

# RBI introduces stringent norms for Core Investment Companies

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Core Investment Companies ('CICs'), as the name suggests, are those companies that make investment as part of their core activity. They are a class of NBFCs, which hold majority investments in companies within the same group.

The regulatory framework for CICs is governed by the Master Direction - Core Investment Companies (Reserve Bank) Directions, 2016<sup>1</sup> ('Master Directions'). The provisions apply to Core Investment Companies with an asset size of not less than Rs. 100 crores, either individually or in aggregate along with other CICs in the group and having access to public funds, currently known as 'Systemically Important CICs'.

Due to the growing number and size of CICs there arose complexity of group structures, multiple layers of CICs and other corporate governance issues. A Working Group was set up under the Chairmanship of Shri Tapan Ray, on 3rd July, 2019 in this regard to review the extant framework and make recommendations on the same, to enhance effective corporate governance, disclosures, etc.<sup>2</sup> The Working Group's report<sup>3</sup> was published on 06th November, 2019.<sup>4</sup>

Taking into consideration the recommendations of the Working Group, the RBI has on 13th August, 2020<sup>5</sup> notified a set of guidelines making amendments to the extant Master Directions.

## Major changes to the CIC regulations -

Here we discuss in detail some of the major changes that have been made to the regulatory framework for CICs.

### **Adjusted Net worth (ANW) -**

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<sup>1</sup> [https://www.rbi.org.in/Scripts/BS\\_ViewMasDirections.aspx?id=10564](https://www.rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=10564)

<sup>2</sup> Our article on the same can be read here- <http://vinodkothari.com/2019/07/rbi-to-strengthen-corporate-governance-for-core-investment-companies/>

<sup>3</sup> <https://www.rbi.org.in/Scripts/PublicationReportDetails.aspx?UrlPage=&ID=945>

<sup>4</sup> Our article on the same can be read here <http://vinodkothari.com/2019/11/working-group-proposal-for-stricter-vigilance-on-cics/>

<sup>5</sup> <https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11949&Mode=0>

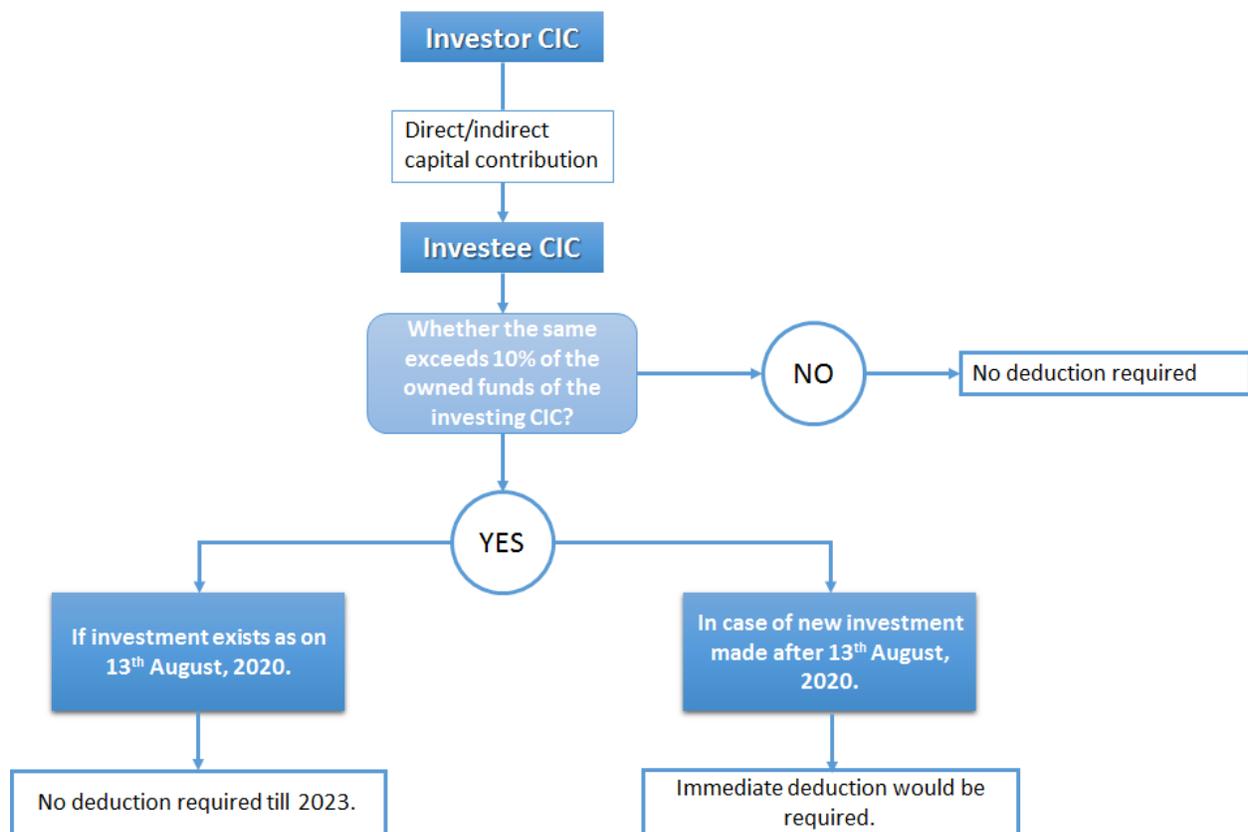
The RBI has introduced a new requirement while computing the Adjusted Net Worth (ANW) of a CIC. The amount representing any direct or indirect capital contribution made by one CIC in another CIC, is required to be deducted, to the extent such amount exceeds ten percent of Owned Funds of the investing CIC.

