BASILSTONE
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atharv

August 2023

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Basilstone Consulting is pleased to present to you the **August 2023** 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 Consultation Paper on collating and defining use cases of Financial Information Users in the Account Aggregator Framework in Securities Market.

a. The Account Aggregation framework, initiated by the FSDC during 2014-2015, was adopted by the RBI) to institute regulations for a distinct category of NBFCs known as Account Aggregators. AAs facilitate consolidated access to an individual's accounts across multiple financial institutions with their consent. This framework initially encompasses electronically stored financial assets overseen by regulators. Customer data shared through AAs is kept confidential within this structure.

b. The AA network addresses challenges in consumer financial system access, such as cumbersome paperwork and prolonged processing times, by providing a secure digital approach hinged on user authorization, eliminating the need for physical documentation. These AAs, regulated by RBI, enable secure digital sharing of account information among regulated financial entities within the AA network. Data sharing hinges on individual authorization, and AAs offer meticulous control over data usage permissions, fostering innovative service opportunities.

c. A crucial feature of AAs is their role in collecting customer data from diverse financial sources while preserving data privacy through encryption. They function as intermediaries, ensuring secure end-to-end data transmission among financial institutions based on customer direction.

d. The AA framework extends beyond traditional data types, encompassing financial dimensions such as tax, pension, securities markets, and insurance. To ensure seamless and secure data exchange across varied financial entities, each operating under different regulatory and technological environments, the framework's technical integrity is upheld by core specifications developed by Reserve Bank Information Technology Private Limited (ReBIT).

Impact:
In summary, the Account Aggregation framework, initiated by the FSDC and governed by RBI, empowers individuals to securely access and share financial data across institutions. AAs, facilitated by encryption and technical standards, foster efficient and authorized data movement, shaping a landscape of innovative financial services

1.1.2 Trading Preferences by Clients- Applicability for Commodity Derivatives.

a. SEBI, in its circular dated June 21, 2023 introduced an updated "Trading Preferences" format, aiming to facilitate clients' access to all exchanges within the same trading segment through their respective stock brokers. This revision seeks to enhance trading convenience by streamlining access.

b. Earlier, SEBI had outlined the account opening process for commodity derivatives exchange members in its circular which incorporated under SEBI's Master Circular for Stock Brokers of May 17, 2023. However, members exclusive to commodity derivatives exchanges highlighted concerns about applying the newly introduced trading preference format to them, citing the distinct nature of their market. Considering the limited overlap of traded commodities among these exchanges, SEBI clarifies that members exclusively registered with commodity derivatives exchanges need not follow the format detailed in the June 21, 2023 circular. Instead, they should adhere to the trading preference format established by the former Forward Markets Commission (FMC), recognizing the unique dynamics of commodity derivatives trading. Which is provided in the circular.

c. Stock brokers are mandated to maintain records of this written negative consent for a minimum of five years. All other stipulations outlined in the June 21, 2023 circular retain their validity. Stock Exchanges are directed to disseminate these circular provisions to brokers, publish them on their websites, amend relevant rules, and oversee compliance through audits and inspections. They are required to report the implementation status of these provisions to SEBI in their monthly development reports.

d. Stock Exchanges are instructed to carry out the following actions: Firstly, they must inform stock brokers about these updates and publish the information on their respective websites. Secondly, they need to make adjustments to their relevant bylaws, rules, and regulations to implement these provisions. Thirdly, they are responsible for overseeing compliance through semi-annual internal audits and broker inspections. Lastly, they must communicate the implementation status of these circular provisions to SEBI in their monthly development reports.

Impact:
In this commodity market members are exempt, following FMC's format. This adaptive approach underscores diverse market needs while maintaining regulatory integrity, ensuring an effective and controlled trading landscape.

1.1.3 Corrigendum cum Amendment to circular dated July 31, 2023 on Online Resolution of Disputes (ODR) in the Indian Securities Market.

a. In accordance with the amended circular, all entities participating in the securities market, including listed companies, intermediaries, and regulated entities ("Market Participants"), are required to enrol on the ODR Portal within specified timelines. This enrolment includes electronically agreeing to terms with MIIs and ODR Institutions.

b. The option to enrol via SEBI SCORES or SEBI Intermediary credentials may also be provided. If an investor's grievance with a Market Participant remains unresolved, they can escalate it through the SCORES Portal as per its guidelines. If still unsatisfied, they can initiate dispute resolution through the ODR Portal, provided the matter isn't already under consideration or pending arbitration, legal proceedings, or non-arbitrable in accordance with Indian law.

c. Additionally, the ODR Institution receiving a complaint or dispute reference will appoint an independent and neutral conciliator from their panel, ensuring qualifications and neutrality. Measures for conciliator appointment by ODR Institutions should be established by MIIs. The circular's updates emphasize the steps and criteria for dispute resolution and grievance escalation within the securities market framework.

d. For disputes involving individual investors or clients and listed companies, registrar, share transfer agents, or specified intermediaries/ regulated entities, the venue is where the investor resides permanently or is registered in India. In cases of disputes between institutional/corporate clients and specified intermediaries/regulated entities:
   - If the client is registered in India, the venue is determined by KYC documents.
   - If not registered in India, the venue is where the specified intermediary/regulated entity is registered in India.
   - Alternatively, both parties can agree on a suitable court in India.

Impact:
The changes that are brought would be beneficial, as it would help in the redressal of the investor grievances in a better way. It would also help in resolving disputes between the participants.

1.1.4 Master Circular for Commodity Derivatives Segment.

a. In order to ensure the availability of comprehensive information mentioned in various circulars pertaining to the commodity derivatives market or segment at one place, the Securities and Exchange Board of India ("SEBI") has been issuing Master Circulars. This Master Circular has covered various circulars issued till March 31, 2023. The references in this circular to the Statutes/Regulations which now stand repealed have been suitably updated.

1.1.5 Master Circular for Online Resolution of Disputes in the Indian Securities Market.

a. After extensive public consultations and in furtherance of the interests of investors and consequent to the gazette notification (dated July 3, 2023) of the SEBI (Alternative Dispute Resolution Mechanism) (Amendment) Regulations, 2023 the existing dispute resolution mechanism in the Indian securities market is being streamlined under the aegis of Stock Exchanges and Depositories (collectively referred to as MIIs), by expanding their scope and by establishing a common ODR Portal which harnesses online conciliation and online arbitration for resolution of disputes arising in the Indian Securities Market.

