BASILSTONE
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Basilstone Consulting is pleased to present to you the **April 2021** issue of atharv, covering regulatory insights as well as discussion papers. This issue covers the following areas:

1. Regulatory updates & its expected impact

1.1. Securities & Exchange Board of India

1.1.1. Regulatory Reporting by AIFs

SEBI has prescribed formats in which AIFs are required to submit quarterly reports, within 10 days from the end of the quarter starting from the quarter ended December 2021. SEBI has also prescribed that any changes to the private placement memorandum, or fund/scheme documents should be submitted to SEBI on a consolidated basis within 1 month from the end of the Financial Year.

Impact: Specific reporting in set formats will help AIFs comply with the requirements of submitting periodical reports to SEBI relating to their activity.

1.1.2. Reporting Formats for Mutual Funds

Reporting by AMC to Trustees – the Bi monthly Compliance Certificate and Half Yearly Compliance Certificates that are to be submitted by AMCs to Trustees have been discontinued and replaced by a Quarterly Report to be submitted within 21 days from the end of the Quarter (applicable from the quarter ended June 2021). A Specific format for the same has been prescribed.

Reporting by AMC to SEBI – AMC are now required submit complete Compliance Test Reports to SEBI on a quarterly basis, to synchronize the same with Quarterly Report (applicable from the quarter ended June 2021).

Reporting by Trustees to SEBI – the format of the Half Yearly Trustee Report required to be submitted by Trustees to SEBI has been revised, and the responsibility of submitting corrective steps with respect to non-compliance included in these reports has been added (applicable from the half year ended March 2021).

Impact: The synchronization of the reports to be submitted to SEBI can make the process of reporting easier for the Mutual Funds.

1.1.3. Informal Guidance to Paytm Money

SEBI, vide its response Informal Guidance issued to Paytm Money clarified the below pertaining to Investment Advisers (IAs):

a. IAs are not permitted to avail reimbursement from AMCs, whose schemes they recommend, for Out-of-Pocket services such as KYC, technology hosting, platform maintenance etc.

b. It is mandatory for IAs to sign an agreement with their clients, and online consent is not sufficient compliance with this requirement

c. In case of a Body Corporate the head/member of the Board of Directors shall be the Principal Officer

Impact: Investment Advisers who currently are, or in the future plan to claim such reimbursement from AMCs/others whose schemes/products they advise may have to revise such arrangements. With online investment advisory increasing in popularity, it may also be necessary for the Investment Adviser to ensure that a proper Agreement exists with their clients. Body corporates who were interpreting the term 'Equivalent Management Body' in the Definition of Principal Officer ("Principal officer" shall mean the managing director or designated director or managing partner or executive chairman of the board or equivalent management body who is responsible for the overall function of the business and operations of non-individual investment adviser.) to possibly mean a committee responsible for the IA division of the Company, may have to reconsider who their principal officer is based on the above guidance.

1.1.4. Relaxations relating to Issues & Listing – Extension of earlier relaxations

SEBI has, vide circular extending the relaxation in certain procedural matters relating to Issues and Listing for a further period of six months, i.e., up to 31 September 2021.

Impact: Continued relaxation in this matter, may help Listed Companies in carrying out their operations during the second wave of the Pandemic.

1.2. Reserve Bank of India

1.2.1. ECB - Relaxation in the period of parking of unutilised ECB proceeds in term deposits

Reserve Bank of India has, under the Statement on Developmental and Regulatory Policies stated that under the extant ECB framework, ECB borrowers are allowed to place ECB proceeds in term deposits with AD Category-I banks in India for a maximum period of 12 months. In view of the difficulty faced by borrowers in utilizing already drawn down ECBs due to Covid-19 pandemic induced lockdown and restrictions, the regulator shall relax the above stipulation as a one-time measure, with a view to provide relief.

Impact: Accordingly, unutilised ECB proceeds drawn down on or before March 1, 2020 can be parked in term deposits with AD Category-I banks in India prospectively up to March 1, 2022.

1.2.2. IRAC following expiry of Covid-19 regulatory package

Pursuant to the pronouncement of the judgement of Honourable Supreme Court of India on 23 March 2021, RBI vide its Notification dated 07 April 2021 notified the "Asset Classification & Income Recognition following the expiry of Covid-19 regulatory package" addressed to all lending institutions. The Notification focused primarily on two things i.e.:

a. Refund/adjustment of Interest on Interest
b. Asset Classification

Impact: The Lending institutions are required to immediately put in place a Board approved Policy to refund/adjust the 'interest on interest' charged to the borrowers during the moratorium period, i.e., March 1, 2020 to August 31, 2020. However, to ensure consistency of calculation of amount, methodology shall be finalized by the Indian Banks Association (IBA) in consultation with other industry participants/bodies, which shall be adopted by all lending institutions.

