



# atharv

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Basilstone Consulting is pleased to present to you the **January 2023** 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. Circulars/Clarification on Alternative Investment Fund

AIFs are now allowed to participate in Credit Default Swaps (CDS).

- a. Cat I and Cat II AIF can participate only for the purpose of hedging however Cat III AIF can use for the purpose of hedging or otherwise subject to restriction on leverage.
- b. Cat II and Cat III AIF can sell CDS by earmarking unencumbered Government bonds/Treasury bills, and the same shall not form part of leverage. In case of any shortfall, immediate corrective action to be taken and report the same to custodian.
- c. Concentration norms shall continue to apply on investment through CDS.
- d. Any unhedged position exceeding 25% of investable funds of scheme shall be taken only after intimating to all the unitholders.
- e. AIFs transacting in CDS shall comply with RBI Master Direction – Reserve Bank of India (Credit Derivatives) Directions, 2022

#### **Impact:**

AIFs will have a new instrument to hedge their exposure in the debt market resulting in AIFs taking greater positions in debt market which in turn will boost fixed income markets in India.

#### Consultation Paper on standardised approach of Valuation of Investment Portfolio of Alternative Investment Fund

- a. It is proposed to carry out valuation of investment portfolio as per International Private Equity and Venture Capital Valuation (IPEV) Guidelines and relevant valuation norms as prescribed for mutual funds.
- b. It is proposed to specify conditions to qualify as “independent valuer”.
- c. It is proposed that Cat III shall appoint independent valuer for valuing unlisted securities by Cat III AIF.
- d. It is proposed that Managers of AIF shall ensure to mention timeline of submission of relevant audited financial data to AIF in the Investment Agreement. It is done to ensure timely submission of performance benchmarking data.
- e. It is proposed valuation should be based audited data is reported in performance benchmarking report.
- f. It is proposed that policies and procedures be documented and any deviation from the disclosed policy shall be disclosed to investors and other stakeholders.
- g. In case of significant deviation over a prescribed period, reasons for the same shall be documented.



### 1.1.2. Introduction of Future Contracts on Corporate Bond Indices

- Introduce derivative contracts on indices of corporate debt securities rated AA+ and above with at least 8 issuers.
- The contract value will be minimum of Rs.2 lakhs and having a tenure of maximum 3 years with expiry on weekly, monthly, quarterly, and half-yearly basis.
- Maximum position limits for each member is as follows: -

Nature of Members	Maximum Position Limit
Trading Members/ Mutual Funds /Insurance Companies /Housing Finance Companies/ Pension Funds / Banks and Primary Dealers dealing as clients/ Institutions belonging to Category I and II FPIs (i.e. other than individuals, family offices and companies).	10% of Total Open Interest or Rs.1200 crores whichever is higher
Non-institutions in Category II FPIs (i.e. individuals, family offices and companies), Mutual Fund (Scheme level) and other Clients.	3% of the total open interest or INR 400 crore whichever is higher.

**Impact:**

Futures on bond indices will strengthen the debt markets in India with increased participation from all kinds of members.

### 1.1.3. Mode of settlement for trades executed on the Request for Quote (RFQ) platform

- RTGS is usually used for settlement of trades.
- Now, Existing payment mechanisms can be used to settle trades on RFQ platform.

**Impact:**

As trades of online Bond Platform will be routed through RFQ platform and retail participation is encouraged in debt markets, hence to service transactions with ticket size of lower than Rs. 2 lakhs, other payment mechanisms will ensure smooth functioning.

### 1.1.4. Consultation paper on “Blocking of Funds for Trading in Secondary Market

- The objective behind the consultation paper is to ensure that funds are not blocked or misused at stage of settlement.
- It is proposed to block the funds through UPI mechanism and remain in the account of the client till block is released by Clearing Corporation.



- c. Once the blocking of funds is initiated by client, the same is confirmed by client's bank and clearing corporation's bank.
- d. The confirmation from clearing corporation will be sent to broker who will in turn allow the client to execute the trade for the amount blocked.
- e. Once the trade is executed, clearing corporation will accept the amount which was lying in customer's bank account as blocked funds.