1.1.6 Press Release- Industry Standards Forum to facilitate ease of implementation of Regulation: Industry Associations take next steps.

a. SEBI's commitment to fostering capital formation and business ease led to the proposal of an Industry Standards Forum in July 2023. This forum, chaired by an industry leader and supported by Industry Associations under Stock Exchanges' guidance, aims to create practical standards for specific regulations. These standards, based on industry input and SEBI consultation, intend to enhance compliance.

b. The pilot initiative has gained positive feedback, with priority areas including Rumour Verification, Disclosure requirements (Regulations 30 and 30A), BRSR Core/ESG assurance, and Structured Digital Database requirements.

c. ASSOCHAM, CII, and FICCI nominated representatives for the pilots and are finalizing the Forum's structure, including selecting a chairperson. Designing standards for the priority areas is targeted within three to four months, aimed at providing comprehensive compliance guidelines.

Impact:
The Industry Standards Forum by SEBI aims to simplify rules for businesses. It's like a guide co-created with industry groups, making it easier for companies to follow the rules. The test run has gone well, and they're focusing on areas like checking rumours, sharing information, and being more transparent about social and environmental efforts. Important business groups are part of this, and they're working on picking a leader. If this goes smoothly, it could help companies understand and follow the rules better, which would make India's business market look good to the world.

1.1.7 Facility to remedy erroneous transfers in Demat Accounts.

a. SEBI has addressed concerns from depositories about difficulties in obtaining OTP for reversing mistaken transfers in demat accounts. To handle this, they're introducing a mechanism exempting OTP for such reversals.

b. Depositories will create internal committees, led by Public Interest Directors, to oversee errors within and between depositories. These committees will review pending reversals, give both parties a chance to speak, examine evidence, and make written decisions.

c. Depositories will then act on these decisions and notify the transferee via email. This circular supplements SEBI's previous one on stock brokers, adding these provisions. To prevent errors, depositories will let investors and DPs verify beneficiaries before off-market transfers. They must also establish systems and procedures, share Standard Operating Procedures on their websites, and inform participants.

d. Depositories are instructed to modify their bylaws, rules, and regulations to incorporate the mentioned decision. Additionally, they are required to report the progress of implementation in their monthly development reports submitted to SEBI.

Impact:
SEBI addresses OTP issues in reversing demat errors and introducing exemptions via internal committees. This aligns with prior stock broker rules, emphasizing beneficiary checks for error prevention. These measures boost transaction efficiency, transparency, and investor trust, requiring depositories to amend rules, report progress to SEBI, and ensure compliance.

1.1.8 Reduction of timeline for listing of shares in Public Issue from existing T+6 days to T+3 days.

a. Following thorough consultations with market participants and public feedback, there will be a reduction in the time required for listing specified securities after the closure of a public issue from 6 working days (T+6 days) to 3 working days (T+3 days). "T" represents the issue closing date.

b. These changes aim to expedite the listing process and enhance efficiency. The revised timelines for listing specified securities, along with related activities in the public issue process, are provided in the circular's Annexure.

c. The new T+3 listing timeline will be disclosed in Offer Documents, and the timelines for application submission, allotment, unblocking of application funds, and listing will be prominently included in pre-issue, issue opening, and issue closing advertisements as per SEBI regulations.

d. For Direct Bank and Syndicate ASBA applications, SCSBs must ensure matching PANs with the applicant's bank accounts before blocking funds. This verification needs confirmation from the Registrar with the Final Certificate. Bank-linked PAN must be in Stock Exchange bidding data.

e. Registrar checks PANs in demat and bank accounts. Mismatched PANs mean invalid allotments. Lock-in for pre-issue shares follows ICDR Regulations, per Depositories' August 08, 2023 SOP. Delay compensation for ASBA unblocking changes: starts from T+3 days.

Impact:
This change is set to expedite listing and enhance operational efficiency. The disclosure of the T+3 timeline in Offer Documents, along with pre-issue and issue closing advertisements, ensures transparency for stakeholders. Additionally, the meticulous measures introduced for Direct Bank and Syndicate ASBA applications, including PAN verification and compensation adjustments, strengthen investor protection and bolster market integrity.

1.1.9 Review of Framework for Borrowings by Large Corporates.

a. Currently Large Corporations (having debt securities or non-convertible preference shares listed + Outstanding borrowing greater than or equal to Rs.100 crores + Credit Rating of AA and above) shall raise not less than 25% of its incremental borrowings during the financial year through issuance of debt securities.

b. Proposals suggested in the consultation paper are-
   - To increase the threshold from Rs. 100 crores to Rs.500 crores.
   - To exclude inter-corporate borrowing from group companies, grants from the government, and borrowing from interest capitalization in addition to current exclusions provided (Currently, External commercial borrowings and ICD between parent and subsidiary are excluded).
   - To remove the criteria of credit rating (AA rated and above) for classifying large corporations.
   - To remove the penalty for any shortfall in borrowing by debt security. Instead, additional or lower contributions respectively to the core Settlement Guarantee Fund (SGF) of the Limited Purpose Clearing Corporation (LPCC) shall be made by the LC.
   - To remove the concept of block period and such requirement to be fulfilled on an annual basis (Currently, such requirement is to be fulfilled on a block of 3 years).
   - To provide incentives for listing debt securities (reduced listing fees for greater issuances of debt securities, to increase credit in the form of reduction in contribution to the Core SGF).
   - To provide a disincentive in the form of greater contribution to core SGF if shortfall in fulfilling the above requirement.

1.1.10 Simplification of KYC Process and Rationalisation of Risk Management Framework at KYC (Know Your Client) Registration Agencies (KRAs).

a. SEBI's circular dated April 06, 2022, outlined validation protocols for records by KRAs in the securities market. Responding to industry feedback and aiming to simplify client onboarding and risk management, SEBI has revisited the circular's provisions.

b. As a result, the KYC process will now encompass obtaining proof of identity and address, while emphasizing that PAN serves as the unique identification for all participants in the securities market. This change is designed to facilitate investor ease and prompt access to account opening and transactions in the securities market once the KYC process is completed.

c. Under the risk management framework, KRAs will verify specific client attributes within 2 days of receiving KYC records. These attributes include PAN (including PAN Aadhaar linkage), name, address, mobile number, and email ID. Clients with unverifiable attributes won't be permitted to continue trading until verification is completed.

d. Clients with verified attributes will have validated records, offering portability across different intermediaries without re-doing KYC. KRAs will coordinate and establish uniform guidelines for attribute identification and verification. Integrating intermediary and KRA systems will ensure seamless data transfer for risk management verification.