The requirement is on the “investing CIC” making any investment in the “investee CIC”.

**What happens to any existing investment by a CIC in another CIC exceeding 10%, prior to or as on the date of the circular?**

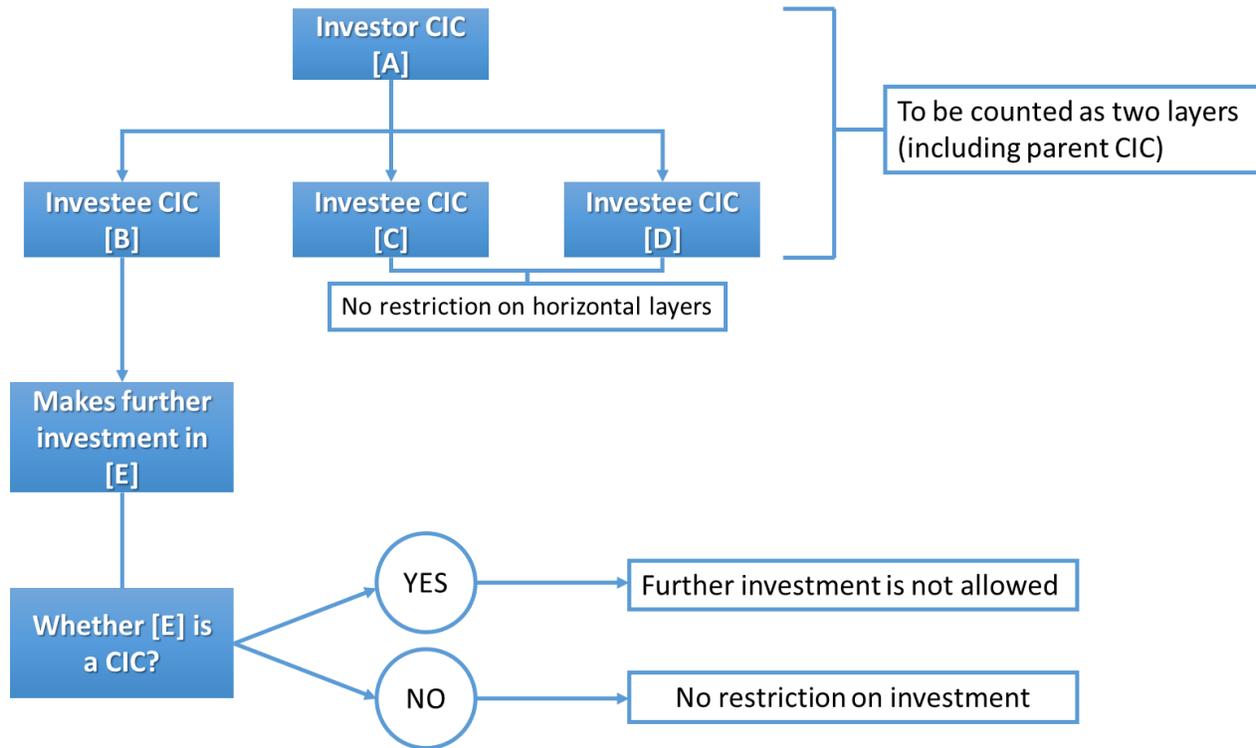
There may be cases where the CICs already have investment in another CIC as on the date of the circular. In that case, the RBI has clarified that the CIC need not deduct the excess investment as on the date of this circular from owned funds for computation of its ANW till March 31, 2023. Therefore a blanket time gap has been given till 2023 for existing investment exceeding 10%.

