BASILSTONE
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Basilstone Consulting is pleased to present to you the **December 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. Portfolio Management Services for Accredited Investors

In the case of large value accredited investors, the quantum and manner of exit load applicable to the client of the Portfolio Manager shall be governed through bilaterally negotiated contractual terms.

Impact: This implies that large value accredited investors shall **not** be subject to exit load prescribed hereunder and can be contractually decided amongst the Portfolio Manager and large value accredited investor:

i. In the first year of investment, maximum of 3 % of amount redeemed
ii. In the second year of investment, maximum of 2 % of amount redeemed
iii. In the third year of investment, maximum of 1 % of amount redeemed
iv. After a period of three years from date of investment, no exit load

1.1.2. Investment Advisory Services for Accredited Investors

In the case of large value accredited investors, the modes and fees that can be charged by an investment adviser from a client shall be governed through bilaterally negotiated contractual terms.

Impact: This implies that large value accredited investors shall **not** be subject to Para 2 (iii) of the SEBI Circular No SEBI/HO/IMD/DF1/CIR/P/2020/182dated September 23, 2020("Circular") inter alia specifying the modes and limits of fees that can be charged by an Investment Adviser (IA) from a client. The IA is not governed by the following restrictions in charging fees to large value accredited investors:

i. The Fixed Fees Mode - Rs 1,25,000 per annum per client across all services offered by IA or
ii. The Assets under Advice (AUA) mode – 2.5 % of AUA per annum per client across all services offered by IA.

1.1.3. Transaction in Corporate Bonds through Request for Quote Platform

a. Portfolio Management Services (PMS) shall undertake atleast 10 % of their total secondary market trades by value in Corporate Bonds (CBs) in that month by placing/seeking quotes through one to one (OTO) or one to many (OTM) mode on the request quote platform (RQF) of the stock exchanges
b. PMS shall consider the trades executed by value through OTO or OTM mode of RFQ with respect to the total secondary market trades in CBs, during the current month and immediately preceding two months on a rolling basis.

c. All transactions in CBs wherein PMS is on both sides of the trade shall be executed through RFQ in OTO mode. However, any transaction entered by PMS in CBs in OTM mode which gets executed with another PMS, shall be counted in OTM mode.

d. PMS are permitted to accept the Contract Note from the stock brokers for transactions carried out in OTO and OTM modes of RFQ.

The said circular is effective from 01 April 2022.

Impact: Participation of Portfolio Managers in the Corporate Bond Market shall result in enhancing transparency pertaining to debt investments by PMS and also increase liquidity on the exchange platform.

1.1.4. Circular on Mutual Funds

a. Norms for Investing in Bills Re Discounting Scheme (BRDS)

Investments in unrated debt and money market instruments, other than government securities, treasury bills, derivative products such as Interest Rate Swaps (IRS), Interest Rate Futures (IRF), etc., can only be made in instruments like bills re-discounting, usance bills, etc., that are generally not rated and for which separate investment norms are not provided in MF Regulations and various circulars issued thereunder. The exposure of mutual fund schemes in such instruments, shall not exceed 5% of the net assets of the schemes. The single issuer limit and the group exposure limit shall be calculated at the issuing bank level as BRDS are issued with recourse to the issuing bank. Investment in BRDS by debt schemes of mutual funds shall be considered as exposure to financial services sector for the purpose of sector exposure limits.

Impact: This amendment shall result in uniformity across the industry with regards to investment in BRDS.

b. Usage of Pool Accounts by Mutual Funds

- Mutual Funds may use pool accounts, only for such transactions which are executed at mutual fund level owing to operational and regulatory requirements subject to:
  - AMCs shall have internal policies approved by the Board of AMC and Trustees to ensure that adequate operational processes and internal controls are in place to segregate and ring-fence the assets and liabilities of each scheme along with the segregation and ring-fencing of securities and bank accounts
  - At the end of day, the assets and liabilities of each scheme shall be segregated and ring-fenced from other schemes of the mutual fund; and bank accounts and securities accounts of each scheme shall be segregated and ring-fenced. The pool accounts for both securities and funds should have nil balance at end of the day.
  - If the funds lying in the pool bank account of the mutual fund are not identified, due to the reasons beyond the control of the AMC, the same shall be transferred to the

respective scheme account not later than one business day from the day such transactions are identified.

