the exceptions the data throws up

The software is the ledger

Loan origination → **Loan management** → **General ledger** → **RBI returns**

IT controls to test

- User access and segregation of duties
- Changes to overdue-days and interest logic
- Interface reconciliations between systems
- Reliability of system reports used as evidence

RBI cyber & technology Directions, 2026

- Issued 31 Jul 2026, in force
- Requirements scale with layer and asset size
- Information systems audit expected
- Cyber incident reporting to RBI

Thank you

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