**Impact:**

The proposed process will ensure that funds are changing hands only once which currently is not the case. It will also ensure less defaults whether in delivery of funds and securities or misuse of funds by any party to the process flow.

### 1.1.5. Management and advisory services by AMCs to Foreign Portfolio Investors

- a. Earlier, Asset Management Companies (AMC) were allowed to charge Management and Advisory Fees to specified FPIs operating from IFSC and regulated by IFSCA.
- b. Now, SEBI has allowed Asset Management Companies (AMC) to charge Management and Advisory Fees to FPIs (who were not specified earlier) operating from IFSC and regulated by IFSCA.

However, such FPIs: -

- I. Shall be not be allowed to invest in thematic mutual funds.
- II. Shall not take contra-positions in equity and equity derivatives for a period of 6 months from date of purchase.

### 1.1.6. Consultation Paper on Review of Regulatory Framework for Sponsor of a Mutual Fund

- a. SEBI has proposed an alternative eligibility criteria where sponsor can contribute to the mutual fund business in terms of funding, providing infrastructure, Mobilizing Human Capital, etc.
- b. Private Equity (PE) are proposed to be allowed as sponsor of Mutual Fund as they can invest in technology, provide strategic guidance and attract good talent. Also, it was discussed to allow PE to act as sponsor for REITs and ARCs.
- c. SEBI has also proposed reduction of sponsor's stake in AMC if the AMC can be classified as self-sponsored AMC.  
SEBI has also proposed to have mirror image of shareholding in Trustee and AMC to protect the interest of unitholders. So, if sponsor reduces shareholding in AMC same will have to be translated in Trustee's shareholding.
- d. SEBI has proposed to have a signatory in place of Sponsor to all amendments to relevant documents after disassociation of Sponsor.

**Impact:**

Participation of Private Equity shall allow an innovative perspective to the Mutual Fund Industry and also allow opportunity for participation to a larger segment of players, which at present don't fit in the requirements of sponsor eligibility but have the ability to stimulate growth to the mutual fund industry.





### **I.1.7. Comprehensive Framework on Offer for Sale (OFS) of Shares through Stock Exchange Mechanism**

- a. OFS under this route shall be available for companies with market cap of Rs.1000 crores or more which will be subject to cooling off period based on liquidity of security.
- b. The minimum offer size is Rs. 25 crores.
- c. The floor price shall be disclosed on T-1 day to stock exchange and public. Seller can offer discount to buyer.
- d. A separate window shall be created for order placement for securities under OFS. However, upfront margin will be required in case of all investors other than institutional investors.
- e. Minimum 25% shall be allocated towards Mutual Funds and Insurance Companies. And minimum 10% shall be allocated to retail investors. However, no category of investors other than Mutual Funds and Insurance Companies shall be allocated more than 25%.
- f. Broker shall issue contract notes based on the price determined.





## 1.2. Reserve Bank of India

### 1.2.1. Periodic Updation of KYC details of Customers

- a. The Reserve Bank of India (RBI) issued a Press Release regarding the Periodic updation of KYC. The RBI through the press release has emphasised on using various non-face-to-face channels for the purpose of re-KYC.
- b. The various non-face-to-face channels include registered email-id, registered mobile number, ATMs, digital channels (such as online banking / internet banking, mobile application), letter, etc.
- c. The RBI has also provided an option for fresh KYC through Video Based Customer Identification process (V-CIP) along with the already existing method of visiting the Bank Branch.

#### Impact:

To comply with the Prevention of Money Laundering Act of 2002, the regulator has made these adjustments to make it easier for consumers to update their KYC information by video-based Customer Identification Process (V-CIP). The adjustments also make it easier for the Regulated entities to comply with the KYC Norms by streamlining the verification process.

