



atharv

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

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I. Regulatory updates & its expected impact

I.1. Securities & Exchange Board of India

I.1.1. Foreign investment in Alternative Investment Funds (AIFs)

- a. At the time of on-boarding an investor, the manager of AIF to ensure: -
 - i. Foreign Investor of AIF shall be resident of country whose securities market regulator is signatory to IOSCO MoU or signatory to bilateral MoU with SEBI.
AIF may accept commitment from an investor being government or government related investor (not satisfying above condition) if such country is approved by Government of India.
 - ii. Investor(s) contributing more than 25% of corpus of investor or investor having control, is not mentioned in UNSC sanction list and not a resident of a country identified by FATF as a jurisdiction having strategic AML/Combating the financing of Terrorism deficiencies to which counter measures apply or a jurisdiction which has not made sufficient progress in addressing the deficiencies to an action plan developed with FATF to address the deficiencies.
- b. An investor who is already onboarded and does not satisfy the above conditions, the manager of AIF shall not further drawdown any capital commitments until the investor again meets the said conditions.

I.1.2. Performance Benchmarking and Reporting of Performance by Portfolio Managers

- a. Portfolio Managers have Investment approaches for their respective schemes, which will have to be linked to “Strategies” viz. Equity, Debt, Hybrid and Multi Asset.
- b. Each Investment Approach can only be tagged to a particular strategy.
- c. Each strategy will have 3 benchmarks out of which the portfolio manager will have to select a benchmark.
- d. Once the strategy and benchmark are linked, same can only be changed after giving investors an option to exit without any exit load.
- e. APMI will prescribe valuation norms similar to corresponding norms applicable to mutual funds. And APMI will empanel certain valuation agencies for deriving fair valuation of securities.
- f. Portfolio Managers to provide Time Weighted Rate of Return along with trailing return of benchmark.
- g. Portfolio Manager shall present XIRR for each Investment Approach the investor invests in along with minimum, maximum and median XIRR return generated across all investors in each Investment Approach where the respective investor has invested.
- h. Portfolio managers shall submit monthly reports to APMI along with SEBI.

Impact:

Performance Benchmarking will ensure comparability of scheme performance with streamlined benchmarks and ensure fair investment decisions.

1.1.3. Introduction of Investor Risk Reduction Access (IRRA) platform in case of disruption of trading services provided by the Trading Member (TM)

- a. A platform to provide Investor Risk Reduction Access service to provide the investors an opportunity to square off/close the open positions and/or cancel pending orders in case of disruption of trading services provided by the Trading Member.
- b. TMs, upon facing technical glitches which lead to disruption of trading services, can request for enablement of the IRRA service

Impact:

IRRA will ensure safety of investment and improve confidence of investor in case of disruption.

1.1.4. SEBI Board Meeting dated 20th December 2022

- a. SEBI has proposed participation of AIF in Corporate Bond Markets by acting as protection buyers and protection sellers through Credit Default Swap.
- b. SEBI has proposed to introduce framework to facilitate Execution Only Platforms for direct plans of Mutual Fund Schemes.
- c. Enhanced risk management framework is proposed for stock brokers.
- d. SEBI has proposed streamlining the on-boarding process to facilitate ease of doing business and reducing the time taken for registration of Foreign Portfolio Investors.
- e. In addition to Green Bonds, SEBI has proposed Blue Bonds and Yellow Bonds as an additional move towards sustainable finance.
- f. Corporate Governance norms which are applicable to listed entities are proposed to be made applicable to REITs and InvITs with some carve outs.



1.2. Reserve Bank of India

1.2.1. Draft Master Directions on Information Technology Governance, Risk, Controls and Assurance Practices

The Regulator has published draft Master Directions pertaining to Information Technology (IT) Governance and Controls, Business Continuity Management and Information Systems Audit witnessing the extensive leveraging and outsourcing of critical IT services.

The said directions shall be applicable from 6 months from the date of issue of final directions and shall be applicable to the following Regulated Entities (“REs”) namely: Scheduled Commercial Banks, Small Finance Banks, Payments Banks, Credit Information Companies, All India Financial Institutions and NBFC-Top, upper and Middle Layer.