Impact:
SEBI simplifies client onboarding and risk management, combining identity/address proof and PAN for KYC. KRAs verify client attributes within 2 days, enabling secure trading. Verified attributes offer seamless portability across intermediaries. KRAs' guidelines and system integration enhance risk management and data transfer.

1.1.11 Consultation Paper- Review of Voluntary Delisting Norms under SEBI (Delisting of Equity Shares) Regulation, 2021

a. The PMAC has put forth significant recommendations to modify the reverse book-building process used to determine the price for delisting shares from exchanges. When companies opt for voluntary delisting, they extend an exit opportunity to public shareholders.

b. Under the current norms, the exit price is established through the reverse book-building mechanism, which involves the cumulative shareholding of the promoter and public shareholders reaching 90% of the total issued shares.

c. However, challenges emerge when the promoter's or acquirer's aggregate post-offer shareholding falls short of the 90% threshold. In such cases, the existing delisting regulations don't permit the promoter to make a counteroffer to the public shareholders.

d. This situation can result in the failure of the delisting offer even if the majority of public shareholders are in favour of delisting. The acquirer is then required to wait for six months to attempt another delisting offer.

e. To address this, the committee proposes to lower the threshold required for a counteroffer, which would grant the acquirer the chance to present an offer that could potentially be accepted based on public shareholders' bids.

f. Amid the need to revamp the reverse book-building process due to market volatility following delisting announcements, the sub-group explores alternatives. One such alternative suggests the introduction of a fixed price for delisting, but this fixed price must not be lower than the floor price.

g. This approach provides both acquirers and shareholders with pricing certainty, allowing shareholders to decide upfront whether to participate in the delisting process

at the given price. However, success is conditioned upon the acquirer reaching a 90% threshold of post-offer shareholding.

Impact:
The proposed changes seek to provide acquirers with more flexibility in making counter offers, while alternatives like fixed pricing aim to offer stability and informed decision-making for shareholders amidst market fluctuations.

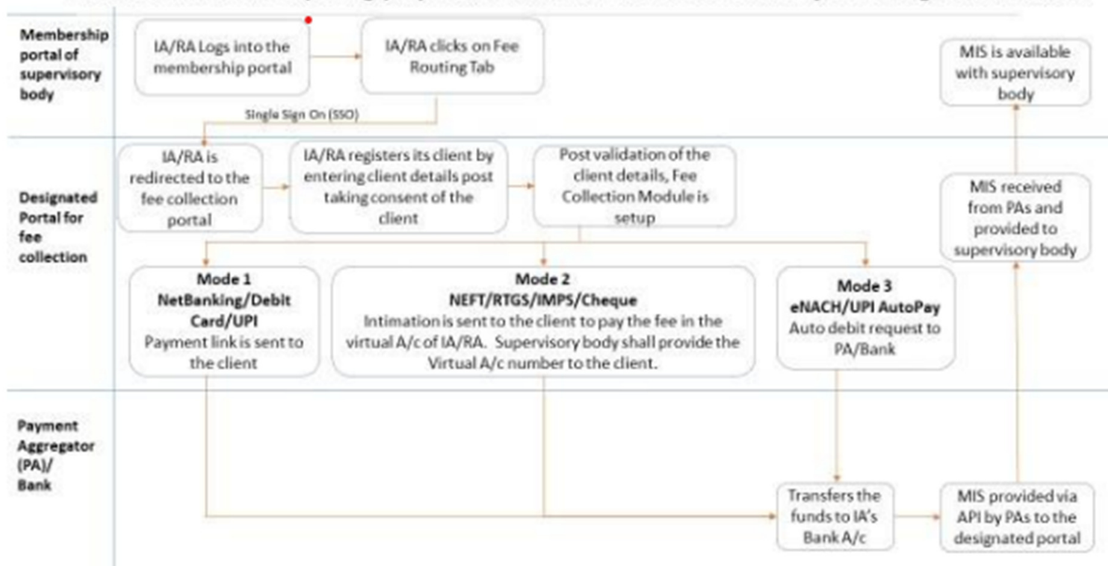
1.1.12 Consultation Paper on Mechanism for Fees Collection by SEBI Registered Investment Advisers and Research Analyst.

a. The context is shaped by the concerning trend of unregistered entities misleading investors, which breaches the regulations set for both IAs and RAs. In response to this challenge, there is a growing need to proactively curtail the spread of such unregistered entities and their deceptive practices.

b. To ensure clear recognition and differentiation of registered Investment Advisers (IAs) and Research Analysts (RAs) from unregistered entities, a distinct fee collection approach is proposed.

c. This mechanism, recommended by a working group involving BSE, BASL, and ARIA, aims to establish transparency and boost investor confidence. Under this proposal, fees will be paid through designated platforms specified by a SEBI-recognized supervisory body.

d. IAs and RAs will disclose their designated bank accounts solely for fee collection from investment advisory/research activities. These details will be part of client agreements, educating clients about the mechanism and cautioning against payments outside it.



1.1.13 Consultation Paper on Association of SEBI Registered Intermediaries/ Regulated Entities with Unregistered Entities' (including Finfluencers).

a. Financial influencers (finfluencers) have gained attention for providing financial advice to followers. While some are genuine educators, many are unregistered Investment Advisers (IAs) or Research Analysts (RAs). A consultation paper suggests a fee platform for registered IAs/RAs to help investors distinguish them from unregistered finfluencers. This move aims to prevent association between SEBI-registered intermediaries and unregistered finfluencers who might promote compensated products/services to followers.

b. The Advertising Standards Council of India defines an 'influencer' as someone who can impact purchasing decisions or opinions due to their authority, knowledge, or relationship with their audience. Financial influencers, known as 'finfluencers,' offer advice on financial matters through digital platforms, potentially affecting followers' financial choices in areas overseen by regulators like SEBI, RBI, PFRDA, and IRDA.

c. Finfluencers engage audiences on social media with engaging content, but those not registered with financial regulators might lack qualifications and conflict-of-interest disclosure. Many unregistered finfluencers promote products or services, receiving compensation like referral fees, non-cash benefits, and profits from underlying products. SEBI registered entities sometimes use these unregistered finfluencers for promotion.

d. This paper suggests curbing revenue for unregistered finfluencers who violate SEBI rules and proposes measures to deter perverse incentives. SEBI registered intermediaries must not have any association, monetary or non-monetary, with unregistered entities for promotion.

e. Registered entities must not share clients' confidential information with unregistered entities. Registered finfluencers should display their registration details, adhere to codes of conduct, and comply with advertisement guidelines.

f. No trailing commission based on referrals will be paid by registered intermediaries. Limited referrals from retail clients and associated fee payments by stockbrokers will be allowed. Registered intermediaries should distance themselves from unregistered entities using their name and report violations to enforcement agencies.