This is a great relief to all borrowers who have availed moratorium, either partially or fully or not availed at all and also including those who have availed working capital facilities during the moratorium period. Such aggregate amount to be refunded/adjusted in respect of the borrowers has to be disclosed in the lender's financial statements for year ending 31 March 2021.

Further, Asset Classification of borrower accounts shall be as follows:

a. Accounts where moratorium is not granted: Asset Classification as per IRAC norms applicable to specific category of lending institutions
b. Accounts where moratorium is granted: Asset Classification for period 01 March 2020 to 31 August 2020 – As per guidelines provided in Notifications issued by RBI on Covid 19 Regulatory Package on 17 April 2020 & 23 May 2020
c. Asset Classification for period on or after 01 September 2020 – As per IRAC norms applicable.

1.2.3. Guidelines on appointment of Statutory Auditors by Banks and NBFCs (Including HFCs)

RBI vide it's notification dated 27 April 2021 has prescribed Guidelines for Appointment of Statutory Auditors for and applicable to Commercial Banks (excluding RRBs), UCBs and NBFCs (including HFCs) from FY 2021-22 However, this is optional for non-deposit taking NBFCs with asset size below □1,000 crore and can continue with their extant procedure.

Impact: Being the first time NBFCs from FY 2021-22, they shall have the flexibility to adopt these guidelines from H2 (second half) of FY 2021-22 in order to ensure that there is no disruption.

Albeit NBFCs are not required to take prior approval from RBI for appointment, they need to inform RBI each year about appointment within one month of appointment in the prescribed FORM A by way of a certificate.

Further, limits have been prescribed to the maximum number of Statutory Auditors that can be appointed based on the Asset size of the NBFCs to ensure that the number of Statutory Auditors appointed by the entities are adequate, commensurate with the asset size and extent of operations of the entities, with a view to ensure that audits are conducted in a timely and effective manner.

For other Entities (excluding Payment Banks and Core Investment Companies), SCAs/SAs shall visit and audit at least the Top 20 branches / Top 20% of the branches of the Entities (in case of Entities having less than 100 branches), to be selected in order of the level of outstanding advances, in such a manner as to cover a minimum of 15% of total gross advances of the Entities. The provisions of Section 143 (8) of the Companies Act, 2013 regarding audit of accounts of all branches shall be applicable.

Guidelines have been prescribed for Eligibility criteria and in order to protect the Independence of Auditors tenure and rotation have been determined along with the Professional standards to be maintained.

A board approved policy and minimum procedures for appointment of Statutory Auditors aim to ensure transparency and independence of the assurance function.

1.3. Ministry of Corporate Affairs

1.3.1. Pre-Packaged Insolvency Resolution Process

On account of outbreak of COVID-19 and slowdown of economic recovery the businesses of small, medium and micro enterprises were largely impacted and exposed to financial distress. To aid quick and effective recovery of these small, medium and micro enterprises public comments were invited on Pre-packaged Insolvency Resolution Process (PIRP) under the Insolvency and Bankruptcy Code, 2016.

The Ministry of Law and Justice introduced the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2021 (IBC Amendment) promulgated by the President on April 4, 2021.

This IBC Amendment has inserted a new Chapter –III A in the Insolvency and Bankruptcy Code, 2016 and introduces the concept of PIRP for corporate persons classified as micro, small and medium enterprises (MSMEs). However, this scheme of PIRP is only applicable to MSMEs which

have neither undergone bankruptcy proceedings in the preceding three years nor are facing liquidation orders.

Some of the salient features of the PIRP are:

a. Default value – Any minimum amount as may be specified by the Central Government but which shall not be more than INR 1 Crore.

b. Who can file the application for initiating the process of PIRP – A corporate debtor after obtaining approval of its shareholders by special resolution and its unrelated financial creditors representing not less than 60% in value of the financial debt due to such creditors.

c. Base Resolution Plan – The corporate debtor shall provide a base resolution plan to its financial creditors before obtaining their approval for initiating the PIRP.

d. No shift in management under PIRP - The existing management retains control in PIRP whereas a resolution professional takes control of the debtor as a representative of creditors in the case of Corporate Insolvency Resolution Professional.

e. Duration of PIRP – One of the key distinguished feature of PIRP is the no. of days provided to the corporate debtor for effectively putting in place the resolution plan. The maximum duration allowed is 120 days with a period of only 90 days available to the stakeholders to bring the resolution plan to the National Company Law Tribunal.

f. Swiss Challenge – The concept of PIRP also permits the creditors to seek resolution plans or from any third party in the event they are not satisfied with the resolution plan put forth by the promoter of the MSME proposing PIRP.