Key highlights of the draft master directions have been highlighted below:

1. It focuses on three aspects of IT impacting the organization the most viz-a-viz Governance and Controls, Business Continuity Management and Information Systems Audit.
2. Formulation of various committees namely IT Strategy Committee, IT Steering Committee, as well as appointment of Head for IT function and assignment of formalized responsibility centres to the committees, board and Head of IT function based on guidance of the RBI shall be put in motion to strengthen the IT governance.
3. IT services and Infrastructure set-up shall be efficiently designed to manage the capacity of operations of the organization and shall have features to implement the Change Management process developed.
4. A streamlined procedure to adopt new/emerging technologies needs to be developed. Projects having significant impact on risk shall undergo appropriate strategic and cost-benefit analysis.
5. To incorporate in the risk management policy, a framework for managing IT risk which shall be subject to annual review by the Risk Management Committee (RMC).
6. Develop & deploy Information Security and Cyber Security policies with formulation of Information Security Committee (ISC) under RMC to overlook Information security and management within the organization. Appointment of a Chief Information Security Officer (CISO) functioning independently for establishing the security of the customer data and shall be assigned powers as guided by the said notification.
7. The IT services/facility outsourced shall be guided by the existing guidelines in the Master Directions for Systemically Important as well as Non-Systemically Important.
8. Infrastructure adopted by the REs shall provide adequate Audit Trails and have Controls for effective and secured Data migration.



9. A robust IT Risk Management Framework to evaluate and manage the risk from IT to the organization can be dealt with needs to be adopted.
10. Adequate Policies for Information Security and Cyber Security shall be adopted by the REs as well as appointment of Chief Information Risk Officer and Cyber Security Response Team shall be appointed/formulated.
11. Adequate Controls including Access controls, physical and environmental controls, controls on tele networking, etc. shall be incorporated into the Information System.
12. Vulnerability Assessment/Penetration Testing need to be conducted from time-to-time as guided by the RBI.
13. A detailed Business Continuity and Disaster Recovery Mechanism bearing the minimum criterion stated by the RBI shall be formulated, implemented, tested and revised from time-to-time.
14. Information System Audit by eligible person in the manner and within the timelines prescribed by the RBI shall be conducted for evaluating the existence and efficiency of the appropriate Information System/Information Technology within the company.

Impact:

A stronger emphasis on the IT governance, Risk management and Assurance of the Infrastructure was the need of the hour due to growing digital lending markets and market players. Except for the Base Layer NBFC's all the banks and NBFC's shall be required to revisit their IT Framework and consolidate it into a cohesive structure functioning uniformly across the organization.

1.2.2. Furnishing information to the Credit Information Companies

All the Entities required to submit the Credit information shall also provide information for cases admitted with NCLT/ NCLAT under the Insolvency and Bankruptcy Code, 2016. The Credit Institutions shall roll out the reporting forms till 28 February 2023.

1.2.3. Central Payment Fraud Information Registry-Migration to Daksh

Central Payments Fraud Information Registry (CPFIR) is operational from March 2020 for the Scheduled Commercial Banks; however, the regulator has now decided to shift the reporting module and the existing information to its new RegTech platform Daksh in order to streamline the fraud reporting, enhance efficiency and automate the payments fraud management process. The platform adopted shall provide functions such as maker-checker facility, online screen-based reporting, option for requesting additional information, facility to issue alerts / advisories, generation of dashboards and reports, etc.



To lineate with the platform, a new reporting guideline has been prescribed by the regulator; salient features of which are as follows:

1. The Guidelines shall be applicable from 1 January 2023 and the reporting to earlier platform shall be stopped once the new platform is live, however functionality to updated the already existing data will be available
2. Applicable to all RBI authorised Payment System Operators (PSOs) / providers and payment system participants
3. Reporting requirement can be met through Bulk upload Facility available on Daksh or report individual fraud reporting through screen-based facility under the Incident Module on the new platform.
4. The responsibility to submit the details of fraud transactions shall be on the issuer bank / PPI issuer / credit card issuing NBFCs used as a vehicle for fraud.
5. Before reporting to the regulator, entities shall validate the fraud information reported by customer in their own systems to ensure the authenticity and completeness of the transaction information.
6. The transactions shall be reported within the timeline prescribed (currently 7 calendar days)
7. The transaction shall be reported in the prescribed reporting format (akin to previous format) within the timelines as may be prescribed.

Impact:

The Reg Tech initiative of the RBI shall reap benefits not only to the RBI by consolidating the data and information of entities regulated by it but shall also create convenience for the companies obligated to report. Since the quantum of digital payments has increased in the past 5 years such efforts of the RBI shall also enhance the customer confidence.

1.2.4. Individual Housing Loans extended by UCB's

Pursuant to the RBI notification dated 01 December 2022, the Urban Co-operative banks (UCB's) have been categorized in Four Tiers from earlier Two-Tier categorization. The classification is as below

- Tier 1- All unit UCBs and salary earners' UCBs (irrespective of deposit size), and all other UCBs having deposits up to ₹100 crore
- Tier 2- UCBs with deposits more than ₹100 crore and up to ₹1000 crore
- Tier 3- UCBs with deposits more than ₹1000 crore and up to ₹10,000 crore
- Tier 4- UCBs with deposits more than ₹10,000 crore

Hence, the maximum limit to grant housing loan, per borrower, for the new categorization is INR 60 lakhs for Tier I UCB's and 140 lakhs for Tier II, Tier III and Tier IV UCB's.



