BASILSTONE
CONSULTING PRIVATE LIMITED

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Basilstone Consulting is pleased to present to you the **Aug 2022** issue of atharv, covering regulatory insights as well as discussion papers. This issue covers the following areas:

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1. Regulatory updates & its expected impact

1.1. Securities & Exchange Board of India

1.1.1. Guidelines for overseas investment by Alternative Investment Funds (AIFs) / Venture Capital Funds (VCFs)

a. The requirement of an overseas company to have an Indian connection has been done away with. However, an application for allocation of investment limit in the prescribed format shall be made to SEBI.

b. AIFs/VCFs shall invest in an overseas investee company, which is incorporated in a country whose securities market regulator is a signatory to the International Organization of Securities Commission's Multilateral Memorandum of Understanding or a signatory to the bilateral Memorandum of Understanding with SEBI.

c. AIFs/VCFs shall not invest in an overseas investee company, which is incorporated in a country identified in the public statement of Financial Action Task Force (FATF)

d. If an AIF/VCF liquidates investment made in an overseas investee company previously, the sale proceeds received from such liquidation, to the extent of investment made in the said overseas investee company, shall be available to all AIFs/VCFs (including the selling AIF/VCF) for reinvestment

e. AIFs/VCFs shall transfer/sell the investment in overseas investee company only to the entities eligible to make overseas investments, as per the extant guidelines issued under the Foreign Exchange Management Act, 1999

f. AIFs/VCFs shall furnish the sale/divestment details of the overseas investments to SEBI in the format given within 3 working days of the divestment

g. All the overseas investments sold/divested by AIFs/VCFs till date, shall also be reported to SEBI in the format given within 30 days from the date of this circular

h. The Trustee/Board/Designated Partners as well as the manager of the AIFs/VCFs shall submit an undertaking to SEBI in respect of the matters prescribed in the circular.

Impact:
Expanding horizons for Indian VCFs to invest in entities which have no connection in India and establishing its place in the world markets. However, as a backdrop the Indian markets and start-ups may face difficulties.

1.1.2. Informal Guidance – M/s Club Millionaire Financial Services Pvt Ltd

a. A portfolio manager may not be held accountable for securities held by its clients outside the PMS arrangement.

b. As per Depository Participant regulations, prior approval of SEBI is required for acquiring more than 5% of the total paid up equity capital of the Depository, for a Portfolio Manager falling under Person Acting in Concert with its client, pursuant to its PMS agreement.

Impact:
In addition to evaluating its own books, the PMS shall also evaluate the holding of the shares of a Depository effected by their client, in pursuance of the PMS agreement, to ensure that the combined holding does not exceed the prescribed investment limit; since the shares of Depository are a matter affecting Public Interest at large.

1.1.3. SEBI (Portfolio Managers) (Amendment) Regulations, 2022

a. Definition of Related Party in relation to Portfolio Manager has been inserted

b. Prior consent of the client shall be required for Portfolio Manager's making investments in securities of its related parties or its associates. Such requirement shall not apply to such Portfolio Managers, as may be specified by SEBI.

c. The Portfolio Managers shall disclose the details of investment of client's funds by the portfolio manager in the securities of its related parties or associates

d. The Portfolio Managers shall disclose the details of diversification policy of the portfolio manager.

e. The portfolio manager shall ensure compliance with the prudential limits on investments as may be specified by SEBI.

f. The prudential limits, as specified under sub-regulation (3A), shall be applicable at the client level at the time of making investments by the portfolio managers

g. The portfolio manager shall not be allowed to invest clients' funds in unrated securities of their related parties or their associates.

h. The portfolio manager shall put in place an alert-based system to monitor compliance with the prudential limits on investments.

i. The portfolio manager shall ensure investment of its clients' funds on the basis of the credit rating of securities as may be specified by SEBI

1.1.4. Disclosure Requirement for Asset Management Companies

a. Amendment has been carried out the definition of Associates under the SEBI (Mutual Fund Regulations), 1996, whereby vide a proviso the definition is rendered not applicable to a sponsor investing in various schemes on behalf of beneficiaries of schemes stated by the SEBI.

b. AMCs shall ensure scheme wise disclosure of investments, as on the last day of each quarter, in securities of such entities that are excluded from the definition of associate

c. Disclosure of Investment shall include ISIN wise value of investment and value as percentage of AUM of scheme. Such disclosure shall be made on the websites of respective AMCs and on the website of AMFI, within one month from the close of each quarter.