Impact: With multiple benefits attached to the process of PIRP the promoters of MSMEs would largely benefit from this scheme. This pre-pack scheme provides adequate protection to the promoters as well as to the financial creditors. Since the onus of initiating the PIRP is placed on the corporate debtor the misuse of the scheme by errant promoters wouldn't arise.

Further, to protect the interest of financial creditors, the concept of Swiss Challenge has also been maintained in the PIRP whereby the financial creditors can seek approval on the resolution plan provided by third parties if they are not satisfied with the resolution plan crafted by the corporate debtor.

PIRP is seen as a consensual restructuring process between the corporate debtor and financial creditors so the possibility of litigations and disputes inter-se are churned out and this will help the PIRP process to be completed within the designated time period of maximum 120 days.

1.3.2. Clarification on CSR spending on makeshift hospitals & temporary Covid care facilities

In continuation to General Circular No. 10/2020 dated March 23, 2020, the MCA has further clarified that spending of CSR funds for 'setting up makeshift hospitals and temporary COVID Care facilities is an eligible CSR activity under item nos. (i) and (xii) of Schedule VII of the Companies Act, 2013 relating to promotion of health care, including preventive health care, and, disaster management respectively. The companies may undertake the aforesaid activities in consultation with State Governments subject to fulfilment of Companies (CSR Policy) Rules, 2014 and the circulars related to CSR issued by MCA from time to time.

Impact: This will lead to more companies allocating their CSR budgets for fighting the current pandemic in compliance with law.

1.4. International Financial Services Authority

1.4.1. Fee structures issued by IFSCA

IFSCA has, in the month of April 2021, issued circulars laying down the fee structures applicable to various financial services intermediaries functioning in GIFT-IFSC such as Market Infrastructure Institutions, Investment Advisers, Portfolio Managers and Finance Company / Unit.

The charges are as under:

Entity Type	Application / Renewal Fees	One-Time Registration Fees	Annual Fees	Other
Depositories	USD 1,000	USD 10,000	USD 5,000	2% of Annual Custody Charges
Clearing Members	-	USD 1,000	USD 1,000	-
Stock Brokers	-	USD 1,000	-	Monthly Turnover fees of 0.0001% of turnover
Investment Advisers	USD 750	USD 7,500	-	USD 7,500 every five years
Portfolio Managers	USD 1,500	USD 15,000	-	USD 10,000 every five years
Finance Company / Unit	USD 1,000	USD 12,500	USD 12,500	-

1.4.2. Computation of Regulatory Capital by Finance Companies / Units

The IFSCA has, under the International Financial Services Centres Authority (Finance Company) Regulation, 2021 prescribed maintenance of Regulatory Capital of 8%. Vide Circular dated 26th April 2021, IFSCA has prescribed the methodology of computation for Finance Companies / Units conducting either one or more Core Activities or Specialized Activities.

The methodology considers Credit Risk Weighted Assets (IRB as per Basel III), Market Risk Weighted Assets (Standardized Approach as per Basel III) and Operational Risk Weighted Assets (Basic Indicator Approach as per Basel III).

The minimum regulatory ratios are prescribed as under:

CET1	:	4.5% RWA
Tier I (CET1 + AT1)	:	6.0% RWA
Tier I + Tier II	:	8.0% RWA

Impact: The circular comes as a clarification on the minimum standards to be followed in complying with the minimum regulatory capital requirements prescribed under the Regulations.

1.4.3. Guidelines on offering Portfolio Management Services by Banking Units

IFSCA has issued guidelines on the procedural aspects of Banking Units providing Portfolio Management Services. The Banking Units shall comply with Operating Guidelines for Portfolio Managers in International Financial Services Centre dated 09th September 2020 issued by SEBI, and shall maintain "Clients' Portfolio Account" in its general ledger, as well as create a functional separation of trading and back-office operations.

Impact: The circular brings the entire PMS activities in the IFSC to be regulated under the same regulatory environment. The step displays indications of movement of regulatory approach from Entity specific regulations to Activity specific regulations.