1.3. International Financial Services Centre Authority

1.3.1. Prescription for format for Monthly Development Report (MDR) and Monthly Activity Report (MAR)

To ensure uniformity in the submission of MDR and MAR by the Stock Exchanges in IFSC, the regulator has prescribed standardized reporting formats. Further, a timeline to furnish the requirement within 10 days from the end of every month is highlighted in the notification.

A special MDR for Bullion Exchange in IFSC has been separately prescribed by the regulator through circular.

1.3.2. Distribution of Capital Market Products and Services

Addressing the crucial role played by the entities engaged in distribution of Capital Market Products and Services, the authority provides a structured framework for the engagement in the said activity. A separate registration shall be obtained for engagement in the activity:

1. By submission of an application, post-complying the minimum requirements (including minimum net-worth, appointment of Eligible Principal Officer and adoption of code of conduct) and payment of fees.
2. Simplified Registration process is available for Banking Units, Finance Company or Finance Units, Broker-Dealers, Investment Bankers, Investment Advisers, Corporate Agents and other entities as specified already registered with the IFSCA.

The minimum net-worth to be maintained at all times for the conduct of the activity is at least USD 50,000.

A registered Distributer may be eligible to undertake the following activities:

- Distribution of capital market products and/or services to any client in IFSC or Foreign Jurisdiction
- Distribution of capital market products and/or services to sophisticated investors in IFSC or Foreign Jurisdictions. (“sophisticated investor” shall be such person as defined in the regulations)
- Distribution of capital market products and/or services to any client in India
- Distribution of capital market products and/or services to sophisticated investors in India
- Any other activities as may be specified by the Authority

The Registered Distributor (including associated distributor as defined in the guidelines) as well as the issuers of instruments and service provider need to adhere to the obligations and responsibilities.

Special provisions for distribution for distribution through digital mode shall be adhered:



- a) an arrangement with issuers, service providers or associated distributors for sale through any digital mode.
- b) Registered distributors, issuers and service providers, shall ensure that the obligations and responsibilities as attributed to them in the Circular, Regulations and other applicable laws shall be duly adhered in the course of distribution through digital mode.

1.3.3. FAQs on Fund Management in IFSCA

The regulator realizing the increasing complexity in the Fund Management Activity published a simplistic explanation of processes / issues / terms / concepts related to IFSCA (Fund Management) Regulations, 2022.

The FAQs are available on the IFSC portal at the <https://ifsc.gov.in/FAQs>.

2. Discussion Papers

2.1. Key Regulatory Changes – SEBI (Investment Adviser) Regulations, 2013

Introductory Background

SEBI (Investment Advisers) Regulations, 2013 is the foundation framework for Investment Advisers providing advisory services to clients. They were introduced to regulate activities provided by investment advisers. As per regulation 2(m) “investment adviser” means any person, who for consideration, is engaged in the business of providing investment advice to clients or other persons or group of persons and includes any person who holds out himself as an investment adviser, by whatever name called.

To address the need for the same, SEBI came out with consultation papers to seek public comments on the proposals that were required to make to strengthen regulations for Investors and work for Investment Advisers to make a fair playing ground for them.

The first consultation paper was issued on 28th September 2016, which suggested proposals for segregation of Investment Advisory and Distribution services; relooking exemptions from registration given to Mutual Fund Distributors and other persons; seeking clarifications on matters like Investment products and advertising in electronic & broadcasting media; restrictions on providing tips and free trials; etc.

This was followed by a second set of proposals which was released on 22nd June 2017 which included regulating the activity of ranking of Mutual Funds schemes; relaxation in registration requirements; incidental advice by a recognized intermediary, etc.

The third round of consultation paper released on 2nd Jan 2018, included clear segregation between two activities i.e., investment Advisory services and Distribution services; Individual IA/banks/NBFC/BC/LLP or other firms not to provide distribution services; existing IA offering distribution services through intermediaries need to choose between providing investment advisory or distribution service; mutual fund distributors shall keep investors benefit in mind and shall disclose a list of mutual funds affiliated.

The consultation paper issued on 15th Jan 2020, paved the way for amendment in the SEBI (Investment Adviser) Regulations 2013. Some of the key amendments are summarized as under:



1. Client Level Segregation of Advisory and Distribution Services

Earlier, Individuals and partnership firms registered as IA were not allowed to provide distribution and/or execution services. Corporate entities registered were allowed to provide both services on condition that they have separate departments or divisions and there is client-level segregation for the same and maintain an arms-length relationship between both activities. An investment adviser was receiving fees on both services provided i.e., advisory and distribution services which gave rise to a conflict of interest. IAs may not give advice that was in the best interest of clients.