### 1.2.2. Utkarsh 2.0 – Reserve Bank of India’s Medium-term Strategy Framework

- a. The Reserve Bank of India (RBI) has launched Utkarsh 2.0, the second phase of its medium-term regulatory and supervisory mechanisms strengthening strategy. Utkarsh 2.0 expands on the foundation established by Utkarsh 2022, which was released in July 2019 and covered the years 2019 to 2022. Utkarsh is a three-year roadmap developed by the Reserve Bank of India (RBI) to improve regulation and supervision, among other central bank functions.
- b. Utkarsh 2.0 will guide the RBI from 2023 to 2025 and includes six vision statements aimed at improving the performance of the RBI's statutory and other functions, increasing the RBI's relevance and significance at the national and global levels, and improving internal governance, infrastructure, and human resources.

The Vision in Utkarsh 2.0 that will guide the Reserve Bank of India over the period 2023-25 are:

- I. Excellence in performance of its functions- The objective of the RBI through Utkarsh 2.0 is to achieve excellence in executing its core functions i.e., Regulation, Supervision, Managing Foreign Exchange etc. To ensure successful implementation of this vision the RBI shall undertake various strategies like- Phased introduction of Central Bank Digital Currency, Creating and monitoring resilient ecosystem for financial stability, Rationalising and Simplifying regulations pertaining to banks and non-banks etc.



- II. Strengthened trust of citizens and Institutions in the RBI- The RBI has made continuous effort over the past decades to strengthen the trust of citizens and institutions in it. The RBI ensure the same by improving the transparency of functions, better and effective communication and reach etc. For this purpose the RBI shall undertake- Better information to public through contemporary and accessible RBI Website, Comprehensive external and internal RBI policies, Facilitating improvement in compliance culture among the Regulated Entities etc.
- III. Enhanced relevance and significance in national and global roles- This vision focuses on sharpening and augmenting the Bank's focus on international financial diplomacy and participation in the formulation of global regulatory standards in a proactive manner. The RBI will also engage with other Central Banks for innovation as well as adopting updated and latest Technological trends.
- IV. Transparent, accountable and ethics-driven internal governance- The RBI's vision is also to achieve transparent, accountable and ethics driven internal governance by strengthening its strategy framework and business continuity management, upgrading internal control measures, assessing emerging risks and adopting international best practices of enterprise risk management. The strategies for implementing this mission of the RBI includes- Leveraging of Audit Management and Risk Monitoring System Application for effective risk assurance, Periodic review of aspects of internal governance, enabling uniform understanding of rules and regulations to improve compliance etc.
- V. Best-in-class and environment-friendly digital and physical infrastructure- The RBI looks to integrate architectural excellence and aesthetic appeal with green ratings in the premises of the Bank and to also achieve the integration of information, and ensuring dissemination through a robust Information Technology (IT) system.
- VI. Innovative, dynamic and skilled human resources- The RBI wishes to undertake various strategies to ensure innovative and dynamic workspace. The RBI is focussing on Building a proficient and facilitative employee interface for effective communication, positive workplace experience, and enhanced employee engagement.

**Impact:**

A stronger emphasis on governance will draw in new clients and customers who will encourage more investment in the nation. Additionally, the timing of this announcement coincides with India's assumption of the G20 presidency and promotion of their expertise in the use of artificial intelligence (AI) and machine learning (ML).

The strategy framework will also make the RBI a listening oriented, transparent organisation equipped with best-in-class and environment friendly digital and physical infrastructure



### **I.2.3. Master Direction – Reserve Bank of India (Acquisition and Holding of Shares or Voting Rights in Banking Companies) Directions, 2023**