For any new investment made after the date of the circular, however, the requirement applies immediately.



**Group structure investment layer restrictions -**

The new norms have put a restriction on the number of layers of CICs in a group to avoid complexity of structures. The limit on the number of layers of CICs within a Group (including the parent CIC) has been restricted to two, irrespective of the extent of direct or indirect holding/ control exercised by a CIC in the other CIC. While there is a restriction on the number of layers of CICs in the group, there is no restriction on the downstream entity making an investment in any other entity which is not a CIC. The requirements are better presented graphically below –



### Consolidation of Financial Statements (CFS) –

The changes also require CICs to now prepare CFS as per provisions of Companies Act, 2013, so as to provide a clear view of the financials of the group as a whole.

This means that CICs would have to consolidate all subsidiaries and associates in the group while preparing consolidated financial statements. However, there may be other entities, who may form part of “companies in the same group” but may not require consolidation under the Companies Act, 2013.

For such entities as well, RBI has mandated certain disclosure requirements (as laid down in para 2 of the Annex to the RBI circular) while presenting consolidated financial statements. These disclosure requirements are reproduced below –

*“The following shall be disclosed by the CIC with regard to group entities that are not consolidated in the CFS:*

- a) Name of the entity, type of business, size of its assets, debt-equity ratio, and profitability for the last two years*
- b) Nature and type of exposure on each entity: i) Investments in equity ii) investments in convertible instruments, iii) investments in bonds/ debentures/ other instruments, iv) loans and advances, v) any other*
- c) Total exposure of the CIC towards non-financial business (entity-wise)*
- d) Loans and advances to firms/companies in which directors are interested*
- e) Investments by the loanee of the CIC in the shares of parent company and group companies”*

While the disclosure requirements seem to be made with “regard to group entities not consolidated”, there is lack of clarity whether the details mentioned in certain points such as point (d) and (e) relate to the parent CIC or the group entities being consolidated.

**Comparative analysis of the changes made -**

We had already provided our analysis on the recommendations of the Working Group in separate write ups. In this write up we intend to cover what the extant regulations earlier provided, and what measures have been taken on a review of the guidelines in a comparative table below -