- At no point of time, the securities or funds of one scheme shall be used for other scheme(s)and there shall be any conflict of interest amongst investors of various schemes.
- The responsibility to ensure segregation and ring-fencing of the assets and liabilities of each scheme along with segregation and ring-fencing of bank accounts & securities accounts shall lie with the Board of AMC and Trustees. Trustees in their Half Yearly Trustee Report (HYTR) to SEBI shall confirm that the assets and liabilities of each along with their bank accounts & securities accounts are segregated and ring-fenced on daily basis, except the unidentified transactions of funds, during the half-year period. The whole mechanism shall be audited on half yearly basis by the auditor appointed by the trustees.

▪ Margin or collateral requirement for execution of transactions
  - AMC shall ensure that margins or collaterals for such transactions are placed from the assets of the respective schemes only, without co-mingling with the assets of other schemes.
  - overnight funds can deploy, not exceeding, 5% of the net assets of the scheme in G-secs and/or T-bills with a residual maturity of upto 30 days for the purpose of placing the same as margin and collateral for certain transactions

1.1.5. Clarification regarding amendment to SEBI (Portfolio Managers) Regulations, 2020

a. Procedure for undertaking of Co-investment portfolio management services

▪ A Manager of an AIF who is also a SEBI registered Portfolio Manager, and intends to offer Co-investment services through portfolio management route, shall do so only under prior intimation to SEBI.
▪ Any other Manager who is not a SEBI registered Portfolio Manager, and intends to offer Co-investment services through portfolio management route, shall seek registration from SEBI as a Portfolio Manager in terms of the PMS Regulations. Pursuant to grant of registration, if such Portfolio Manager is desirous of offering portfolio management services other than Co-investment, the same shall be subject to compliance with all provisions of the PMS Regulations including eligibility criteria, and with the prior approval of SEBI.

b. Periodic Reporting by Portfolio Managers on the SEBI intermediary's portal shall include details of Co-investment by Portfolio Manager w.e.f. April 2022.

c. Portfolio managers are required to furnish a quarterly report to their clients which shall include details of co-investment offered by portfolio Manager w.e.f. April 2022.

d. Provisions of fees and charges prescribed for Portfolio managers shall not be applicable to Co-investment Services.

e. The provisions with respect to direct on boarding of clients by Portfolio Managers shall not be applicable to co-investment services.

1.2. Reserve Bank of India

1.2.1. Changes due to LIBOR transition

RBI has, vide its Notification amended the External Commercial Borrowings & Trade Credit policy to accommodate transition to Alternative Reference Rate (ARR). The notification has effected the following changes:

- The meaning of Benchmark Rate under the policy has been amended to any widely accepted interbank rate or ARR of 6-month tenor, applicable to the currency of borrowing
- All-in-cost ceiling has been revised for all new Foreign Currency ECBs to 500 bps and Trade Credits to 300 bps over the ARR
- Further, to enable smooth transition for existing ECBs / Trade Credits, all-in cost ceiling for such ECBs/ TCs has been revised upwards to 550 bps and 350 bps, respectively, over the ARR, incurred on account of transition from LIBOR only.

Impact: The circular amends the extant policy to accommodatively effect the transition from LIBOR to ARR, while smoothening the pricing aspects of existing ECBs / Trade Credits on account of this transition w.e.f. 31st December 2021.

1.2.2. Introduction of LEI for Cross-Border transactions

RBI has mandated obtaining Legal Entity Identifier from the resident entities (non-individuals) undertaking capital or current account transactions of ₹50 crore and above (per transaction) under FEMA, 1999. Once an entity has obtained an LEI number, it must be reported in all transactions of that entity, irrespective of transaction size. The said notification will come into effect from 01st October 2022, however transacting entities can adopt its implementation voluntarily.

Impact: The Legal Entity Identifier (LEI) is a 20-digit number used to uniquely identify parties to financial transactions worldwide to improve the quality and accuracy of financial data. The said mechanism would link international transactions to specific-entities, which have benefits of trackability of funds.

1.2.3. Extension of Card-On-File restriction timeline

RBI has amended the timeline for storing of Card-on-File (CoF) data by extending it by six months, i.e., till June 30, 2022. Post this date, the data shall be purged.

The notification further permits industry stakeholders to devise alternate mechanism(s) (apart from tokenisation) to handle any use case (including recurring e-mandates, EMI option, etc.) or post-transaction activity (including chargeback handling, dispute resolution, reward / loyalty programme, etc.) that currently involves / requires storage of CoF data by entities, other than card issuers and card networks.