1.1.5. Participation as Financial Information Providers (FIP) in Account Aggregator framework

a. Depositories and AMCs (through their RTAs) are referred as FIPs in the securities markets

b. The FIPs in the securities market will provide the "Financial Information as specified through any of the Account Aggregators registered with RBI

c. The Financial Information Providers (FIPs) in securities market must disclose prominently on their websites the names of the Account Aggregators through which the FIP shares the information about assets held with respect to securities markets with the customers and Financial Information Users (FIUs)

d. Guidelines of Participation as FIP in Account Aggregator framework has also been prescribed

Impact:
This will give a boost to RBI regulated financial data sharing system and will allow customers to share their information about mutual funds and stock holdings with financial service providers.

1.2. Reserve Bank of India

1.2.1. Regulation of Payment Aggregators – Timeline for submission of applications for authorisation

Keeping in view the disruption caused by the COVID-19 pandemic, and to ensure smooth functioning of the payments ecosystem, RBI has decided to allow another window to all PAs (existing as on March 17, 2020) to apply to RBI even if they have not complied with minimum net worth criterion of INR 15 Crore by March 31, 2021. They can now apply by September 30, 2022 and shall have a net worth of ₹15 crore as on March 31, 2022. They shall be permitted to continue their operations till they receive communication from RBI regarding the fate of their application. The timeline of March 31, 2023 for achieving the net worth of ₹25 crore, however, remains.

1.2.2. Foreign Exchange Management (Borrowing and Lending) Regulations, 2018 – Temporary relaxation

The Individual limits of borrowing of USD 750 million or equivalent per financial year is temporarily increased to USD 1500 million or equivalent for ECBs raised till December 31, 2022 for all the entities eligible for ECB.

Additionally, RBI has permitted increase in the all-in-cost ceiling for ECBs, by 100 bps. The enhanced all-in-cost ceiling shall be available only to eligible borrowers of investment grade rating from Indian Credit Rating Agencies (CRAs). Other eligible borrowers may raise ECB within the existing all-in-cost ceiling.

Impact:
This shall infuse additional liquidity facility and additional inflow of foreign exchange to support the depreciating Rupee in time of inflationary pressures.

1.2.3. Reserve Bank - Integrated Ombudsman Scheme, 2021 – Inclusion of Credit Information Companies

RBI has now made the Integrated Ombudsman Scheme, 2021 applicable to Credit Information Companies as well, providing an alternate resolution mechanism to the public at large.

1.2.4. Outsourcing of Financial Services - Responsibilities of regulated entities employing Recovery Agents

In view of concerns arising from the activities of recovery agents, RBI has advised that the Regulated Entities (Including NBFCs) shall strictly ensure that they or their agents do not resort to intimidation or harassment of any kind, either verbal or physical, against any person in their debt collection efforts, including acts intended to humiliate publicly or intrude upon the privacy of the debtors' family members, referees and friends, sending inappropriate messages either on mobile or through social media, making threatening and/ or anonymous calls, persistently calling the borrower and / or calling the borrower before 8:00 a.m. and after 7:00 p.m. for recovery of overdue loans, making false and misleading representations, etc., in addition to the extant guidelines applicable.

Impact:
The regulator has re-iterated compliance with the overall Fair Practices norms to be complied with the Regulated Entities as well as agents to whom they have outsourced. The re-iteration comes especially amid various reports of Digital Lending platforms allegedly not complying with the spirit of Fair Practices.

1.2.5. FEMA Overseas Investments

RBI's new Foreign Exchange Management (Overseas Investment) ~~Directions, 2022 and Regulations,~~Rules, 2022 have been prescribed with the objective to add clarity and ease of transactions for resident Indians in matters of foreign investment and overseas ownership via equity capital.

Transactions may have been possible previously as well but there were no rules defined for aspects such as roundtripping (a situation where one invests in an overseas company that has an investment or holding in an Indian company), which made execution and scrutiny of deals unpredictable.

As per the recent rules, resident Indian individuals can directly invest in an operating foreign entity even without the presence of a subsidiary company where the individual may have already owned capital. This was not the case earlier and it is now permitted even for foreign entities not in financial services.

The stake can be acquired through specified means including direct capitalisation, mergers, demergers, sweat equity, gift and inheritance. Prima facie, the rules state that the stake acquired through such transactions should be less than 10 percent of the equity capital of the foreign entity.

