BASILSTONE
CONSULTING PRIVATE LIMITED

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Basilstone Consulting is pleased to present to you the **February 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

1.1. Securities & Exchange Board of India

1.1.1. Guidelines on Accounting with respect to Ind AS

- The AMCs shall prepare the Financial Statements and Accounts of the Mutual Fund Schemes in accordance with IND AS with effect from April 01, 2023.
- AMCs shall be required to prepare the opening balance sheet as on date of transition and the comparatives as per the requirements of IND AS.
- Perspective historical per unit statistics requires disclosure of scheme wise per unit statistics for the past 3 years.
- Mutual fund schemes may not be mandatorily required to restate the previous years published perspective historical per unit statistics as per requirement of IND AS for the first two years from first time adoption of IND AS.
- Align with Ind AS requirements regarding transactions cost of investment to be expensed out.

1.1.2. Audit Committee of Asset Management Companies

Currently the requirement of Audit Committee is at the level of trustees of Mutual Funds. However, it was recommended that the AMC of the Mutual Fund should constitute an Audit Committee. The Audit Committee of the AMC shall be responsible for oversight of financial reporting process, audit process, company's system of internal controls, compliance to laws and regulations and other related process, with specific reference to operation of its Mutual Fund business.

Impact:
The requirement of Audit Committee was only compulsory at trustee level, however, with the new requirement for making it mandatory to have audit committee for all AMCs, shall now bring parity with the listed AMCs, as they were mandatorily required to have an Audit Committee.

1.1.3. Informal Guidance – Sicomoro Advisors Pvt Ltd

Investment Adviser can only provide implementation services in direct schemes /products in the securities market. Further, in terms of the proviso to Regulation 22A (1) of the IA Regulations, an IA 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 advisers' group or family level for the said service, as the case may be.

Impact:
Investment adviser recommending investment products which do not have direct schemes shall not be allowed to provide implementation services for the same.

1.1.4. Informal Guidance – HDFC Securities Ltd (HSL)

In the absence of any personal financial liability, the prohibition prescribed under Rule 8(3)(f) of the SCRR, 1957 shall not be applicable to a member of the exchange, to act as broker/distributor, to tie up with third party RIAs to offer advice to its distribution clients. However, while providing aforesaid services to the clients, HSL would have to maintain high standards of service and maintain segregation of business to avoid any conflict of interest.

1.2. Reserve Bank of India

1.2.1. Reserve Bank of India (Credit Derivatives) Directions, 2022

RBI has issued the Reserve Bank of India (Credit Derivatives) Directions, 2022 applicable to credit derivatives transactions undertaken in Overthe-Counter (OTC) markets and on recognised stock exchanges in India. The Directions are to be made effective from 09th May 2022.

The Directions permit NBFCs, HFCs and Standalone Primary Dealers to act as Market Makers, provided their net owned funds are INR 500 Crore and above, with specific approval from Department of Regulation, RBI.

Existing contracts entered into, that spill over the applicability date of above Directions, would however, continue to be guided by the existing directions applicable till their expiry.

Impact: In line with the draft regulations, RBI has provided additional impetus to development of Debt / Bond markets in India by streamlining and making efficient the Credit Default Swaps' regulations.

Apart from the normal limited utilisation of CDS, this would provide treasury houses with alternate investment class to participate in.

1.2.2. Review of Rupee Interest Rate Derivatives (Reserve Bank) Directions

RBI has permitted Banks in India having Authorised Dealer Category-I (AD Cat-I) license under FEMA, 1999, to be eligible to offer Foreign Currency Settled OIS (FCS-OIS) based on the Overnight Mumbai Interbank Outright Rate (MIBOR) benchmark published by Financial Benchmarks India Pvt. Ltd. (FBIL) to persons not resident in India as well as to other AD Cat-I banks. Banks can now undertake these transactions through their branches in India, through their International Financial Services Centre (IFSC) Banking Units (IBUs) or through their foreign branches (in case of foreign banks operating in India, through any branch of the parent bank). Banks are also permitted to undertake FCSOIS transactions beyond onshore market hours.

1.2.3. Clarifications on IRACP

RBI has issued certain additional clarifications pertaining to Income Recognition, Asset Classification and Provisioning, in line with the 12th November 2021 notification, as under:

a. The definition of 'out of order' shall be applicable to all loan products being offered as an overdraft facility, including those not meant for business purposes and/or which entail interest repayments as the only credits.
b. The 'previous 90 days period' for determination of 'out of order' status of a CC/OD account shall be inclusive of the day for which the day-end process is being run.
c. In case of borrowers having more than one credit facility from a lending institution, loan accounts shall be upgraded from NPA to standard asset category only upon repayment of entire arrears of interest and principal pertaining to all the credit facilities.