Impact: The notification comes as a relief to the industry for effective transition from CoF to tokenisation methodologies, while also permitting utilisation of alternate mechanisms to handle varied use-cases of CoF. It is yet to see how the authorisation etc. would function for alternate mechanisms.

1.3. Ministry of Corporate Affairs

1.3.1. Extension of timelines for Video Conference / Other Audio Visual Means on account of Covid-19

MCA has, vide General Circulars extended the utilisation of Video Conference / Other Audio-Visual means for conduct of EGMs / AGMs held upto 30th June 2022. For abundant clarification, these circulars do not extend the date of holding meetings, but extend the applicability of VC / OAVM to meetings held upto 30th June 2022.

1.4. International Financial Services Authority

1.4.1. Investment Banking in IFSC by IBUs

IFSCA has notified that Banking Units in IFSC shall intimate IFSCA before commencement of Investment Banking activities in prescribed format, alongwith requirement of maintaining arm's length relationship between investment banking activity and other activities. The circular also lays down half-yearly reporting requirements in the prescribed format.

2. Discussion Papers

2.1. Prompt Corrective Action (PCA) Framework for NBFCs

Reserve Bank of India has issued a detailed Prompt Corrective Action framework for Non-Banking Financial Companies, in line with those applicable to banks, albeit skewed with regulatory arbitrage that NBFCs offer. The PCA framework is applicable to:

- Deposit Taking NBFCs
- Non-Deposit taking NBFCs in Middle, Upper & Top layers (including Core Investment Companies, Micro-Finance Institutions, Factors, Infrastructure Finance Companies, Infrastructure Debt Funds and Investment & Credit Companies)
- Excludes:
  - NBFCs not accepting public funds
  - Government Companies
  - Primary Dealers
  - Housing Finance Companies

The criteria for selection of entity under PCA framework have been prescribed as:

For NBFCs-D and NBFCs-ND (excluding CICs):

Indicator	Risk Threshold-1	Risk Threshold-2	Risk Threshold-3
CRAR	Upto 300 bps below the regulatory minimum CRAR [currently, CRAR <15% but ≥12%]	More than 300 bps but upto 600 bps below regulatory minimum CRAR [currently, CRAR <12% but ≥9%]	More than 600 bps below regulatory minimum CRAR [currently, CRAR <9%]
Tier I Capital Ratio	Upto 200 bps below the regulatory minimum Tier I Capital Ratio [currently, Tier I Capital Ratio <10% but ≥8%]	More than 200 bps but upto 400 bps below the regulatory minimum Tier I Capital Ratio [currently, Tier I Capital Ratio <8% but ≥6%]	More than 400 bps below the regulatory minimum Tier I Capital Ratio [currently, Tier I Capital Ratio <6%]
NNPA Ratio (including NPIs)	>6% but ≤ 9%	>9% but ≤12%	>12%

For CICs:

Indicator	Risk Threshold-1	Risk Threshold-2	Risk Threshold-3
Adjusted Net Worth / Aggregate Risk Weighted Assets	Upto 600 bps below the regulatory minimum ANW/RWA [currently, ANW/RWA <30% but ≥24%]	More than 600 bps but upto 1200bps below regulatory minimum ANW/RWA [currently, ANW/RWA <24% but ≥18%]	More than 1200 bps below regulatory minimum ANW/RWA [currently, ANW/RWA <18%]
Leverage Ratio	≥2.5 times but <3 times	≥ 3 times but <3.5 times	≥3.5 times
NNPA Ratio (including NPIs)	>6% but ≤ 9%	>9% but ≤12%	>12%

The corrective actions for various Risk Threshold include:

Mandatory and Discretionary actions		
Specifications	**Mandatory actions**	**Discretionary actions**
Risk Threshold 1	• Restriction on dividend distribution/remittance of profits; • Promoters/shareholders to infuse equity and reduction in leverage; • Restriction on issue of guarantees or taking on other contingent liabilities on behalf of group companies (only for CICs)	Common menu • Special Supervisory Actions • Strategy related • Governance related • Capital related • Credit risk related • Market risk related • HR related • Profitability related • Operations/Business related • Any other.
Risk Threshold 2	In addition to mandatory actions of Threshold 1, • Restriction on branch expansion	
Risk Threshold 3	In addition to mandatory actions of Threshold 1 & 2, • Appropriate restrictions on capital expenditure, other than for technological upgradation within Board approved limits • Restrictions/reduction in variable operating costs	