1.1.14 Consultation Paper on permitting increased participation of Non–Resident Indians (NRIs) and Overseas Citizens of India (OCIs) into SEBI registered Foreign Portfolio Investors (FPIs) based out of International Financial Services Centres (IFSCs) in India and regulated by the International Financial Services Centres Authority (IFSCA).

a. SEBI has proposed measures to encourage higher participation of NRIs and Overseas Citizens of India (OCIs) in the Indian securities market via the Foreign Portfolio Investor (FPI) route, aiming to boost FPI investments in India. Currently, FPI applicants cannot be NRIs or OCIs, but they can be constituents of an applicant after fulfilling specified conditions.

b. To promote FPI investments, SEBI suggests allowing NRIs and OCIs as constituents of FPIs operating from International Financial Services Centres (IFSCs) under IFSCA regulation. Concerns of market manipulation by NRI/OCI-owned entities persist, but SEBI recognizes the potential for increased investments through well-regulated FPIs with safe custody arrangements.

c. SEBI's proposals include allowing aggregate NRI/OCI contribution beyond 50% in the corpus of FPIs based in IFSCs, stricter criteria for granular level disclosures for such FPIs, and obtaining a Government of India identifier from NRI/OCI beneficial owners.

d. Individual NRI/OCI contributions should stay below 25% of the total corpus, while the aggregate contribution can be 50% or more under specific conditions. FPI applicants from IFSCs desiring over 50% NRI/OCI contributions can declare this to their designated depository participants, ensuring compliance throughout the registration validity. SEBI seeks comments on these proposals until September 10.

1.1.15 Validity period of approval granted by SEBI to Alternative Investment Funds (AIFs) and Venture Capital Funds (VCFs) for overseas investment

a. AIFs and VCFs are required to apply to SEBI for grant of overseas investment limits. Such allocated limits were to be utilized within 6 months from the date of prior approval which is now amended to 4 months from the date of prior approval.

Impact:
Allocated limit is utilised efficiently and, if unutilised, the same is again available to the AIF industry in a shorter time span.

1.1.16 Transactions in Corporate Bonds through Request for Quote (RFQ) platform by FPIs

a. FPIs shall undertake at least 10% of their total secondary market trades in Corporate Bonds by value by placing/seeking quotes on the RFQ platform of stock exchanges, on a quarterly basis.

Impact:
It will lead to increase in liquidity on RFQ platform of stock exchanges and enhancing the transparency and disclosure pertaining to trading in secondary market in corporate bonds.

1.1.17 Audit of firm-level performance data of Portfolio Managers.

a. APMI in consultation with SEBI will provide Terms of Reference for the audit of firm-level performance data.

b. Standard ToR will include a requirement to consider all services for the purpose of performance-level data. Advisory clients may be excluded if the same are not reported in any marketing material or website.

c. Portfolio Managers to submit compliance with such requirements to SEBI within 60 days from the end of each financial year. Also, audit reports on firm-level performance data are to be submitted within 60 days from the end of each financial year.

1.1.18 FAQs on SEBI Registered Investment Advisor

Changes in Investment Adviser Registration Process and Related Requirements-
In recent times, significant changes have been introduced in the registration process for Investment Advisers (IAs), accompanied by updates in the circulars issued by the Securities and Exchange Board of India (SEBI). These changes aim to enhance transparency, accountability, and investor protection within the financial advisory landscape. Several key modifications have been observed, as outlined below:

a. Membership Requirement with BSE Administration and Supervisory Body (BASL)-
Previously, the registration process for IAs did not mandate membership with the BSE Administration and Supervisory Body (BASL). However, under the new framework, prospective IAs are now required to obtain BASL membership before applying for an IA License from SEBI. This alteration signifies a crucial step towards streamlining the advisory profession and ensuring adherence to industry standards.

b. Revised Fee Structure and Net Worth Requirements-
Changes in fee structures and net worth prerequisites have been observed in comparison to prior FAQs. These adjustments have been detailed in circulars issued by SEBI. The intention behind these changes is to ensure that IAs possess the financial capacity to fulfil their fiduciary responsibilities effectively.

c. Adherence to Advertisement Code and Brand Name Usage-
A noteworthy inclusion in the updated FAQs is the mandatory adherence to the Advertisement Code issued by SEBI for IAs. Furthermore, specific directives have been provided concerning the usage of brand names or trade names. These measures underscore the need for transparent and responsible marketing practices within the advisory sector.

d. Introduction of Investor FAQs-
A notable addition to the FAQs is the dedicated section for Frequently Asked Questions (FAQs) tailored for investors. This section, absent in previous versions, places significant emphasis on fostering investor awareness. It provides insights into the registration process, highlights the importance of due diligence while selecting an IA, and educates investors on registering complaints against IAs through the SEBI SCORES platform.

e. **Continual Updates and Circular Compliance-**

The evolving landscape of regulations is evident through FAQs issued to provide elaborative guidance on the aforementioned changes. These FAQs serve as a crucial resource for IAs and investors alike, offering clarity on the evolving regulatory framework.

Impact:
In conclusion, the recent updates in the IA registration process and guidelines reflect SEBI's commitment to fortifying the advisory landscape for the betterment of investors. These changes collectively contribute to the creation of a more accountable, transparent, and investor-centric advisory environment. As these modifications continue to shape the financial advisory domain, staying informed and compliant with the evolving regulations remains paramount for all stakeholders involved.

1.1.19 Guidelines for MIIs Regarding Cyber security and Cyber Resilience

a. Market Infrastructure Institutions (MIIs) -like Stock Exchanges, Clearing Corporations, and Depositories - are essential for smooth securities market operations. To manage operational risks effectively, robust cybersecurity frameworks are now mandated. This safeguards trading, clearing, and settlement activities. MIIs must continually enhance their IT processes and controls to ensure data and system security.

b. MIIs' interdependence has grown in the evolving Indian Securities market. Their cyber risk now extends beyond internal systems. In response, SEBI, with input from MIIs, has introduced guidelines to fortify their cybersecurity and resilience framework, aligning with existing SEBI circulars. MIIs need to comply with these guidelines during cybersecurity audits and report their compliance using established reporting mechanisms. Immediate implementation is required, with necessary amendments to bye-laws, rules, and regulations within 120 days.

c. In this rapidly digitizing landscape, these guidelines enhance MIIs' ability to manage cyber risks, reinforcing market stability and integrity. This approach reflects SEBI's proactive stance in addressing the challenges posed by increasing interconnectedness.