The other aspect addressed pertains to the acquisition of foreign securities by way of inheritance or gift. One may inherit such securities from any person resident in India and one may be gifted such securities by a person resident in India provided they are classified as being a relative. One can also receive it as inheritance or gift from a person residing outside India within the provisions of the Foreign Contribution Regulation Act.

Impact:
Overall, the recent regulations seem to bring a sigh of relief and much-needed clarity for standard transactions. This, consequently, will open the gates for more foreign investment activity by resident individuals seeking opportunities in overseas markets.

1.3. International Financial Services Centre Authority

1.3.1. Issuance of Debit Cards by IBUs

IFSCA has permitted IBUs to issue Debit Cards (Physical / virtual) to its Customers having Savings / Current accounts with them. Such Debit Cards, although, are not permitted to be linked to accounts in Domestic territory.

1.3.2. India International Bullion Exchange (IIBX) – Supply of bullion by Overseas Suppliers

IFSCA has permitted eligible overseas supplier entities to participate on IIBX for the limited purpose of 'selling' - without having to set up an establishment, office or a unit - as a branch or subsidiary at International Financial Services Centre (IFSC).

1.3.3. Framework for Ship Leasing

IFSCA has notified the detailed framework for Finance Companies / Units to undertake the non-core activity of Ship Leasing. A minimum owned fund of USD 200,000 (For Operating Leases) and USD 3 million (For Finance Leases) or its equivalent in freely convertible foreign currency, is to be maintained at all times by the entity. The permitted activities are:

a. Operating Lease
b. Asset Management Support Services for assets owned or leased out by the entity or by its wholly owned subsidiary(ies) or by a branch of its wholly owned subsidiary set up in IFSCs in India
c. Sale and lease back, purchase, novation, transfer, assignment, and such other similar transactions in relation to ship lease
d. Financial lease
e. Hybrid of financial and operating lease

2. Discussion Papers

Fintech Market and Fintech Products

FinTech has been a modern-day revolution and India is striving to be at the forefront, as discussed in the previous paper. The Indian FinTech firms have played a substantial role for the growth of the Indian GDP, especially in the distressed COVID-19 period, not only on basis of the absolute quantum but by creating additional stream of Employment. The success story of the FinTech companies have given a hint of the rapid pace of the growth technology can render.

Although Indian Fintech Industry is not more than a decade old, out of every five unicorn companies in India roughly one is a fintech company. The Indian Firms lean towards constant innovation to obtain a first mover advantage in the market, has been paramount to their success graphs.

Primarily, the Indian Fintech Scenario revolves around the payment system and digital lending. No Indian FinTech success story can be explained without the role of UPI which has changed the entire dynamics of retail payment systems as they are being used at every nook and corner of the country

We have currently explored a solar system in the universe of fintech, refinement of wide variety of fintech products currently being offered might unturn pages beyond thoughts. The current Fintech offerings can be classified into:

Digital Payment

The FinTech developments in the payment segment are seen throughout the entire eco-system However, the roots to many of the innovations can be linked to the Unified Payment Interface (UPI). UPI is a single interface for all the payment through linking of bank account, maintained and regulated by National Payments Corporation of India (NPCI) and acting as an aggregator for the payment system.

The system also acts as a Real Time Settlement between banks registered with it. The offering has further enabled payment aggregators for extending smooth merchant payments experience such as UPI based payments through QR/RFID/Biometric, Proprietary Applications, Push/Pull model for payment, Tap-to-Pay, etc.

Further, accommodations such as voice-based payment, UPI Pin authentication, RFID payment, show prominence in further simplifying the payment mechanism for the society at large, with UPI providing a backbone support.

Another Development, AePS is a bank led model which allows online interoperable financial inclusion transaction at PoS (MicroATM) through the Business correspondent of any bank using the Aadhaar authentication. AePS supports six types of banking transactions viz-a-viz. Cash Deposit, Cash Withdrawal, Balance Enquiry, Statements, Fund transfer, Authentication.

NPCI has steamrolled digitization in the banking industry through products such as Immediate Payment Service (IMPS), National Automated Clearing House (NACH), National Fast Switch(NFS) and the government activities through Aadhar Payment Bridge (ABPS), Bharat Bill Payment System (BBPS), NETC

The Digital Payments Products have been at the forefront of the Fintech Innovation in India and has evolved under watchful eye of the regulator, whereby a separate department and directions on the matter have been issued. The product is highly regulated with entry restrictions in terms of networth and infrastructure requirements, since it involves affecting the public interest. Growth of Digital Payments has managed to create a huge disruption in the market of debit cand credit cards.