NBFCs have time till 30th September 2022 to put in place the necessary systems to implement the clarification that loan accounts classified as NPAs may be upgraded as 'standard' asset only if entire arrears of interest and principal are paid by the borrower.

Impact: The clarifications act as a logical step towards identifying shadow exposures and to bring them within the IRACP regulatory model.

1.2.4. Implementation of Core Financial Services Solution by NBFCs

RBI has prescribed implementation of Core Financial Services Solutions, akin to Core Banking Solutions, which shall provide for seamless customer interface in digital offerings and transactions relating to products and services with anywhere / anytime facility, enable integration of NBFCs' functions, provide centralised database and accounting records, and be able to generate suitable MIS, both for internal purposes and regulatory reporting.

NBFC – Middle Layer (ML) and Upper Layers (UL) with 10 or more 'Fixed point service delivery units' are to implement the Core Financial Services Solution on or before 30th September 2025. However, NBFC-UL shall ensure that the CFSS is implemented at least in 70% of 'Fixed point service delivery units' on or before 30th September 2024.

A quarterly progress report on implementation of the Core Financial Services Solution, along with various milestones as approved by the Board / Committee of the Board, shall be furnished by the NBFC to the Senior Supervisory Manager (SSM) Office of Reserve Bank starting from quarter ending 31st March 2023

Impact: Mid-size NBFCs that are currently not equipped with Core Financial Services Solution would quickly transition to the CFSS environment with the above regulatory requirement, which in turn would improve service delivery and efficiency across the industry.

1.2.5. Enhancement of the Cap under e-RUPI

RBI has enhanced the Cap on amount for e-RUPI vouchers issued by Governments to ₹1,00,000/- per voucher and allow use of the e-RUPI voucher multiple times (until the amount of the voucher is completely redeemed), in order to facilitate digital delivery of various government schemes to the beneficiaries.

1.2.6. Increase in NACH Mandate Limit for TReDS Settlements

RBI has proposed to increase the NACH mandate limit to INR 3 Crore for TReDS settlements, in line with the requests raised by the industry.

1.2.7. IT Outsourcing and Information Technology Governance, Risk, Controls & Assurance Practices

RBI has stated that aspects such as risk management framework for IT outsourcing, managing concentration risk, periodic risk assessment and outsourcing to foreign service providers require suitable regulatory guidelines. So, it has proposed to issue guidelines addressing the above captioned aspects - two draft directions will be issued for comments of stakeholders and members of the public: (i) Reserve Bank of India (IT Outsourcing) Directions, 2022; and (ii) Reserve Bank of India (Information Technology Governance, Risk, Controls and Assurance Practices) Directions, 2022**.**

1.3. International Financial Services Authority

1.3.1. IFSCA (Insurance Web Aggregator) Regulations, 2022

IFSCA has notified regulations aimed to put in place a process of registration and operations of Insurance Web Aggregator (IWA) in an International Financial Services Centre under the regulatory purview of the International Financial Services Centres Authority.

The minimum Paid-Up share capital / contribution as well as minimum Net Worth amount is prescribed as USD 30,000, with certain relaxations to certain types of IWAs. The Certificate of Registration would be valid for three years, and require periodic renewal.

Impact: The regulations lay the foundation stone of complete transfer of regulatory powers of IRDAI to IFSCA for the IFSC jurisdictions.

2. Discussion Papers

2.1. Introduction to FinTech and its recent innovations

2.1.1. What is Financial Technology (FinTech)?

In recent times, we all have been bedazzled by the term "Fintech". But what exactly do we mean when we say Fintech and how it has impacted our daily life in a cardinal way is a thought to be pondered.

The term "FinTech" is a contraction of the words "finance" and "technology". It refers to the technological start-ups that are emerging to challenge traditional banking and financial players and covers an array of services, from crowd funding platforms and mobile payment solutions to online portfolio management tools and international money transfers.

FinTech has played a pivotal role in enabling consumers to take charge of their financial lives, leading to much greater financial literacy than ever before. It's tearing down the old silos and helping to advance the consumers' financial situation and outcomes by leveraging advanced technology.