2. Discussion Papers

2.1. Duties of Nominee Directors

A board member must not allow himself to be compromised by looking to the interests of the group which appointed him rather than to the interests for which the board exists.

Appointment of Nominee Director:

A Nominee Director is a director appointed by any institution in terms of Section 161(3) of the Companies Act, 2013, in pursuance of financial assistance granted by it or in terms of equity investment made by such institution. Such a nominee director plays the role of a 'watch dog' for the appointing institution who can monitor the activities, operations and developments in the investee company, which is otherwise not feasible for the nominator to ensure.

Duties of Nominee Director:

In our previous article on 'Duties of Director' we discussed in detail the duties of directors applicable to every director of the Company and the measures the directors should undertake to perform those duties.

While Section 161 governs the appointment of Nominee Director and Section 166 lays down the 'duties of directors' there is no specific stipulation under the Act which lays down the 'duties of nominee directors'.

Indian Courts have from time to time spelt out the following dual responsibility structure that a nominee director owe to the shareholders of a company as well as its appointing institution.

a. Firstly, the nominee director is obligated to secure and, or duly represent the interest of the nominator including the government or any financial institutions that appoints it and in doing so act as a watchdog and oversee the operations of the investee company; and

b. Secondly towards the shareholder acting in ensuring the larger interest of the company as a whole.

The dual responsibility of the nominee director has been well noted by the Gujarat High Court in the matter of ***Ionic Metalliks vs. Union of India [2014] SCC Online Guj 10066; (2015) 2 GLH*** while deciding the legality and validity of the Master Circular No RBI/2012- 13/43 dated 2 July 2012 on 'Wilful Defaulters' issued by RBI. The Gujarat High Court inter alia noted that:

"…The extent of a nominee Director's rights and the scope of supervision by the shareholders, is contained in the contract that enables such appointments, or (as appropriate) the relevant statutes applicable to such public

financial institution or bank. However, nominee Directors must be particularly careful not to act only in the interests of their nominators but must act in the best interests of the company and its shareholders as a whole…."

Therefore, a nominee director, irrespective of the nature of his title and scope, has a duty to act in the best interests of the company, and to ensure that they are overarching over his own as well as over the nominator. A nominee director should well perform his duties keeping in mind the larger interest of the shareholders of the Company and that as well of the appointing institution, however, given a situation of conflict the former will prevail over the latter.

In ***Re Broad Casting Station 2GB Pty. Ltd***, the court expressed the view that a Nominee Director can follow the wishes of the nominator provided he bona fide believes that the interests of the nominator are identical with the interests of the company.

Similarly, in ***Bennetts vs. Board of Fire Commissioners of New South Wales (1995) 7 BOND L R*** the court *inter alia* noted that:

"…In particular, a board member must not allow himself to be compromised by looking to the interests of the group which appointed him rather than to the interests for which the board exists. He is most certainly not a mere channel of communication or listening post on behalf of the group which elected him…".

Therefore, to secure the benefits in favour of the appointing institution the nominee director cannot overlook the duty it owes towards the shareholders of the Company, which will then be considered as acting in contravention to Section 166 of Companies Act, 2013.

Responsibilities of a Nominee Director:

It is imperative for a Nominee Director to demonstrate that while there is dual allegiance, he as a Nominee Director of a Company has always placed the interest of the shareholders of the Company over and above the appointing institution. At the same time, he should also be demonstrating that he has performed his role of Nominee Director diligently and per the duties laid down by the Nominator.

Some of the responsibilities that a nominee director should perform to avoid conflict of interest between the appointing institution and his fiduciary duty towards the shareholders of a company are enumerated below:

a. To act diligently and review the information or documents including agenda papers as well as supporting documents carefully;

b. To understand the matter clearly on which the nominee director is voting and the consequences attached to such matter;

c. To disclose his interest in a company considered at the board meeting for any business proposal, approval or any other matter whatsoever including conflicting with the interest of the appointing institution;

d. To lend his expertise and skill to the company by providing his views and opinions on the functioning, operations, fund raising, borrowings or other matters related to the affairs of the company;

e. To act in best interest of the shareholders of the company and should strive to get his dissenting opinion on any matter to be recorded in the minutes of the meeting;

f. Update the developments in the company from time to time to the nominator, as may be requisite for the nominator to be aware of;

g. Maintain confidentiality of the information shared and do not reveal any information of the company to any person or to third party.