d. The comprehensive measures taken to reinforce cybersecurity within Market Infrastructure Institutions (MIIs) carry significant positive implications. These enhancements ensure operational continuity and resilience, reducing system downtimes during cyber threats. By conducting security drills, implementing up-to-date software patches, and promoting user awareness, MIIs mitigate risks and bolster investor confidence in the market's stability. This proactive stance not only reduces potential financial losses but also positions MIIs as responsible entities within the financial industry.

e. Moreover, the improved cybersecurity framework enhances operational efficiency and user empowerment while complying with regulatory standards. These steps not only safeguard sensitive financial data but also establish a foundation for future preparedness in an evolving cyber landscape. In essence, the reinforced cybersecurity

measures have the potential to elevate market integrity, investor trust, and operational effectiveness across the financial ecosystem.

f. The adoption of these comprehensive cybersecurity measures by Market Infrastructure Institutions (MIIs) will yield significant impacts on the financial landscape. Firstly, the implementation of rigorous backdoor elimination, secure domain controller practices, and access management will fortify the foundation of MIIs' cybersecurity. This not only reduces the potential for unauthorized access and cyber threats but also ensures the integrity and confidentiality of critical financial data, enhancing investor trust and market stability.

g. Secondly, the robust security mechanisms, network segregation, and thorough testing of response and recovery plans will significantly improve the MIIs' ability to withstand and recover from cyber incidents. This translates to reduced operational downtimes, minimized financial losses, and sustained business continuity. Moreover, the engagement of Dark Web monitoring services and stringent API security demonstrates a proactive stance against emerging threats, preventing brand abuse and credential leaks.

Impact:
In essence, the adoption of these measures will bolster MIIs' overall cybersecurity posture, fostering a secure financial ecosystem that can effectively navigate the challenges of a digital age.

1.1.20 Consultation Paper on Flexibility in the Framework on Social Stock Exchange (SSE)

a. Notable SSE advancements by NSE and BSE: A dedicated SSE segment for 31 NPOs, NISM's Social Auditor certification for 957, and a Rs. 10 Crore Capacity Building Fund (CBF) initiated by NABARD, NSE, BSE, and SIDBI for NPOs' SSE involvement. SEBI, Exchanges, NABARD, SIDBI, ICAI, ICSI, and ICMA collaboratively raised awareness of SSE intricacies for NPOs. SEBI's SSEAC, chaired by Dr. R. Balasubramaniam, further propels SSE growth.

b. SEBI's impactful brainstorming session aimed to simplify NPO fundraising. It engaged investors, NPOs, SSE, NABARD, SIDBI, SEBI officials, and SSEAC's Chair. Insights merged from stakeholders and SSEAC, identifying key hurdles.

c. Challenges & Solutions-
   - High minimum issue size for ZCZP by NPOs at INR 1 crore.
   - Reduction of the INR 2 lakhs minimum application size for ZCZP.
   - Inclusion of Section 10(23C) and 10(46) Income Tax Act entities without 80G in SSE.
   - Re-evaluation of Income Tax scrutiny prerequisite.

- "Social Impact Assessor" substitution for "Social Auditor."
- Flexible past social impact presentation beyond SEBI's format.

d. Changes that are suggested in the consultation papers.
   - Based on feedback from the Brainstorming session, SSEAC suggests reducing the minimum issue size of ZCZP to Rs. 50 lakhs.
   - SSEAC recommends lowering the minimum application size for NPOs issuing ZCZP to Rs. 10,000.
   - SSEAC proposes considering NPOs registered under Income Tax Act Sections 10(23C) and 10(46) eligible for SSE, without mandating a valid 80G certificate for SSE registration.
   - SSEAC suggests allowing NPOs with ongoing Income Tax scrutiny on SSE, with disclosure of pending notices or scrutiny cases during SSE registration application, and timely disclosure of fines or penalties.
   - SSEAC advises changing "Social Auditor" to "Social Impact Assessor."
   - Exchanges propose a flexible format for disclosing past social impact by NPOs, based on their past practices, aiming to ease the requirement.

1.1.21. Extension of timeline for submission of public comments on the Consultation Paper on collating and defining use cases of Financial Information Users in the Account Aggregator Framework in Securities Markets.

SEBI had issued a consultation paper for the Account Aggregator Framework seeking comments till 31st August 2023. Now SEBI has extended the said timeline for submission till 15th September 2023.

1.1.22. Consultation Paper on Performance Validation Agency.

a. In the financial industry, AMCs, portfolio managers, IAs, RAs, and stock brokers need to showcase their performance to attract clients and sustain their businesses. However, there's a concern that some of these entities might make exaggerated claims to attract more clients, potentially misleading investors. Currently, they self-verify their claims, and there's no dedicated agency for validation.

f. In response to the demand a proposal has been put forth to establish an independent entity called the PVA. The primary objective of this agency is to validate and verify claims and performance-related information provided by SEBI-registered intermediaries.

g. PVA will validate performance claims made by intermediaries and entities based on specific parameters such as returns, risk, volatility, and other relevant criteria, as determined through industry consultation with PVA and SEBI. Ensuring the confidentiality of the information received during this process is a fundamental

responsibility. PVA may collaborate with other knowledge partners, such as Credit Rating Agencies, to fulfil its objectives.

d. PVA will validate various claims, including Actual Profits, Performance Claims, Recommended Stock/Portfolio Performance and other claims.

e. Client-specific recommendations will be displayed on intermediaries' websites for restricted client access. Public recommendations and validations will be published simultaneously on intermediaries' and PVA's websites. Recommended securities/portfolios' performance will be displayed in a format decided in consultation with industry forums, covering a reasonable period around the recommendation date on both intermediaries' and PVA's websites.

Impact:

The establishment of the PVA aims to boost transparency and credibility in the financial industry. It empowers investors with validated information while requiring SEBI-registered entities to adapt to new compliance standards. Challenges include data management, algorithmic trading scrutiny, and maintaining data privacy.

1.2. Reserve Bank of India

1.2.1. Fair Lending Practice - Penal Charges in Loan Accounts

The Reserve Bank of India (RBI) has been regulating the lending and borrowing industry, but with sudden emergence of digital lending platforms necessitated closer regulation, especially in light of the challenges faced during the pandemic. The digital lending sector has raised serious concerns regarding several issues, including the unchecked involvement of third parties, mis-selling practices, breaches of data privacy, unfair business conduct, excessive interest rates, and unethical debt recovery practices.