The wide range of discretionary actions include, indicatively, the following:

1. Special Supervisory Actions
   - Special Supervisory Monitoring Meetings (SSMMs) at quarterly or other identified frequency
   - Special inspections / targeted scrutiny of the NBFC
   - Cause a special audit / inspection of NBFC / Group entities by the extant supervisory mechanism and/or through external auditors
   - Restricted and need based regulatory / supervisory approvals to be given by the Reserve Bank
   - Resolution of NBFC by Amalgamation / Reconstruction / Splitting (Section 45MBA of RBI Act, 1934)
   - File insolvency application under IBC (As per the rules dated November 15, 2019 notified under section 239 of the Insolvency and Bankruptcy Code, 2016 (31 of 2016))
   - Show Cause Notice for cancellation of CoR and winding up of the NBFC

2. Strategy related Actions
   - Activate the Recovery Plan that has been duly approved by the Supervisor
   - Undertake a detailed review of business model in terms of sustainability of the business model, profitability of business lines and activities, medium and long-term viability, etc.
   - Review short-term strategy focusing on addressing immediate concerns
   - Review medium-term business plans, identify achievable targets and set concrete milestones for progress and achievement
   - Undertake business process reengineering as appropriate
   - Undertake restructuring of operations as appropriate

3. Governance related Actions
   - RBI may actively engage with the NBFC's Board on various aspects as considered appropriate
   - RBI may recommend to promoters/shareholders to bring in new Management/ Board
   - RBI may remove managerial persons under the RBI Act, as applicable
   - Removal of Director and/or appointment of another person as Director in his place
   - RBI may supersede the Board under the RBI Act and appoint an Administrator
   - RBI may require the NBFC to invoke claw back and malus clauses and other actions as available in regulatory guidelines, and impose other restrictions or conditions
   - Impose restrictions on Directors' or Management compensation, as applicable.

4. Capital related Actions
   - Detailed Board level review of capital planning
   - Submission of plans and proposals for raising additional capital
   - Requiring the NBFC to bolster reserves through retained profits
   - Restriction on investment in subsidiaries/associates
   - Restriction in expansion of high risk-weighted assets to conserve capital
   - Reduction in exposure to high-risk sectors to conserve capital
   - Restrictions on increasing stake in subsidiaries and other group companies

5. Credit risk related Actions
   - Preparation of time bound plan and commitment for reduction of stock of NPAs
   - Preparation of and commitment to plan for containing generation of fresh NPAs
   - Strengthening of loan review mechanism

- Restrictions/reduction in total credit risk weight density (example: restriction/ reduction in credit for borrowers below certain rating grades, restriction/reduction in unsecured exposures, etc.)
- Reduction in loan concentrations in identified sectors, industries or borrowers
- Sale of assets
- Action plan for recovery of assets through identification of areas (geography-wise, industry segment-wise, borrower-wise, etc.) and setting up of dedicated Recovery Task Forces, etc.
- Prohibition on expansion of credit/ investment portfolios other than investment in government securities / other High-Quality Liquid Investments
- Higher provisioning for NPAs/NPIs

6. Market risk related Actions
   - Restrictions on/reduction in borrowings from the debt market
   - Restrictions on extent of ALM mismatch
   - Restrictions on accepting/ renewing deposits and escrowing of cash inflows to meet deposit liabilities to protect the interest of the depositors
   - Restrictions on investment activities

7. HR related Actions
   - Restriction on staff expansion/staff compensation
   - Review of specialized training needs of existing staff

8. Profitability related Actions
   - Restrictions on capital expenditure, other than for technological upgradation within Board approved limits
   - Restrictions/reduction in variable operating costs

9. Operations related Actions
   - Restrictions on branch expansion plans; domestic or overseas
   - Reduction in business at subsidiaries/ in other entities
   - Restrictions on entering into new lines of business
   - Reduction in leverage
   - Reduction in risky assets
   - Restrictions in undertaking businesses, as may be specified
   - Restriction/reduction of outsourcing activities
   - Restrictions on new borrowings

10. Any other specific action that the RBI may deem fit considering specific circumstances of the NBFC.

Impact: The PCA framework for NBFCs provides RBI vast powers to effectively monitor and control operations of a deteriorating NBFC. The policy changes being effected suggest that RBI is keen to negate the arbitrage between Banking & NBFC regulatory environment for large NBFCs.

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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