The FinTech industry encompasses technology-enabled firms offering financial services, as well as entities providing technology services directly to financial institutions. Fintech companies employ technology to support financial transactions among businesses and consumers. Technological advances, changing demand for financial products and competition in financial services are all driving a new wave of fintech start-ups and investments that have drawn attention to the industry in recent years.

Reserve Bank of India categorizes FinTech as "technologically enabled innovation in financial services that could result in new business models, applications, processes or products with an associated material effect on financial markets and institutions and the provision of financial services"

2.1.2. Categorization of Major FinTech Innovations

Payments, Clearing & Settlement	Deposits, Lending, Capital Raising	Market Provisioning	Investment Management	Data Analytics & Risk Management
Mobile and web-based payments, Digital currencies, Distributed ledger	Crowd-funding, Peer to peer lending, Digital currencies, Distributed Ledger	Smart contracts, Cloud computing, e-Aggregators	Robo advice, Smart contracts, e-Trading	Big data, Artificial Intelligence & Robotics

2.1.3. FinTech in Financial Services

Financial sector is undergoing a revolutionary transformation. Digital technologies are reshaping payments, lending, insurance and wealth management – a process that the COVID-19 pandemic has accelerated. While this is making financial services in India more diverse, competitive, efficient, and inclusive, it also increases concentration in markets.

FinTech has led to instrumental Innovations in financial sector such as mobile money, peer-to-peer (P2P) or marketplace lending, prepaid instruments, UPI and other payment mechanism, insurance technology, crypto-assets, etc. which have rapidly gained prominence around the world. These new age technologies provide greater access to and convenience of financial services for retail users, while creating opportunities for the corporates to exploit the untapped potential in the sectors and the regulators actively managing the supervisory regulations.:

2.1.4. Broking and PMS services

Digitization of broking industry has brought technology-based benefits to investors, providing increasingly easy-to-use, secure and hassle-free trading platforms. The digital transformation of the Indian broking industry has accelerated in 2020 - during lockdown, more people turned to trading on online brokerage platforms. To cater to this unprecedented trading volume and deliver enhanced trading experiences, brokers are adopting innovative technologies such as cloud-based systems and IT-enabled applications that form the broking industry's backbone for the years to come.

SEBI regulatorily enabled Internet Based Trading (IBT) for the broking houses a long time ago, and it has, over time, strengthened the compliances in the form of system audits, safety features (including 2-factor authentication, encryption of trades, Disaster Recovery Systems, etc.), IP-tracking, responsibility of exchanges for securing the services provided to client (SEBI circular dated 30th June 2011). However, at present no guidelines are specified for tackling and regulating AI enabled services.

A different case in point are AI powered chatbots, which enables personalized services to investors, like stock research, quick and personalized portfolio creation, and addressing the customers' queries. AI enabled Trading and investing may well be the new normal of future.

2.1.5. Insurance Companies

The rise of fintech and advanced technologies in other sectors are disrupting the insurance industry. The developments in technology have led to possibilities of new methods of service provision as well as greater opportunities for data collection that can lead to better risk identification and mitigation measures, which are being referred to as "InsurTech". Compared to FinTech, it is more related to service improvements for individuals.

InsurTech companies (digital insurance services) redefine customer experience through innovations such as risk-free underwriting, on-the-spot purchasing, activation, and claims processing. Also, Artificial intelligence (AI), predictive modeling, internet of things (IoT), connected devices open API insurance models have been opted for, and have led to a growing customer base.

The success of Insurance Web Aggregators as a concept, also potrays the exponential possibilities that may arise in the underserved Insurance Market.

The Regulator has stated the guidelines on issuance of e-policy which shall be adhered, however, a stringent guidelines on operations of the e-insurers is required to ensure safety and reliance to the end-users.

Further, these companies can act as a brokers to the major and traditional insurance houses, which shall give them a space in the digital markets.

The development of e-Insurance Accounts and combining them within the Consolidated Account Statement issued by a leading depository, is not only a move towards a more efficient insurance management system for end-consumers, but also a data goldmine for relevant data users.

2.1.6. Lending Services

In India, digital lending ecosystem is still evolving and presents a patchy picture. While banks have been increasingly adopting innovative approaches in digital processes, NBFCs have been at the forefront of partnered digital lending.