The Reserve Bank of India [RBI] in a bid to enhance transparency, fairness, and customer trust in the lending sector, has issued a circular on August 18, 2023, addressing the subject of fair lending practices and penal charges in loan accounts. This circular is applicable to all commercial banks, primary cooperative banks, NBFCs, and financial institutions.

The central theme of the circular revolves around tackling the current challenges associated with penal interest and charges imposed on borrowers by lending institutions. The Reserve Bank of India (RBI) acknowledges that issues have emerged concerning the fairness and transparency of these charges.

This has given rise to disputes and customer complaints. RBI has introduced these set of guidelines aimed at achieving three key objectives: enhancing clarity, ensuring fairness, and establishing a uniform approach to the imposition of penal charges.

The circular's implementation is scheduled to commence on January 1, 2024. In preparation for this date, lending institutions are strongly advised to review and update their policy frameworks, aligning them with the new guidelines.

Key Highlights:

Distinguishing between 'Penal Charges' and 'Penal Interest':

1. RBI placed a strong emphasis on establishing a clear demarcation between these two concepts. While penal interest typically involves an additional interest component applied to the borrowed amount, the concept of penal charges is now underscored as a distinct entity, deliberately separate from the interest framework.

2. Furthermore, the RBI sheds light on the precise classification of penalties linked to the violation of essential terms and conditions specified in the loan agreement. These penalties, arising from the non-adherence to critical contractual obligations, are now formally designated as 'penal charges.'

Promoting transparency and comprehensive disclosure.

1. Lending institutions are obligated to embrace an explicit approach by unveiling both the magnitude and reasoning underlying penal charges.
2.
3. This requirement necessitates the integration of such disclosure within various crucial documents, including the loan agreement, key fact statements, terms and conditions, and evidently showcased on the official website of the lender.

Reasonableness and fairness of penal charges:

1. It underscores that the extent of these charges must be both rational and commensurate with the nature of the contractual breach.

2. Moreover, these charges should remain consistent and justifiable, maintaining a direct correlation to the specific terms that have been violated.

3. Penal charges for loans granted to 'individual borrowers for non-business purposes' must not exceed the penal charges imposed on non-individual borrowers for comparable breaches of essential terms and conditions.

Policy on penal charges:

1. Lending institutions are mandated to establish a comprehensive policy, duly approved by their Board, that outlines the parameters for the imposition of penal charges.

2. The formulated policy serves as a structured framework through which lending institutions determine when and how penal charges are applied.

Effective communication reminders:

1. Lending institutions are required to proactively communicate the relevant penal charges to borrowers when issuing reminders for non-compliance with loan terms.

2. Additionally, any instances where penal charges are imposed must be communicated, accompanied by clear explanations for their application.

3. Lenders shall ensure that borrowers are well-informed about the potential consequences of non-compliance.

Impact-

1. NBFCs will be required to adopt a much more transparent approach in disclosing the quantum and rationale behind penal charges to borrowers. This would necessitate revising their communication practices, loan agreement terms, and website information to ensure that borrowers are fully informed about the implications of penal charges.

2. **Policy Revision:** NBFCs will need to review and revise their policy frameworks to ensure they are aligned with the RBI's new guidelines. This involves developing a clear policy on imposing penal charges, which should be approved by their Board of Directors.

3. **Customer Communication:** NBFCs will need to establish effective communication channels to inform existing and new borrowers about the changes brought about by the circular. This includes conveying the availability of options and educating borrowers about their rights and responsibilities regarding penal charges.

Impact:
NBFCs will be required to adopt a much more transparent approach in disclosing the quantum and rationale behind penal charges to borrowers. This would necessitate revising their communication practices, loan agreement terms, and website information to ensure that borrowers are fully informed about the implications of penal charges. NBFCs will also need to review and revise their policy frameworks to ensure they are aligned with the RBI's new guidelines. Furthermore, they will need to establish effective communication channels to inform existing and new borrowers about the changes brought about by the circular. This includes conveying the availability of options and educating borrowers about their rights and responsibilities regarding penal charges.

1.2.2. Review of Regulatory Framework for IDF-NBFCs

The Reserve Bank of India [RBI] has introduced revised guidelines for Infrastructure Debt Fund-NBFCs (IDF-NBFCs), aimed at enhancing their role in financing the infrastructure sector and aligning the regulations governing infrastructure financing by non-banking financial companies (NBFCs). The circular emphasizes that all other regulatory norms applicable to NBFC-Investment and Credit Companies (NBFC-ICCs) will be applicable to IDF-NBFCs

The circular provides the definition of an IDF-NBFC, classifying it as a non-deposit taking Non-Banking Financial Company (NBFC) with the specific authorization to undertake certain financial activities. An IDF-NBFC's primary functions encompass refinancing infrastructure projects after their commencement operations date (COD) and acting as a direct lender for toll-operate-transfer (TOT) projects.

The updated guidelines introduce specific financial requirements that IDF-NBFCs are mandated to adhere to in terms of their Net Owned Funds (NOF) and Regulatory Capital. As per these guidelines, an IDF-NBFC is required to maintain a minimum Net Owned Funds of at least ₹300 crore. In addition, the capital adequacy is stipulated through the capital-to-risk weighted assets ratio (CRAR), which should be maintained at a minimum of 15%. Within this CRAR, a minimum Tier 1 capital of 10% is also prescribed.

To secure funds, Infrastructure Debt Fund-NBFCs (IDF-NBFCs) will follow the following avenues, as outlined under the revised guidelines:

1. Bonds and Commercial Papers (CPs):
    a. IDF-NBFCs will primarily raise funds by issuing bonds denominated in either rupees or dollars, with a minimum maturity period of five years.

    b. To optimize asset-liability management (ALM), IDF-NBFCs can also access funds through the issuance of shorter tenor bonds and commercial papers (CPs) within the domestic market. This is allowed up to a maximum of 10% of their total outstanding borrowings.

2. External Commercial Borrowings (ECBs):
    a. In addition to the bond route, IDF-NBFCs have the option to raise funds through external commercial borrowings (ECBs) via the loan route.

    b. However, these ECB borrowings must have a minimum tenor of five years, ensuring a long-term financing approach.

    c. Notably, these ECB loans must not be sourced from the foreign branches of Indian banks.

    d. IDF-NBFCs opting for external commercial borrowings (ECBs) are required to comply with the guidelines issued by the Forex Department of the RBI.

3. Exposure Limits:
    a. IDF-NBFCs will operate within specified exposure limits to manage their risk exposure effectively. These limits for Single Borrower/Party Exposure are limited to a maximum exposure of 30% of their Tier I capital to a single borrower or party.

    b. For Single Group of Borrowers/Parties Exposure the same is capped at 50% of the Tier I capital.