Sr. No.	Current provisions under CIC regulations	Amendments in CIC regulations vide notification dated 13th August, 2020	Whether similar provisions exist under NBFC Directions?
<b>Adjusted Net Worth (ANW)</b>			
1	<p>As per para 3(i) of master directions ANW means:</p> <p>(a) The aggregate of Owned Funds as appearing in the last audited balance sheet as at the end of the financial year,</p> <p><b>(b) as increased by:</b></p> <p>A. 50% of the unrealized appreciation in the book value of quoted investments as at the date of the last audited balance sheet as at the end of the financial year; and</p> <p>B. the increase, if any, in the equity share capital since the date of the last audited balance sheet.</p> <p><b>(c) as reduced by:</b></p> <p>A. the amount of diminution in the aggregate book value of quoted investments (such diminution being calculated as the excess of the book value of such investments over the aggregate market value of such investments) and</p> <p>B. the reduction, if any, in the equity share capital since the date of the last audited balance sheet.</p>	<p>Keeping all other terms and conditions same, while computing ANW, additionally any capital contribution whether direct or indirect made by one CIC in another CIC shall be deducted, <b>to the extent such amount exceeds ten percent</b> of Owned Funds of the investing CIC.</p> <p><b>Timeline for compliance in case of existing CICs -</b> The deduction requirement shall take immediate effect for any investment made by a CIC in another CIC after date of issue of this circular.</p> <p>In cases where the investment by a CIC in another CIC is already in excess of 10 percent as on the date of this circular, the CIC need not deduct the excess investment as on the date of this circular from owned funds for computation of its ANW <b>till March 31, 2023.</b></p>	<p>Under NBFC directions, there is a similar concept of deducting investment in subsidiaries and companies in the same group to the extent it exceeds 10% of the owned fund to arrive at the net owned fund.</p> <p>Therefore, the recommendation of the Working Group has been made to align the CIC provisions with that of other NBFCs.</p>
<b>Group Structure</b>			
2	<p>Under the extant master directions, the restriction with respect to 2 layer subsidiaries is applicable only in case of overseas structure which</p>	<p>With a view to resolve the issue of the complex group structures and multiple CICs in the same group, the number of layers of CICs within a Group (including the</p>	<p>NBFCs are exempted from the provision under the Companies (Restriction on number of layers) Rules, 2017, which deals with</p>

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	requires non-operating holding company.	<p>parent CIC) is now restricted to two layers. This is irrespective of the extent of direct or indirect holding/ control exercised by a CIC in the other CIC. If a CIC makes any direct/ indirect equity investment in another CIC, it will be deemed as a layer for the investing CIC.</p> <p><b>Timeline for compliance in case of existing CICs -</b> While the regulation shall be applicable from the date of the circular, existing entities shall reorganise their business structure and adhere to this guideline latest by March 31 2023.</p>	<p>restriction on number of layers.</p> <p>This is one of the reasons why there existed multiple layers of CICs in a Group (with cross holdings).</p>
<b>Risk Management</b>			
3	<p><b>Risk Management Committee -</b> As per Guidelines on Liquidity Risk Management Framework, systemically important CICs were required to constitute a Risk Management Committee (RMC) consisting of the CEO/ MD and heads of various risk verticals.</p> <p>The Risk Management Committee reports to the Board and is responsible for evaluating the overall risks faced by the NBFC including liquidity risk.</p>	<p><b>Constitution of Group Risk Management Committee (GMRC):</b> Either Parent CIC or where parent CIC is not identifiable then CIC with the largest asset size shall constitute GMRC.</p> <p>GMRC shall report to the board of the CIC that constitutes it. It shall meet at least once in a quarter.</p> <p><b>Composition of GMRC:</b></p> <ul style="list-style-type: none"> <li>● Minimum 5 members, including executive members;</li> <li>● At least 2 members shall be an IDs, one of whom shall be a chairperson.</li> <li>● Members shall have adequate and commensurate experience in risk management practices.</li> </ul> <p><b>Terms of reference:</b> As per Para 4.2 of the circular lays down the terms of reference of the Committee which generally relates to effective risk management of the group, analysing material risk, etc.</p> <p>Based on the GRMCs analysis and recommendations, corrective action will be initiated by the CIC/ CRO (where appointed).</p> <p><b>Appointment of a Chief Risk Officer -</b> In line with the requirements laid down for</p>	<p><b>Risk Management Committee requirement -</b> The Liquidity Risk Management Guidelines as applicable to systemically important CICs were also made applicable to NBFCs having an asset size of over Rs. 100 crore.</p> <p>These NBFCs were also required to constitute an RMC consisting of the CEO/MD and heads of various risk verticals.</p> <p>The requirement of a group risk management committee did not exist in any NBFC regulation and is unique to CICs after the amendment. Given that the CIC's investment is mostly in group entities, it becomes important to have a group level RMC.</p> <p><b>Appointment of a Chief Risk Officer (CRO) -</b> NBFCs with an asset size of more than Rs. 50 billion (Rs. 5000 crore) are required to appoint a senior official with adequate professional qualification and experience in the area of risk management as the CRO of the NBFC for a fixed tenure with the</p>