SEBI has addressed this concern through the following amendments by amending Regulation 22;

- i. An individual investment adviser shall not provide distribution services.
- ii. The family of an individual investment adviser shall not provide distribution services to the client advised by the individual investment adviser and no individual investment adviser shall provide advice to a client who is receiving distribution services from other family members.
- iii. The same client cannot be offered both advisory and distribution services within the group of the non-individual entity
- iv. A client can either be an advisory client where no distributor consideration is received at the group level or distribution services client where no advisory fee is collected from the client at the group level.

2. Implementation of Advice (Execution)

In 2020 consultation papers, they came up with a proposal regarding “IMPLEMENTATION OF ADVICE (EXECUTION)”. Back then Individual IAs were not allowed to provide execution services, only corporate entities used to provide execution services keeping client-level segregation as required. IAs used to help clients in the implementation of advice given to the client by charging some consideration as implementation (execution) fees.

New Regulation 22A was introduced to give effect to the following -

- a.) Investment adviser may provide implementation services to the advisory clients in the securities market: Provided that investment advisers shall ensure that no consideration including any commission or referral fees, whether embedded or indirect or otherwise, by whatever name called is received; directly or indirectly, at investment adviser’s group or family level for the said service, as the case may be.
- b.) Investment adviser shall provide implementation services to its advisory clients only through direct schemes/products in the securities market.
- c.) Investment adviser or group or family of an investment adviser shall not charge any implementation fees from the client.
- d.) The client shall not be under any obligation to avail of implementation services offered by the investment adviser.

3. Agreement between the Client and Investment Adviser

Before the amendments, there was no mandatory requirement to enter into an agreement between the Investment Adviser and the Clients, resulting which clients may be unaware of the terms and conditions and the process followed by advisers, and their rights in case of default by an adviser. To overcome this limitation, Regulation 19 was introduced wherein IAs are required to provide a document to the client mentioning all the terms and conditions and other required details.

4. Changes in Fee Structure

One of the major changes required was in the “Fees Structure”, earlier the regulation stated that an investment adviser is required to ensure that fees charged to the clients are fair and reasonable. Due to this SEBI received a lot of complaints stating that exorbitant and unreasonable fees were charged by IAs.



To standardize and streamline the fee structure regulations introduced two options for charging fees to clients, i.e. IAs can either charge on AUA Model or can charge fixed fees. AUA as per regulation 2(ac) shall mean the aggregate net asset value of securities and investment products for which the investment adviser has rendered investment advice irrespective of whether the implementation services are provided by an investment adviser or concluded by the client directly or through other service providers.

- a. Fees shall be charged a maximum of 2.5% of AUA p.a. per family across all schemes and products.
- b. On the other hand, IA can charge a maximum of Rs. 1,25,000 p.a. per family across all schemes and products. There is an option is given to IAs, changes can be made only after 12 months of onboarding/the last change of mode.

5. Qualification Criteria and Net Worth Requirement

SEBI introduced two new terms “person associated with investment advice” and “principal officer” to make things better managed and give the required professionalism, an individual investment adviser or a principal officer of a non-individual investment adviser is required to have a professional qualification or post-graduation degree along with five years of relevant experience. Earlier it was not compulsory. The persons associated with Investment Advice are required to have professional as above along with two years of relevant experience. Net worth criteria for Individual IAs have increased to Rs. 5 lakhs and for Non-Individuals IAs to Rs. 50 lakhs. Existing IAs are required to comply with these norms within three years from the applicability date.

6. Other Amendments

In these amendments, there are also a few changes that can be seen-

- a. The requirement for maintenance of records is five years
- b. Renewal of NISM Certificate can be simply done by attending their CPE hours. Now, this has been removed, the person is required to qualify for exams to renew his certificate.
- c. Compliance concerning Audit reports is also applicable, IAs are required to conduct a yearly audit.

Way Forward

The amendments in regulations also paved way for the formation of BSE Administration and Supervision Limited (BASL), a wholly owned subsidiary of BSE approved by SEBI for the administration and supervision of IA Regulations. All registered investment advisers are required to register with BASL and new registrations are also routed through BASL. This is undoubtedly a welcoming step by SEBI in the Investment Advisory space. We have seen how the regulations have transformed over the years, moving towards a strong and holistic regulatory framework to govern the Investment Advisory Industry which is required to safeguard the interests of Investors at large and protect Investment Advisers as well.

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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 Processes	In-Depth Knowledge	Invaluable Experience	Deep-Rooted 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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