4. Sponsorship
    a. Under the previous guidelines, it was obligatory for an Infrastructure Debt Fund-NBFC (IDF-NBFC) to have sponsorship from either a bank or an NBFC-IFC. This stipulation has now been eliminated and shareholders of IDF-NBFCs shall be subjected to scrutiny as applicable to other NBFCs, including NBFC-IFCs.

    b. Previously, IDF-NBFCs were mandated to establish a tripartite agreement involving the concessionaire, project authority, and the IDF-NBFC itself. This arrangement was applicable for investments in Public-Private Partnership (PPP) infrastructure projects

that involved a project authority. However, the requirement for a tripartite agreement has now become optional, granting more flexibility in this aspect.

5. Guidelines for Sponsorship of IDF-MFs by NBFCs

All NBFCs are eligible to sponsor Infrastructure Debt Fund-Mutual Funds (IDF-MFs) subject to prior approval from the RBI. This eligibility is contingent upon fulfilling the following conditions, in addition to those stipulated by SEBI Regulations for Mutual Funds:

a. The NBFC aiming to sponsor an IDF-MF must possess a minimum Net Owned Fund (NOF) of ₹300 crore and a Capital-to-Risk Weighted Assets Ratio (CRAR) of at least 15 percent.

b. The NBFC's net Non-Performing Assets (NPAs) must amount to less than 3 percent of its net advances.

c. The NBFC must have been in existence for a minimum of 5 years.

d. The NBFC should have maintained profitability for the last three consecutive years, with a satisfactory overall performance record.

e. The CRAR of the NBFC subsequent to its investment in the IDF-MF must not fall below the regulatory minimum stipulated for the NBFC.

f. The NBFC must continue to maintain the necessary level of Net Owned Fund (NOF) even after accounting for its investment in the proposed IDF-MF.

g. There should be no supervisory concerns or issues of regulatory non-compliance with respect to the NBFC's operations.

1.2.3. Framework for Compromise Settlements and Technical Write-offs

The regulator has recently issued the Framework for Compromise Settlements and Technical Write-offs. This framework is a significant milestone as the RBI brings in a new methodology after Prudential Framework for Resolution of Stressed Assets (PFRSA) introduced 4 years ago on 7th June 2019. The RBI's newest framework serves the purpose of rationalizing and harmonizing the existing guidance, simplifying the regulatory landscape for all stakeholders involved.

A notable distinction between the new Framework and the previous PFRSA is its expanded applicability. While the PFRSA was applicable to systemically important Non-Banking Financial Companies (NBFC-SI), the revised Framework now includes all the NBFCs including Housing Finance Company. Key features of the Framework have been stated below:

Policy Framework:
Regulated Entities (REs) are now required to establish board-approved policies to govern the process of undertaking compromise settlements with borrowers and conducting technical write-offs. These policies serve as guidelines to ensure consistency and proper governance in handling such activities.

It will include specific guidance on important prerequisites, such as minimum ageing of the account and collateral value deterioration. Regarding compromise settlements, the policy will outline provisions regarding the permissible sacrifice for different types of exposures. This will involve carefully considering the current realizable value of available security or collateral when determining the settlement amount.

Compromise Settlement is defined as "any negotiated arrangement with the borrower to fully settle the claims of the RE against the borrower in cash." This means that the borrower agrees to pay the bank a lesser amount than the total amount due on the loan. The bank agrees to accept this lesser amount in full and final settlement of the loan.

Technical Write-Off is defined as "any write-off of non-performing assets (NPAs) by a RE from its balance sheet without involving any waiver of claims against the borrower." This means that the RE writes off the loan as a loss, but it does not give up its right to recover the money from the borrower.

Delegation Of Power:
The policy shall also address the delegation of powers for the approval and sanctioning of compromise settlements and technical write-offs. The delegation of power for approvals of compromise settlements and technical write-offs is assigned to an authority, whether an individual or a committee, that holds a higher hierarchical position compared to the authority responsible for sanctioning the credit or investment exposure.

To ensure independence and avoid conflicts of interest, it is stipulated that any official who was involved in sanctioning the loan, either individually or as part of a committee, shall not be involved in the approval process for a compromise settlement related to the same loan account in any capacity.

Prudential Treatment:
Compromise settlements that involve an agreed settlement amount with a payment timeline exceeding three months will be classified as restructuring, as defined within the Prudential Framework on Resolution of Stressed Assets. In the case of partial technical write-offs, the prudential requirements related to the residual exposure, including provisioning and asset classification, will be based on the original exposure.

However, it is important to note that the provisions made, including the portion representing the partial technical write-off, must fulfil the existing provisioning requirements calculated based on the gross value of the asset.

Reporting:

A reporting mechanism has to be established by the REs to provide regular updates on compromise settlements and technical write-offs that have been approved by the authority. This reporting should occur at least on a quarterly basis. In cases where compromise settlements and technical write-offs are approved by the MD & CEO or a Board Level Committee, the information should be reported to the Board of Directors.

Cooling Period:

Regarding borrowers who are subject to compromise settlements, there will be a cooling period, as specified in the respective Board-approved policies, before REs can enter into fresh exposures with such borrowers:

1. The cooling period for exposures other than farm credit will have a minimum duration of 12 months. However, REs have the flexibility to establish longer cooling periods based on their individual Board-approved policies.
2. For farm credit exposures, the cooling period shall be determined by the REs in accordance with their specific Board-approved policies.

Accounts Categorised as Fraud and Wilful Defaulter:

REs are authorized to engage in compromise settlements or technical write-offs for accounts classified as wilful defaulters or fraud, without prejudicing any ongoing criminal proceedings against the debtors. This provision recognizes that the resolution process, including compromise settlements or technical write-offs, can proceed independently of criminal proceedings. It ensures that the financial institution's actions in addressing the account's status do not interfere with the legal proceedings underway.

By allowing REs to pursue compromise settlements or technical write-offs in such cases, the framework enables potential resolutions and the recovery of dues while acknowledging the parallel criminal proceedings.

Impact:

This broadening of the framework's scope ensures that a wider range of financial entities are now subject to its provisions. By encompassing a more diverse set of institutions, the revised framework aims to foster consistency and uniformity in dealing with compromise settlements and technical write-offs across a larger segment of the financial sector.