- a. The Reserve Bank of India (RBI) has issued the 'Directions - Acquisition and Holding of Shares or Voting Rights in Banking Companies' to ensure that the ultimate ownership and control of banking companies are well diversified and that the major shareholders of banking companies are 'fit and proper' on an ongoing basis.
- b. These directions will apply to all banking companies operating in India, including Local Area Banks (LABs), Small Finance Banks (SFBs), and Payments Banks (PBs). The guidelines aim to ensure the safety and soundness of the Indian banking sector by outlining the procedures for acquiring and holding shares or voting rights in banking companies.
- c. The Directions require any person intending to become a 'major shareholder', i.e., acquire shares / voting rights, directly or indirectly, of 5% or more in a bank to procure prior approval of RBI. The RBI, upon receipt of application, would coordinate with the concerned bank, and seek for bank's comments and documentation with respect to the eligibility, i.e., compliance with the 'fit and proper' status, of the applicant.
- d. These Directions have prohibited persons belonging to Financial Action Task Force ("FATF") non-compliant jurisdictions to not acquire major shareholding in an Indian bank. In cases where any existing major shareholder is from such a nation, maintenance of investments has been permitted, provided that any further acquisition would require RBI's prior permission. Having said that, RBI may any time look into the fitness of such shareholders and provide necessary orders on their permissible voting rights in the bank.
- e. In the event where the shareholding drops below 5% and the shareholder seeks to re-raise it to 5%, fresh approval of RBI would be needed. The banking companies must set up a system to gather data on any change in the Significant Beneficial Owner or any acquisition of 10% or more of the major shareholder's paid-up equity share capital by a single person.
- f. Banking companies must also use the information requested in Form A, which has been annexed to the Guidelines, as a guide when collecting the information. The concerned banking company shall conduct the necessary due diligence to determine whether the major shareholder continues to be "fit and proper" based on the information thus received.
- g. The banking company must submit a brief report, the board note, and the resolution to the Department of Regulation at the Reserve Bank of India within 30 days of receiving information about the changes.

### **I.2.4. Guidelines on Acquisition and Holding of Shares or Voting Rights in Banking Companies**

Along with the Master Direction on the Acquisition and Holding of Shares or Voting Rights in a Banking Company, the RBI has issued a set of guidelines.



- I. The guidelines emphasise that if a person is permitted to hold 10% or more of the banking company's paid-up equity share capital but less than 40%, the shares acquired will be locked in for the first five years from the date of completion of the acquisition.
- II. In case of any person permitted to have a shareholding of 40% or more of the paid-up equity share capital of the banking company, only 40% of that will remain under lock-in for the first five years.
- III. In terms of the voting rights ceiling, the RBI states that a depository can only exercise voting rights on behalf of a depository receipts holder if it can be demonstrated that their holdings on behalf of the DR-holder comply with Section 12B of the Banking Regulation Act.
- IV. RBI stipulated that a person can exercise voting rights on behalf of registered shareholders only in cases where it can be demonstrated that their aggregate voting rights conform with Section 12B of the Act.
- V. RBI states that it may also permit higher shareholding on a case-to-case basis under the circumstances such as relinquishment by existing promoters, supervisory intervention, reconstruction or restructuring of banks, the entrenchment of existing promoters or any other action in the interest of the banking company and its depositors or in the interest of consolidation in the banking sector.
- VI. In specific cases, RBI says, where State, Union government, Union Territory (UT), Public Sector Undertaking (PSU), Public Financial Institution (PFI) or specifically permitted investors are promoters of banking companies or have been specifically permitted by the banking regulator to hold a higher shareholding as promoter or non-promoter in certain special circumstances, it may prescribe a differentiated shareholding dilution plan for such holdings.

### **Impact:**

The Directions and Guidelines emphasise the importance of major shareholders meeting the fit and proper criteria not only during acquisition, but on an ongoing basis.

The RBI has broadened the illustrative criteria for determining the fit and proper status of applicants by including applicants' track record in non-financial matters, expanding the nature of proceedings to those of serious nature, removing the disciplinary or criminal nature specification provided by the Acquisition Directions, and requiring adherence to the Guidelines.