Currently Digital Lending has found its element in two forms, viz. balance sheet lending (BSL) and market place lending (MPL), aka platform lending. The difference between BSL and MPL lies in the source of the funds and assuming credit exposure:

- BSL represent the traditional lending where the credit risk assumed by the lender and financed by Capital and Debt raised by it. (Including partnered digital lending)
- MPLs or Market Place Aggregators (MPAs) essentially perform the role of matching the needs of a lender and borrower without the intention to carry the loans' risk in its books. (P2P-lending mechanism)

RBI has put forth the digital lending guidelines whereby banks/NBFCs lending through their own portal or a third-party portal needs to adhere to certain minimum requirements including KYC norms, Fair Practice Norms, Outsourcing Norms and specific guidance over the maintenance of Digital Platforms for Digital Lending. Further, P2P-NBFCs are regulated by RBI's Master Direction dated 4th October 2017 regarding roles and responsibilities of such portal and the adherence to Fair Practice Norms, KYC Norms and other specific guidance on operation of portal, agreements, and services that the portal can offer to its members. Also, Ombudsman scheme for resolution of complaints has been developed for relief of customers.

The growth in Digital Lending responses from the public and the supporting infrastructure has culminated to Banks/NBFCs adopting new modes of Digital Lending such as:

Buy Now Pay Later (BNPL): The mechanism involves financial entities specifically NBFCs to engage in a credit arrangement with the sellers of low value consumer goods to allow the customers to purchase by extending a short-term facility which shall be repaid in short period or converted into formalized lending arrangement with EMI repayments.

Neo-Banks: The concept has gained popularity in the recent times, since it involves providing the banking services, other than service requiring in-person assistance, through digital medium of operation. Generally, they are restricted in the services they can provide. The Neo-Bank platforms are viewed by banks as an opportunity to expand their networks to untapped areas of the country. Hence, many neo-banks operate in collusion with the banks.

RBI is yet to come up with specific regulations to guide the operations of the above mechanisms.

2.1.7. Payments and Transaction Services

Pre-Paid Instruments (PPI)-PPIs are instruments that facilitate purchase of goods and services, conduct of financial services, enable remittance facilities, etc., against the value stored. This includes any digital wallet or card (other than Debit and Credit Cards). The Instruments shall be reloadable or one time use based on its usage.

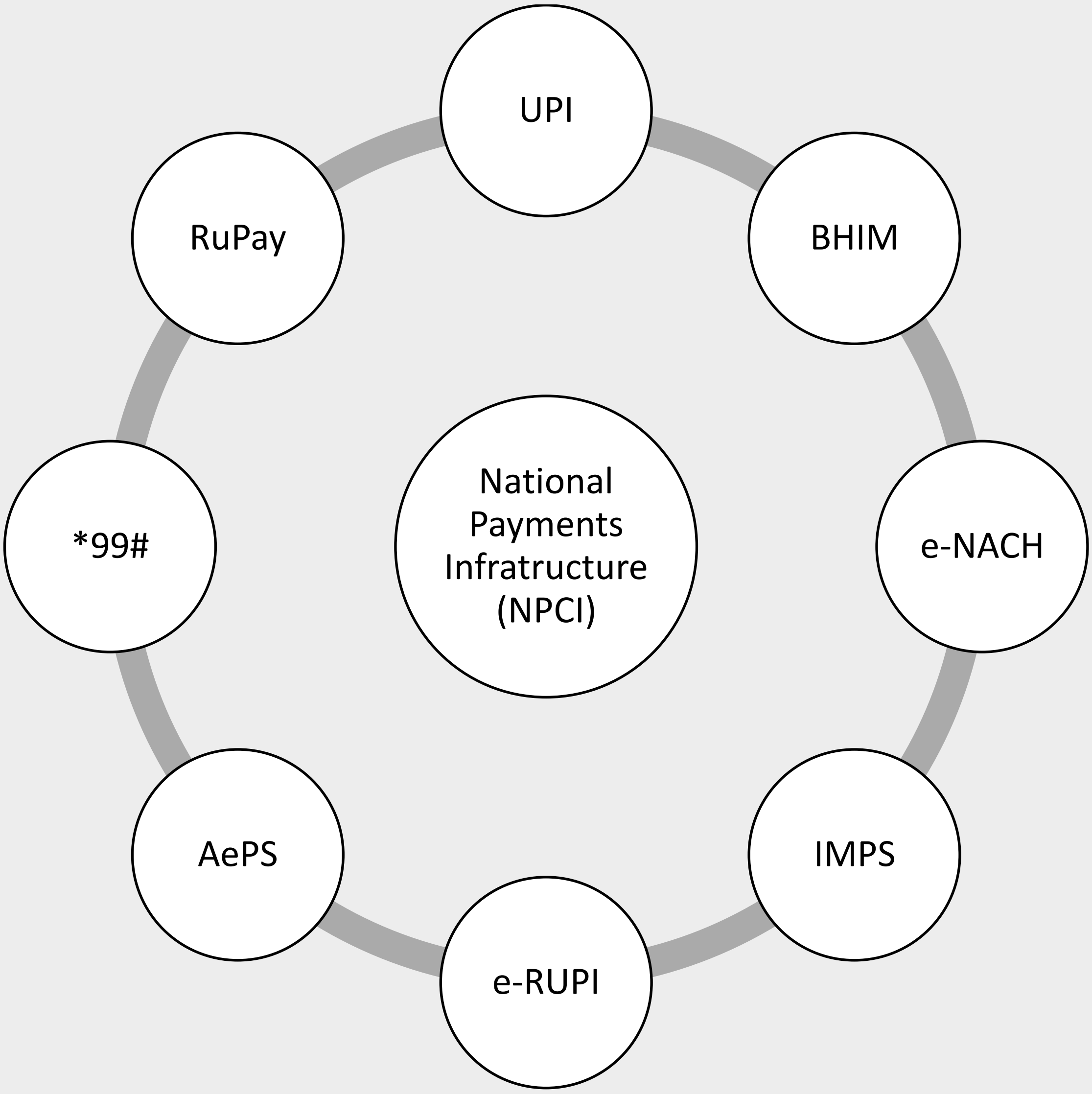
In last 2 years, the usage of PPI has shown herculean spike. RBI realizing the potential of PPI and ease for the customers has recently revised its PPI guidelines on 12th November 2021. The PPI instruments shall now be classified as Full KYC and Small PPI (or minimum detail PPI) and made specific guidelines for operations, restrictions of use, monetary limits, etc.

