

RBI panel proposes stricter rules for core investment companies

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- **Firms may have to form board-level panels, appoint independent directors and conduct internal audits**
- **Unlike NBFCs, which need to have board-level panels, no such rule is mandated for CICs**

Core investment companies (CICs) will have to form board level committees, appoint independent directors and conduct internal audits, if the Reserve Bank of India (RBI) decides to accept the recommendations of a working group formed to improve their corporate governance standards.

The recommendations were made by the Working Group to Review Regulatory and Supervisory Framework for Core Investment Companies set up by the central bank on 3 July and headed by Tapan Ray, former secretary of the corporate affairs ministry.

Core investment companies are non-banking financial companies (NBFCs) holding not less than 90% of their net assets in the form of investment in equity shares, preference shares, bonds, debentures, debt or loans in group companies. Experts have been seeking a review of CIC guidelines ever since defaults by Infrastructure Leasing and Financial Services Ltd (IL&FS), a large systemically important core investment company.

"Currently, corporate governance guidelines are not explicitly made applicable to CICs. To strengthen the governance practices, the working group recommends constitution of board level committees viz. audit committee, nomination and remuneration committee and group risk management committee," the working group said in its report.

Unlike NBFCs which are required to constitute board level committees, no such standards are mandated for CICs. The same director could be part of boards of multiple companies in a group, including CICs.

In a few cases, the working group said, "it has been observed that the CIC had lent funds to group companies at zero percent rate of interest with bullet repayment of 3-5 years and without any credit appraisal".

Further, the committee also recommended preparing consolidated financial statement and ring-fencing the boards of CICs by excluding employees or executive directors of group companies from its board.

The report highlighted that the lack of restriction on the number of CICs that can exist in a group and non-deduction of capital of CICs for their exposures in group companies (including in step-down CICs), creates scope for excessive leveraging.

The working group, therefore, suggested that step-down CICs may not be permitted to invest in any other CIC, while allowing them to invest freely in other group companies. That apart, the committee also suggested that the capital contribution by a CIC in a step-down CIC, over and above 10% of its owned funds, should be deducted from its adjusted networth, as applicable to other NBFCs.

The number of layers of CICs in a group, it said, should be restricted to two and any CIC within a group shall not make investment through more than a total of two layers of CICs, including itself.

Currently, CICs are not required to submit off-site returns or statutory auditors' certificate (SAC). Off-site returns or statutory auditors' certificate are submitted to RBI by NBFCs where the auditor certifies that the company continues to operate as an NBFC. The committee recommended that off-site returns may be designed by RBI and prescribed for CICs on the lines of other NBFCs.

"Annual SAC submission may also be stipulated. Onsite inspection of the CICs may be conducted periodically," it added.

In August 2019, there were 63 CICs registered with RBI. As on 31 March, 2019, the total asset size of the CICs was Rs.2.63 trillion and they had approximately Rs.87,048 crore of borrowings. The top five CICs consist of around 60% of the asset size and 69% borrowings of all the CICs taken together. The borrowing mix consists of debentures (55%), commercial papers (CPs) (16%), financial institutions (FIs) other corporates (16%) and bank borrowings (13%).