## **1.3. International Financial Services Centre Authority**

### **1.3.1. IFSCA (Insurance Products and Pricing) Regulations, 2022**



- a. The IFSCA (Insurance Products and Pricing) Regulations, 2022 have been notified by the authority. The goal of these regulations is to provide a framework for the IFSC Insurance Offices (IIOs) to use in designing and pricing insurance products.
- b. In accordance with the applicable regulatory framework, IIOs now must have a board-approved policy known as the 'Product Oversight and Governance Policy'. The policy shall focus on (a) methods and processes for designing of the insurance product, (b) approval, monitoring, reviewing and distribution of insurance products; and (c) corrective steps to be taken for insurance products that are detrimental to the interest of prospects or policy holders.
- c. The regulations also state that an IIO shall design and market insurance products while taking into account the prospects' understanding of the product and ensuring that products are compatible with the prospects' needs, characteristics, and objectives, including justification of rates, terms, and conditions, which shall be duly certified by a qualified actuary.
- d. Furthermore, IIO shall not market any insurance product without first obtaining a Unique Identification Number and shall develop its own methodology / algorithm for the issuance of UINs and submit it to the Authority. If an IIO wishes to withdraw an Insurance product the same shall be intimated to the Authority at least 3 months prior to such date of withdrawal.
- e. The regulations have been introduced to provide adequate capacity to identify and mitigate product-related risks and issues from the time of design of the product and throughout the life cycle of the product, including providing appropriate distribution strategies taking into account the target market characteristics and to protect the interests of policyholders while designing and pricing of insurance product.

### **1.3.2. Disclosures by Fund Management Entities for Environmental, Social or Governance (ESG) Schemes**

With the intention to promote consistency, comparability and reliability in disclosures concerning ESG schemes and ensure ESG schemes in IFSC are true to their label, The International Financial Services Centres Authority (IFSCA) on January 18, 2023, issued a circular regarding the disclosures by Fund Management Entities for Environmental, Social, or Governance (ESG) Schemes to promote consistency, comparability, and reliability in disclosures concerning ESG schemes in IFSC hereby specified the framework for disclosures by the Fund Management Entities (FMEs) which intend to launch ESG scheme(s).

This Circular shall be applicable to FMEs that intend to launch and manage ESG scheme(s). For this purpose, “ESG schemes” would mean and include such retail schemes, Exchange Traded Funds (ETFs), restricted schemes, and venture capital schemes, which:

- a) have terms, such as ‘Environment’, ‘Social’, ‘ESG’, ‘Green’, ‘Sustainability’, or any combination thereof or similar terms, incorporated in their names, or
- b) represent or market themselves as ESG focused schemes

The salient features of the circular are stated below:



### Initial Disclosures:

1. **Name of the Scheme:** An ESG scheme should have a name that accurately describes its ESG focus and is consistent with its ESG-related investment goals and investment approach.
2. **Investment Objective of the Scheme:** FME should clearly disclose the nature and extent of the scheme's ESG-related investment objectives, which will also include details of the primary components of sustainability addressed by the scheme.
3. **Investment Strategy:** A thorough explanation of the kind of investment strategy—including ESG-related investment strategy—that the FME intends to pursue, which may include integration, impact investing, engagement, and other strategies.
4. **Investment Processes:** FME shall also disclose the methodology for processes that are deemed relevant for ESG investments.
5. **Risks and Risk Management Practices:** FME managing an ESG scheme shall disclose all the specific risks that arise on account of the scheme's goal of ESG-related investment objectives, related investment strategies and processes in addition to all the other material risks that may be faced by the scheme.
6. **Benchmark:** Wherever feasible, the FME may designate a reference benchmark for the ESG scheme to measure the attainment of its ESG focus and/or financial performance vis-à-vis the benchmark.

### Periodic Disclosures for ESG Schemes:

Every ESG scheme launched by an FME must disclose to the Authority and investors information about the compliance with the stated ESG-related investment objectives of the scheme, ESG-related performance, the actual percentage of the investable corpus / assets under management invested as per the stated ESG-related investment objectives, Key findings/Major observations of Internal audits, or both, on a half-yearly basis for a retail scheme and on an annual basis for other types of schemes.

The IFSCA has further laid down standards and practices (including guidance) for FMEs launching and managing ESG schemes. The framework prescribed by IFSCA by way of this circular is principle-based and largely aligned with international best practices.

