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# Upper Layer NBFC (NBFC-UL): RBI's Revised Classification Framework, Regulatory Changes and Implications for Tata Sons' Mandatory Listing

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## Recent Developments:

- The Reserve Bank of India (RBI) has revised the criteria for identifying **Upper Layer Non-Banking Financial Companies (NBFC-ULs)** under the **Scale-Based Regulation (SBR) Framework**.
- The earlier multi-parameter scoring methodology has been replaced by a **single objective criterion**, under which NBFCs having qualifying assets of **₹1 lakh crore or more** will be classified as NBFC-ULs. The **₹1 lakh crore threshold will be reviewed every three years**.
- The revised framework has major implications for **Tata Sons**, whose obligation to undertake a public listing will depend on whether it continues to qualify as an NBFC-UL in the RBI's next annual classification.

## Scale-Based Regulation (SBR) Framework:

- The RBI introduced the **Scale-Based Regulation (SBR) Framework in 2021** to regulate NBFCs according to their size, business activity and systemic risk, instead of applying identical regulations to all entities.
- The framework follows a **risk-based regulatory approach**, ensuring that larger and more interconnected NBFCs are subject to stronger prudential and governance standards.
- The four regulatory layers are:
  - **Base Layer (NBFC-BL)**, covers smaller and low-risk NBFCs.
  - **Middle Layer (NBFC-ML)**, includes deposit-taking NBFCs and larger non-deposit-taking NBFCs.
  - **Upper Layer (NBFC-UL)**, includes systemically significant NBFCs requiring enhanced regulation.
  - **Top Layer (NBFC-TL)**, is generally kept empty and may be activated if an NBFC poses exceptional systemic risk.

## Upper Layer NBFC (NBFC-UL):

- NBFC-ULs are financially significant institutions whose failure could adversely affect the stability of the broader financial system.
- Once an NBFC is classified as an NBFC-UL, it generally remains in the category for at least five years, even if it subsequently falls below the qualifying threshold.
- NBFC-ULs are subject to **enhanced regulatory requirements**, including stricter governance standards, higher prudential norms, enhanced disclosures and mandatory listing requirements.

## Revised RBI Criteria for NBFC-UL:

- The RBI has replaced the earlier scoring-based identification methodology with a **transparent asset-size criterion**.
- Only NBFCs possessing qualifying assets of **₹1 lakh crore or more will now be classified as NBFC-ULs**.
- The revised framework improves regulatory certainty, reduces subjectivity and simplifies supervision.

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- **The asset threshold will be reviewed periodically every three years** to reflect changes in the financial sector.

### Qualifying Assets:

- **Qualifying assets** refer only to the assets that are considered under the applicable **NBFC regulatory framework**.
- **Qualifying assets primarily include**, loans and advances, eligible financial investments and other financial assets forming part of the NBFC business.
- **Qualifying assets do not automatically include** the total consolidated assets of the corporate group.
- **The market value of strategic holdings in group companies is not necessarily counted**, unless those investments qualify under the applicable NBFC framework.
- **Therefore, an NBFC's overall corporate size and its qualifying NBFC assets may differ substantially.**

### Why Tata Sons Became Important:

- **Tata Sons was classified as an NBFC-UL in 2024** because of its systemic significance as a **Core Investment Company (CIC)**.
- **The classification required Tata Sons to:**
- **List its shares on a recognised stock exchange within three years of notification.**
- **Comply with enhanced governance, disclosure and regulatory requirements applicable to NBFC-ULs.**

### Impact of the Revised Framework on Tata Sons:

- **The revised framework does not specifically exempt Tata Sons.**
- **Its future regulatory position will depend entirely on whether its qualifying NBFC assets remain above ₹1 lakh crore.**
- **If Tata Sons continues to satisfy the revised criterion, it will remain an NBFC-UL and the listing requirement will continue.**
- **If it falls below the qualifying threshold and is excluded from the RBI's next NBFC-UL list, the regulatory basis for mandatory listing may cease to apply.**

### Regulatory Significance:

- **The revised framework promotes greater transparency and predictability in regulatory classification.**
- **The simplified asset-based criterion reduces ambiguity in identifying systemically important NBFCs.**
- **The framework aligns regulatory intensity with financial stability risks posed by large non-bank financial institutions.**
- **The revised norms also strengthen supervisory efficiency by using a clear quantitative benchmark instead of multiple qualitative parameters.**

### Importance of NBFCs in the Indian Economy:

- **NBFCs supplement the banking sector by expanding credit access to underserved individuals and businesses.**
- **NBFCs play a significant role in financing MSMEs, infrastructure, housing, vehicle loans and rural credit.**
- **NBFCs contribute to financial inclusion by serving customer segments that may have limited access to formal banking channels.**
- **The growth of large NBFCs has increased their interconnectedness with banks and financial markets, making effective regulation essential for financial stability.**

### Way Forward:

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- **The RBI should continue strengthening risk-based supervision while maintaining proportional regulation across different categories of NBFCs.**
- **Regulatory clarity should balance financial stability with ease of doing business for large financial institutions.**
- **Periodic review of asset thresholds should reflect changes in inflation, financial sector growth and systemic risk.**
- **Enhanced governance standards should improve investor confidence without imposing unnecessary compliance burdens on smaller NBFCs.**

### Value Addition for UPSC:

#### *Important Terms:*

- **NBFC (Non-Banking Financial Company):** A company engaged in financial activities without holding a banking licence and therefore cannot accept demand deposits like banks.
- **Scale-Based Regulation (SBR):** RBI's risk-based regulatory framework that classifies NBFCs according to their size, activity and systemic importance.
- **Core Investment Company (CIC):** An NBFC primarily engaged in holding shares and securities of group companies while satisfying prescribed RBI conditions.
- **Systemically Important Institution:** A financial institution whose failure can create significant disruption in the overall financial system.

#### *Prelims Facts:*

- **SBR Framework** was introduced by **RBI in 2021** and became operational from **October 2022**.
- **NBFC regulatory structure consists of four layers: Base Layer, Middle Layer, Upper Layer and Top Layer.**
- **NBFC-ULs are required to comply with enhanced governance norms and mandatory listing requirements under the RBI framework.**