E-Wallets and Prepaid Instruments

Pre-Paid instruments and E-wallets are products designed to create easy and quick payment facility customers. These products can be in the form of mobile application or a physically issued card and marked the beginning of the payment revolution.

E-wallet has attracted users due to its tempting offerings, including exciting offers, lucrative cashback, reward points, and many more. This has resulted in surge of digital payment across the country. A user can use these E-Wallets for various purposes including, P2P payments, top-up & utility bills, international remittances, booking tickets, and many more.

Although E-wallets came into existence not more than a decade ago, it is facing a downfall since the advent of UPI, whereby direct payments can be made without loading money into a wallet operated or instruments issued by the company

AI/ML investing/lending

Although Artificial Intelligence and Machine Learning are understood as interchangeable words in layman terms, there exist a thin line of difference whereby AI is an autonomous mechanism for decision making and ML refers to using the data from the results for self-learning mechanism.

AI based investment decisions to deploy funds and advisory services (majorly through Mobile application) to client have earned focus in recent times. The parameters of markets (including capital markets, bond market, secondary markets) are used to generate market recommendations without any human intervention with features such as auto-investing, trigger stop loss, auto-portfolio balancing, etc. Another popular and highly innovative fintech contribution, though not new, is the invention of stock-trading apps.

Utilization of AI in P2P lending platforms to offer the features of auto-invest, secondary market feature (to sell their exposure), etc. based on the risk appetite of the lender has been put live for enhancing experience of the customers and encourage reinvestments.

AI/ML has further facilitated essential progress in the operational aspects of traditional lending such as Credit Evaluation, disbursement, etc. by removing human intervention. FinTech Firms have developed software which are customizable as per the internal and applicable lending parameters for speeding the loan processing process. The software are generally offered as SaaS model of revenue by the firms.

Digital Lending

Predominantly most of the retail lending products are available in the digitized form; however, big-ticket loans whereby a formal discussion of the parties to transaction is required are still advanced through offline mechanisms. Following products have gained impetus in the digital lending space:

1. **P2P Lending**

It is a basic lending facilitation model maintaining the spirit of traditional lending, introduced by RBI, whereby the FinTech firms facilitate a platform for match-making of borrowers and lenders New and attractive packaging of the traditional lending product, inspired from the evolving technology has enabled the society at large to participate in, earlier not accessible, the structured financing markets.

The FinTech firms further have innovated part (or percentage) financing facility to diversify the risk over multiple borrowers, reinvestment through AI, IBC protection to lenders, formalized loan kits, Structure Recovery Mechanism, etc. to attract the customers for infusing their surplus funds in the financial system

2. Fintech Invoice Financing

Invoice Financing has been an essential source of finance since over a decade now generating liquidity for traders and manufacturers for utilizing as working capital. The fintech firms have taken this traditional model akin to that for lending to a digitized version whereby a platform (similar to P2P) acts as a bridge to conduct invoicing/factoring activity. The platform can however be a resident of the FinTech firm conducting the financing/factoring activity from its own books.

The model is gaining recognition due to automatic invoice processing; a shorter time frame between invoice processing and liquidity provision; a smaller minimum turnover threshold or factoring of individual invoices; and financing confidentiality for debtors. However, the lenders here need to be registered with RBI to underwrite the invoices. TreDS is an RBI launched platform enabling its participants to engage in factoring activity.

3. Fintech Cash Advance

Unsecured lending through digital means for cash advances ranging from 0% interest rates (relating to Buy-Now Pay Later) to exorbitant rates till 2% p.m. have plagued the retail market, whereby the credit risk is extremely high, with minimum information on the borrower. Hence, it is of prudence for people and Regulated entities to keep their distance and adopt an approach of test-based adoption, to ensure that the product shall not harm public interest.

Merchant Cash Advances is a variant of the cash advance product whereby the Product Merchants are advanced short-term facilities with repayment from the daily receipts on the POS machine used by the Merchant or any other mechanism as may be deemed feasible.

Other than above, the Regulated Entities with the RBI has transformed their operations from *"the brick and mortar"* to *"web-based/app-based"*. They are traditional lending products such as term loan, working capital loans, asset finance, equipment finance, leasing, etc. to compete with the new offerings. The website/application are not always proprietary and are operated by a third party whereby the risk for data leakage and fraudulent activities increase substantially. To cope with this RBI has recently come up with regulations with an attempt to tap the identified problems in the digital lending segments, whereby a clear a distinction and responsibility is placed on entities regulated by it and the Lending Service Providers/Direct Lending App.