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		<p>other NBFCs, large CICs with asset size of over Rs. 5000 crores are now required to appoint a CRO in the same manner laid down in para 71 of the NBFC Master Directions.</p> <p><b>Quarterly statement of deviation -</b> CICs will now be required to submit a quarterly statement (to their Board) indicating deviation in the use of proceeds of any funding obtained by the CIC from creditors and investors from the objects/ purpose stated in the application, sanction letter or offer document for such funding. The statement is required to be certified by the CEO / CFO of the CIC.</p>	<p>approval of the Board.</p> <p>The role of the CRO is more specifically laid down in para 71 of the Master Directions.</p>
<b>Corporate Governance and Disclosure requirements</b>			
4	<p>Earlier, systemically important CICs governed by the guidelines on liquidity risk management were required to set up a RMC and an Asset Liability Management Committee (ALCO).</p> <p>Other Committees such as Audit and NRC were not required to be constituted.</p> <p><b>Disclosure requirements -</b> Additionally disclosures were required to be made by appending a schedule to the balance sheet of the CIC as per Annex II of the Master Direction for CICs.</p>	<p>The new framework specifies that CICs corporate governance requirements will be as per the Companies Act, 2013.</p> <p><b>Disclosure requirements -</b> Additionally CICs will be required to make disclosures as per the <a href="#">Annexure</a> to the notification. The disclosures require the CIC to maintain a website containing basic information about itself and its group, while placing the annual report, CG report, MDA, etc. on its website.</p> <p><b>Fit and proper policy -</b> At present there is no such policy requirement. CICs will not have to frame a fit and proper policy duly approved by the Board for ascertaining the 'fit and proper' status of directors not only at the time of appointment, but also on a continuous basis.</p> <p>The same guidelines for fit and proper determination as applicable to NBFCs shall be applicable to CICs as well.</p>	<p><b>Disclosure requirements -</b> NBFCs also are required to append a schedule to the balance sheet covering broader disclosures (as now applicable to CICs).</p> <p><b>Fit and proper policy -</b> The fit and proper policy requirement was always applicable to NBFCs. The guidelines contained in Annex XIII of the Master Directions which lay down the criteria for determining fit and proper status which is now applicable to CICs as well.</p>
<b>Consolidation Financial Statements</b>			
5	<p>Earlier consolidation of financial statements was not covered under the CIC Master Directions.</p>	<p>CICs are now required to prepare CFS as per provisions of Companies Act, 2013, so as to provide a clear view of the financials of the group as a whole.</p>	<p>NBFCs which were parent companies were governed by the Companies Act, 2013 for preparation of consolidated</p>