2.2. KYC & Technology

Usage of Technology for KYC will lead to standardisation of process and avoid duplication of work for multiple agencies performing the KYC

Introduction

Know Your Customer (KYC) process of SEBI registered intermediary requires every registered intermediary to collect and verify the Proof of Identity (PoI) and Proof of Address (PoA) from the investor. KYC & Customer Due Diligence Policies as part of KYC are the foundation of an effective anti-money laundering process (AML). The Prevention of Money Laundering Act requires banks, financial institutions and intermediaries to ensure that they follow certain minimum standards of KYC and AML. The idea is to know your customers, verify their identities, make sure they're real, confirm that they're not on any prohibited lists and assess their risk factors. The key is to find a balance so that these efforts are effective without penalizing innocent consumers or being so onerous that upstarts can't comply with them.

KYC process & Use of Technology for KYC

SEBI, from time to time has issued various circulars to simplify and harmonize the process of KYC by investors / Registered Intermediaries (RI). Constant technology evolution has taken place in the market and innovative platforms are being created to allow investors to complete KYC process online. Various provisions under PMLA and relevant KYC/AML circulars issued from time to time remain applicable and SEBI registered intermediary shall continue to ensure to obtain the express consent of the investor before undertaking online KYC.

In order to establish an account-based relationship, investor's KYC can be completed through online/App based KYC, in-person verification through video, online submission of officially valid document (OVD) / other documents under e-sign in the following manner:

a. The investor visits the website/App/digital platform of the RI and fills up the online KYC form and submits requisite documents online.

b. The name, photograph, address, mobile number, email ID, Bank details of the investor shall be captured online and Officially Valid Document (OVD) / PAN /signed cancelled cheque. Mobile and email shall be verified through OTP, Aadhar is verified through UIDAI's authentication/verification mechanism, PAN is verified online through Income tax Database, Bank Account Details are verified through Penny Drop Mechanism or any other mechanism using API of bank, any OVD other than Aadhar through Digilocker/under e-sign mechanism, etc.

c. The usage of Aadhar is optional and purely on voluntary basis by the investor.

d. Once all the information as required as per the online KYC form is filled up by the investor, KYC process could be completed as under:
   - The investor would take a print out of the completed KYC form and after affixing their wet signature, send the scanned copy / photograph of the same to the RI under e-Sign, or
   - Affix online the cropped signature on the filled KYC form and submit the same to the RI under e-Sign.

e. The RI shall forward the KYC completion intimation letter through registered post/ speed post or courier, to the address of the investor in cases where the investor has given address other than as given in the OVD. In such cases of return of the intimation letter for wrong / incorrect address, addressee not available etc, no transactions shall be allowed in such account and intimation shall also sent to the Stock Exchange and Depository.

f. The original seen and verified requirement for OVD would be met where the investor provides the OVD in the following manner:
   - As a clear photograph or scanned copy of the original OVD, through the eSign mechanism, or;
   - As digitally signed document of the OVD, issued to the DigiLocker by the issuing authority.

g. Further In person Verification (IPV) or Video In Person Verification (VIPV) would not be required:
   - When the KYC of the Investor is completed using the Aadhar authentication/verification of UIDAI
   - When KYC form is submitted online, documents have been provided through digilocker or any other source which could be verified online.

The features of online KYC through the own app of the RI and features of VIPV have been prescribed vide SEBI Circular dated 24 April, 2020 on Clarification on KYC Process and Use of Technology for KYC.

Conclusion

SEBI has over a period of time held discussions with various market participants and based on their feedback and with a view to allow ease of doing business in the securities market, has integrated the use of technological innovations facilitating online KYC.

Albeit this has made the KYC and account opening process much better, however there still exists lack of standardization and involves duplication of work. In order to address this issue, SEBI has issued a consultation paper proposing segregation of responsibilities i.e., KYC to be done through stock exchanges, depositories, KYC Registration Agencies (KRA's) and documentation for opening accounts for entering into transactions rests with concerned registered intermediaries. This shall eventually lead to cost saving for the RI's and help establish a more robust KYC process.

About Basilstone

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The Purpose of Basilstone is to provide simple solutions and create value backed by:

Strong	**In-Depth**	**Invaluable**	**Deep-Rooted**
Processes	Knowledge	Experience	Values

We clearly resonate ourselves with the ever-growing Basil, inspiring us to imbibe the quality of being natural and pure while we adapt to changing conditions and innovation. The rock-solid Stone is representative of our endurance, stability, permanence and our determination, paving the path of value creation for our clients and our firm allegiance to our principles.

Basilstone is the quintessential blend of traditional values and modern thoughts which are echoed in the experience, enthusiasm and energy of its people and translated in the services rendered to its clients.

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