The Digital Lending space is highly regulated and the regulatory directions are constantly updated so as to prevent any mis-conduct which might affect the public in general. However, regulatory introduction of mechanism, post identifying all its risk and test checking, for E-KYC, Video-KYC, Digital KYC ensure that the company can deliver a superior experience with minimum documentation to the client giving a boost to the digitized traditional and innovative FinTech products.

Crowd Funding

Crowdfunding platforms allow various individuals and businesses to pool funds from a global audience. It makes funding more convenient and have been expanding exponentially in the past few years. They are acting as an alternative source of funding for new entrants or innovative products in ideation stage (start-ups) where banks and other financial institutions lack confidence to extend the facility.

The platforms act as a facilitator for basic financing to kick start a product/project/social work from the interested people in society without any incentive. A good initiative however, does not generate any compensatory return for the contributors has affected its acceptability at a large scale.

Crowdfunding as a main stream financing line may be successful on offering marginal incentives to the contributors on a later stage such as discount coupons, membership offers, etc. The customer awareness shall serve as the biggest hurdle in the growth of the platform since the platforms are successful as the funds that the businesses/projects listed on them are able to attract/raise

Further, the viability, genuineness and trustworthiness of the individuals/business listed is yet an unresolved matter of concern on these platforms.

Block chain facility

Crypto-Currency, NFTs, other digitally traded assets rely on Blockchain that revolves around the creation of unique digital representations of assets that go beyond traditional financial instruments, and which enable you to trade any kind of asset with more liquidity and speed, at lower cost.

Although, accompanied with an invariable risk which is difficult to factor, development of polished blockchain technology innovation may have the power to unite the world on a single trading platform for class of assets that are not currently traded.

Regulation Technology (RegTech)

The idea has been conceptualized since a long time but has translated into reality quite recently, whereby technology is used to cater to the compliance issues and manage regulations such as anti-money laundering policies, financial directives, companies act directives, etc.

The regulators recently have been trying to simplify the compliance through publishing their own material; however, a greater focus on the business aspect shall always render a market for this product but shall continue to have a niche market.

The modern businesses generally focus on delivering specialized value-added services and catering the best quality to the client, while outsourcing the non-value-added services. Hence, the product through cloud computing and SaaS technology assists businesses to comply with the regulations in an efficient and cost-effective manner. The main functions of RegTech are to perform regulatory monitoring, reporting, and compliance. Financial Fraud Detection, Risk Management software.

Supervisory technology (SupTech)

Supervisory technology (suptech) is the use of innovative technology by supervisory agencies to support supervision. It helps supervisory agencies to digitise reporting and regulatory processes, resulting in more efficient and proactive monitoring of risk and compliance at financial institutions. The product shall enable regulated entities to focus on their core areas with outsourcing of the supervision and their intervention limited to formulating and adopting plan of actions for results of periodic supervision.

It is a need of the hour product, as the regulatory directions are being modified to adapt to financial sector disruptions. The FinTech companies find it relatively difficult to set up an in-house supervision mechanism and hence, the demand for the product is inevitable.

On a concluding note, it can be observed that the financial world is evolving rapidly with the newest innovations of technology. Banks and all other financial institutions are in the race to cope up with this technological transformation. From, paying a Rupee to buy chocolate online to planning a budget of millions of dollars can all be done by Fintech. These innovations are causing many tremors that will continuously change how we see and perceive the financial sector forever.

The rate of innovation and sheer quantum of products in the exiting field of finance poses a big dilemma of whether the technology is overpowering the financial sector, leading to development of TechFin rather than Fintech.

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About Basilstone

Basilstone Consulting Private Limited ('Basilstone") has been promoted to partner with the society and its businesses to achieve their true potential and help realize their vision. We work closely with our clients and enrich their growth by offering them solution driven consultancy services in the areas of strategic planning, incubation, impact analysis, idea validation, product validation, feasibility study, synergy evaluations, fund raising, restructuring, transaction advisory, representation – guiding on regulatory / non-regulatory meetings, succession planning, Inbound and outbound investment, due diligence, dealing with regulatory / statutory authorities, etc.

We, at Basilstone aim to position ourselves as the 'Go to Consultants' for **Simple Solutions & Value Creation** recognised by our clients for delivering ultimate desired results.

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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