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		<p>For entities that are not covered under consolidation due to statutory exemptions/ otherwise, disclosures in respect of such entities are required to be made. These disclosures are covered under para 2 of the Annexure to the notification. In the process of consolidation, the auditor of a CIC, as the 'principal auditor', shall use the work of other auditors with respect to the financial information of other respective entities, subject to auditing standards as also guidance notes issued by the Institute of Chartered Accountants of India<sup>6</sup> from time to time.</p>	<p>financial statements.</p> <p>NBFCs were guided by general clarifications issued by ICAI from time to time.</p>
<b>Exceptions to carrying other financial activity</b>			
	<p>CICs are allowed to carry out only the following financial activities as specified in para 2 (1) (iv) of the Master Directions -</p> <ul style="list-style-type: none"> <li>● investment in - <ul style="list-style-type: none"> <li>○ bank deposits,</li> <li>○ <b>money market instruments, including money market mutual funds and liquid mutual funds</b></li> <li>○ government securities, and</li> <li>○ bonds or debentures issued by group companies,</li> </ul> </li> <li>● granting of loans to group companies and</li> <li>● issuing guarantees on behalf of group companies.</li> </ul>	<p>CICs are now allowed to invest in money market instruments, including mutual funds which make investments in money market instruments/debt instruments with a <b>maturity of up to 1 year</b>.</p> <p>The criteria of maturities up to 1 year has now been added.</p>	<p>No such corresponding provision for other NBFCs.</p> <p>Interestingly the Working Group had not addressed this point.</p>
<b>Registration and change in nomenclature</b>			
	<p>Presently as well, following CICs did not require registration with RBI -</p> <p>(a) with an asset size of less than ₹100 crore, irrespective of whether accessing public funds or not and</p> <p>(b) with an asset size of ₹100 crore and above and not accessing public funds</p>	<p>RBI has now clarified that CICs -</p> <p>(a) with an asset size of less than ₹100 crore, irrespective of whether accessing public funds or not and</p> <p>(b) with an asset size of ₹100 crore and above and not accessing public funds</p> <p>Shall not require "registration" with the RBI. The RBI has also provided for a change in</p>	<p>No such provision for other NBFCs. There is only a distinction between Systemically Important and Non-Systemically Important NBFCs. This is unique to CICs.</p>

<sup>6</sup> Standard on Auditing (SA) 600 - "Using the Work of Another Auditor" and Guidance Note on Audit of Consolidated Financial Statements.

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	<p>Although there was no formal statement, there were misinterpretations that the above mentioned CICs were “<b>exempted</b>” from registration.</p> <p>Hence, RBI felt the need for a change in nomenclature.</p>	<p>the present nomenclature stating that henceforth, a CIC-SI will be termed as a CIC.</p> <p>Further, CICs mentioned above which do not require registration shall be termed as “<b>unregistered</b>” CICs instead of “<b>exempted</b>” CICs.</p>	
<b>Ind-AS implementation</b>			
	<p>The circular issued by RBI on 13th March, 2020 providing guidance on implementation of Ind-AS was not applicable on CICs.</p>	<p>RBI has now specified that CICs implementing Indian Accounting Standards shall adhere to the circular dated <a href="#">March 13, 2020</a> on Implementation of Indian Accounting Standards.</p>	<p>The 13th March, 2020 circular was applicable to NBFCs. This circular provided guidance on implementation of Ind-AS.</p>
<b>Submission of Data to CICs</b>			
	<p>CICs were earlier not required to become a member of the 4 Credit Information Companies in India, as against NBFCs.</p>	<p>All CICs shall adhere to the guidelines for submission of data to Credit Information Companies as per para 100 and 101 of NBFC Master Directions, 2016. Therefore, CICs are required to become members of <b>all</b> Credit Information Companies.</p>	<p>There was already a requirement for other NBFCs to obtain membership of the 4 credit information companies and submit data to them as per para 100 and 101 of the NBFC Master Directions.</p>

**Conclusion:**

With this, the Master Direction for CICs is expected to be updated incorporating all the above mentioned changes. The revised norms are expected to further strengthen the administration and functioning of CICs.

Read our related write ups on the topic here -

[RBI to strengthen corporate governance for Core Investment Companies.](#)

[Working Group proposal for stricter vigilance on CICs.](#)