2. Discussion Papers

Transfer of Loan Exposure: A comprehensive view

Transfer of debt/loan is one of the most common forms of transactions in secondary lending markets. In assignment of loan exposure, a lender assigns its rights relating to a loan agreement to a new lender. Usually, the assignor's rights under the loan agreement are assigned and not their obligation under the facility agreement.

In India, the secondary market for corporate loans currently is dominated by the inter-bank transactions, undertaken on an ad hoc basis through transfer of loan accounts from one bank to another, and sale of stressed assets by banks to Asset Reconstruction Companies (ARCs). The banks usually have been using the transfer of Loan Exposure (TLE) transaction for transfer of their risk associated with stressed loan portfolio to ARC's but there are many benefits perceived by the banks.

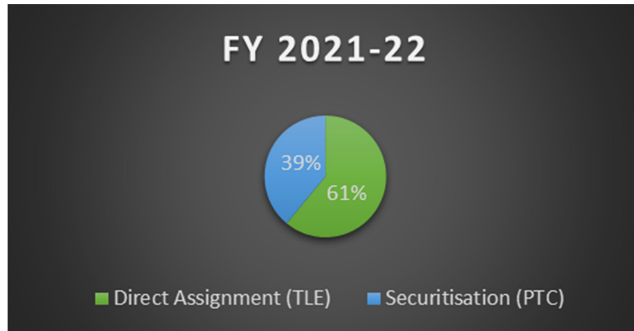
In general, there are three ways that a lender can assign or transfer interests on a loan:

1. Assignment of rights (Legal Assignment) -Under assignment, usually only some of the rights of one party are transferred to a third party. The original contract is not terminated and remains enforceable.
2. Novation of rights and obligations (Legal Assignment)-Under novation, all of the rights and obligations of one party is transferred to a third party by way of a replacement contract. The original contract is terminated and unenforceable.
3. Loan participation (equitable assignment)- "loan participation" means a transaction through which the transferor transfers all or part of its economic interest in a loan exposure to transferee(s) without the actual transfer of the loan contract, and the transferee(s) fund the transferor to the extent of the economic interest transferred which may be equal to the principal, interest, fees and other payments, if any, under the transfer agreement

Though historically Loan Exposures are transferred through true sale and complete assignment of rights. A Novation transaction is unpopular as it tantamount to resolution of a Stressed Asset which shall be undertaken post compliance with Resolution Framework of Stressed Asset introduced in 2019 and Loan Participation being newly introduced in 2021. The total volume of secondary markets for standard assets, including direct assignment transactions, rose to Rs 176,000 crore from around Rs 1,13,000 crore in FY22.

NBFC's have limited access to funding as per regulations of RBI, but the sale of loan assets as well as securitisation transaction shall inject additional liquidity fuelling their expansion. Although securitisation and Transfer of Loan Exposure (TLE) are closely related the transaction differs on a primary operation aspect as well as that the former is not allowed to

be undertaken for stressed assets. However, Transfer of Loan Exposure is usually preferred, primarily due to cost involved in securitisation, as can be seen below:



(Source: Care Rating)

TLE transactions are governed by the SARFAESI Act, 2002 and is regulated by the Reserve Bank of India. It was in early 2006, that the first directions were rolled out by the RBI from which periodic updates have been made with the most recent being for 24 September 2021. The recent directions have its roots in RBI's Report of Task Force on Development of Secondary Market for Corporate Loans published in August 2019. The report identified actions and parameters for the development of the market.

The Directions provide a detailed framework to execute any transfer (whether involving any transfer of underlying loan contract or not), key address in which pertain to:

1. Eligible Participants for (being entities regulated by RBI, including ARCs),
2. Requirement of a Board Approved Policy and other general guidelines for transaction,
3. Transferor's role as a Service Provider,
4. Minimum Holding period and Minimum Risk Retention,
5. Requirement of Ratings and Due Diligence by the purchaser,
6. Stringent directions enabling transfer of Stressed Assets,
7. Special requirements to transfer to an Asset Reconstruction Company,
8. Accounting for the transaction (as per Indian Accounting Standard as well other)
9. Disclosure for transaction

These directions summarize previous directions as well as introduce new grounds allowing the sale of loans classified as fraud and allowing non-ARCs to acquire the stressed loans. Also, the Directions has rightfully modified the requirements of Minimum holding period due to the gaining prominence of short-term lending markets of end customers. The transaction shall be affected post permission of both parties to protect the interest of the borrowers. The Directions also witnessed introduction of a price discovery mechanism for sale of lending portfolio as suggested in the report of Task Force

There are several benefits perceived benefits due to which a NBFC/Bank may decide to assign its debt. This option is often exercised to:

1. Improve liquidity and/or to reduce risk exposure.

2. Injection of funds in the books
3. To transfer/distribute risk
4. Expansion by Outsourcing of collection mechanism
5. Effective Exposure management
6. Better Financial Statements Position and Financial Statement ratios
7. Focus on core activity of credit disbursement

Further, SARFAESI Act 2002 exempts payment of stamp duty on transaction with ARC which shall make it a preferable option over other secondary markets.

Although, there has been growing popularity in the industry but the market is still underperforming as compared to western countries. Secondary Loan Market Association (SLMA), has been formed on the recommendation of the Reserve Bank of India's Task Force on the Development of Secondary Market for Corporate Loans formed by 10 major banks in India with objective to promote and set up an online system for the standardization and simplification of primary loan documentation, and other trading mechanisms for the secondary loan market.

The digital platform provided over a open API to other market participants has presented other eligible investors to sale their loan exposures under appropriate guidance. Since, the portal is relatively new it has only banks as its members. Appropriate Promotion of the portal shall render the inclusion of other financial intermediaries giving boost to the secondary markets.

Further, the post covid era has witnessed a change in the borrowing habits of the customers in respect of growing lower ticket loans volume. In future RBI may bring out changes in its regulations to enable loans in this sector to be sold in the secondary markets. At present merely 2-3% of the total lending market of India is traded in the secondary market indicating a gigantic space of flourishing opportunities to be capitalized. This shall be possible only by developing confidence among the market players and education on the benefits the secondary market shall serve developing a bright future for the market.

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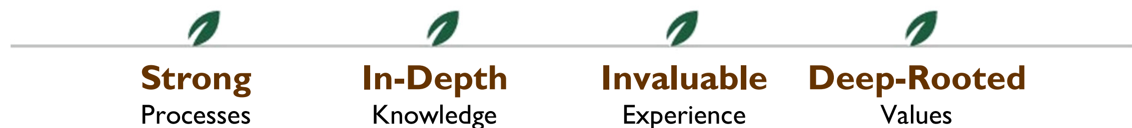

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