Payment Systems- FinTech has greatly contributed to the streamlining, uplifting and reach of the digital Payment system. It has gained a huge momentum in the recent years due to vide acceptance as can be observed around us in daily life.

Banks have access to Central Payment System, therefore to enable active participation in the sector RBI has enabled other eligible participants as given by guidelines dated 28th July 2021. The RBI has a special DPSS department which looks after the regulation and developments in the Payment ecosystem and who shall issue the Certificate to Operate in this environment.

Out of all the accepted mechanisms the rise of UPI has been particularly revolutionary and noteworthy. UPI is a system that powers multiple bank accounts into a single mobile application (of any participating bank), merging several banking features, seamless fund routing & merchant payments into one hood. It also caters to the “Peer to Peer” collect request which can be scheduled and paid as per requirement and convenience.

The national payment processing infrastructure is also rapidly developing, with innovative products already rolled out, such as:



2.1.8. Factoring and Bond Market

Fintech has outgrown its reach to almost all the sectors when we consider that:

- The Factors can now access and trade in Trade Receivables available on the TReDS portal subject to the conditions as laid down in factoring act.
- The introduction of portal for secondary bond market by RBI for retail investors in G-Sec and Bond markets (including Sovereign Gold Bonds)

2.1.9. Way forward

As more business activity is digitised, new sources of information are becoming available. Combining these data sources with the availability of increased computing power is delivering faster, cheaper, and more comprehensive analysis for better informed decision-making. This BigData, which when coupled with Distributed ledger technology, would bring a paradigm shift in the way financial services and products are being designed, delivered to, and consumed by users in India.

Adoption of new innovative financial technology, by leveraging partnerships with other FinTech ecosystem stakeholders, shall become a norm in the coming years.

The FinTech industry's regulatory environment, coupled with the Government's push to globalize the start-ups via International Financial Services Centre and Multi-Services Special Economic Zones is opening up avenues, not only for the industry to cater to the Domestic Markets, but also to off-shore economies.

The Indian FinTech story has been unique where FinTechs, Financial Institutions, regulators and governments have come together to chart its journey. This can be evidenced by RBI's plan to introduce a new Digital currency for the Indian Economy. The Indian markets have been supportive to the new FinTech Technologies and ideas resulting in the increasing opportunity for business. However, currently the ease of these FinTech technologies shall also pose a potential danger to our security to which the regulatory umbrella becomes an essential factor.

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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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