### 1.3.3. International Financial Services Centres Authority (Investment by International Financial Service Centre Insurance Office) Regulations, 2022

The International Financial Services Centres Authority on 21st November 2022, notified the International Financial Services Centres Authority (Investment by International Financial Service



Centre Insurance Office) Draft Regulations, 2022 which inter-alia provides for manners and processes of investment of IIO s by the IIOs, in various global jurisdiction including in India.

An IIO may invest its Assets –

(i) in the IFSC; (ii) in India, through extant regulatory framework on Foreign Portfolio Investment, as specified by the RBI and SEBI; (iii) in the country where its Parent Entity is incorporated or domiciled or (iv) in a country or jurisdiction which is not identified in the public statement of FATF as a high-risk jurisdiction.

The entire investment process of an IIO shall be overseen by an Investment Management Committee composed of persons with financial and actuarial backgrounds who have been duly authorised by the IIO's Board of Directors, as well as persons with relevant knowledge, experience, and understanding of the inherent risks in the insurance or reinsurance business.

### **1.3.4. International Financial Services Centres Authority (Maintenance of Insurance Records and submission of Requisite Information for Investigation and Inspection) Regulations, 2022**

The International Financial Services Centres Authority (IFSCA) has notified the International Financial Services Centres Authority (Maintenance of Insurance Records and submission of Requisite Information for Investigation and Inspection) Regulations, 2022. These regulations are applicable to all International Financial Services Centres Insurance Offices (IIOs) and International Financial Service Centre Insurance Intermediary Offices (IIIOs).

The objective of these regulations is to specify the minimum information that is required to be maintained by an IIO and IIIO, for the purposes of investigation and inspection, under section 33 of the Insurance Act, 1938.

The following are some of its key highlights-

1. Every IIO shall have a Board approved policy for maintaining records.
2. Every IIO and IIIO shall submit to the Authority, as and when required, all records, information, data, documents, books, and registers maintained under the Insurance Act, 1938.
3. Every IIO shall maintain a record of its employees excluding staff or salaried field workers involved in solicitation, comprising of the name; employee identification number; date of appointment; present designation etc.
4. The information, data, and documents maintained by the IIO and IIIO shall be reconciled with the audited financials, wherever relevant, and as per the requirements specified under other applicable laws and regulations.

## **1.4. Ministry of Corporate Affairs**

### **1.4.1. Companies (Appointment and Qualifications of Directors) (Amendment) Rules, 2023**





The MCA has notified Companies (Appointment and Qualifications of Directors) (Amendment) Rules, 2023 to amend the provisions of Companies (Appointment and Qualifications of Directors) Rules, 2014.

Until now, the directors were required to inform the concerned companies about their disqualification under section 164(2) of the Companies Act, 2013 only. However, after this amendment, a declaration regarding disqualification under section 164(1) of the act shall also be required in form DIR-8.

After the amendment, the application for removal or disqualification of directors made in form DIR-10 is required to be filed before the Regional Director.

The following amendments have been made in the forms:

1. DIR-3 (Application for allotment of Director Identification Number):
  - a. Facility to obtain details of the applicant from 'Digilocker' has been enabled in the form.
2. DIR-9 (Report by the company to Registrar for disqualification of Directors):
  - a. Companies are now required to file form DIR-9 within 30 days of receipt of form DIR-8 from its directors. The form has been amended to include reasons of disqualification.
3. DIR-10 (Application for removal or Disqualification of Directors):
  - a. The form has been amended to include provisions of the Companies Act, 2013 under which the director has been disqualified and details of violations/ offences compounded by NCLT/ Court.

#### **1.4.2. Companies (Appointment and Remuneration of Managerial Personnel) Amendment Rules, 2023**

The MCA issued the Companies (Appointment and Remuneration of Managerial Personnel) Amendment Rules, 2023 to further amend the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014.

The following Forms have been substituted namely:-

1. Form No. MR 1 - Return of Appointment of Managerial Personnel-
  - a. The form has been amended to receive additional information such as residential status of the appointee and Central Government's approval
  - b. The amendment has done away with attaching documents like resolutions/approvals and consent from the appointee.
2. Form No. MR 2 - Form of Application to the Central Government for approval of appointment of managing director or whole-time director or manager-
  - a. The form has been amended to receive additional information such as type of company (public/private etc), listing details, IBC application details and has

dispensed with providing details of financial parameters and managerial remuneration.

#### **1.4.3. Companies (Share Capital and Debentures) Amendment Rules, 2023**

The Companies (Share Capital and Debentures) Amendment Rules, 2023 have been published by the Ministry of Corporate Affairs (MCA) to amend the Companies (Share Capital and Debenture) Rules, 2014.

1. SH-7 (Notice to Registrar of any alteration of share capital): The form has been amended to include the following information:
  - a. Members voting at the general meeting
  - b. Appeal to the Tribunal against the Central Government's order
  - c. Tribunal Order- Date of passing of order and receipt of same.
  
2. SH-8 (Letter of offer): The form has been amended has follows:
  - a. Requirement to submit information like objective of buyback and expected capital structure before and after buyback have been done away with.
  - b. Details regarding- Default in repayment of deposits, interest on deposits, debentures, preference shares, term loans to financial institutions or bank, interest of term loans and payment of dividend to shareholders have been included/added.
  
3. SH-9 (Declaration of solvency): In form the SH-9 the following has been amended
  - a. The requirement to attach board resolution and special resolution has been done away with.
  
4. SH-11 (Return in respect of buy-back of securities):
  - a. The form has been amended to include the details such as source of buyback and Promoter wise shareholding details.
  - b. The requirement to submit the balance sheet and Certificate of compliance of buy-back rules has been done away with. Details pertaining to the stock exchanges where the company is listed and the merchant banker appointed by the Company are no longer required to be submitted.
  
5. The Form No. SH-15 has been omitted in the said amendment.

#### **1.4.4. Companies (Prospectus and Allotment of Securities) Amendment Rules, 2023.**

The MCA has notified the Companies (Prospectus and Allotment of Securities) Amendment Rules, 2023. The amendment omits Rule 12(6) of the Companies (Prospectus and Allotment of Securities) Amendment Rules, 2014, and substituted Form PAS-2, Form PAS-3 and Form PAS-6.



Rule 12(6) of the Companies (Prospectus and Allotment of Securities) Amendment Rules, 2014 stated that when bonus shares are issued, a copy of the resolution authorising the issue of such shares, which was passed in the general meeting, should be attached along with Form PAS-3. This implies that when a company, that has made an allotment of securities, files the return of allotment with the registrar under Form PAS-3, it is not obligated to include a copy of the resolution passed in the general meeting authorising the issue of such shares.

The forms have been amended as follows:

1. PAS-3 (Return of Allotment)-
  - a. Key information on the valuation report- (a) Name of the valuer, Method of valuation, Valuation amount and others, (b) Details of securities allotted in case of conversion and (c) Class, number and total amount of securities allotted and conversion terms. The above details have been added in the said return.
  - b. The requirement to attach Board or Shareholders Resolution has been done away with.
2. PAS-6 (Reconciliation of Share Capital Audit Report (Half-yearly)) –
  - a. Details regarding Type of security, Class of shares and ISIN have been added.



## 2. Discussion Papers

### 1. RBI Discussion Paper on Expected Loss (EL)-based Approach for loan loss provisioning by banks

The RBI has issued a discussion paper on expected credit loss (ECL)-based loan loss provisioning by banks. Non-banking financial companies (NBFCs) have already moved to the expected loss model and now the RBI has floated a discussion paper on the same for banks. The proposed method is to develop principle-based guidelines that are complemented by regulatory backstops where needed.

In principle, the expected credit-loss approach requires a credit institution to estimate expected credit losses based on forward-looking estimations rather than wait for credit losses to be incurred before making corresponding loss provisions.

All loans and advances, including irrevocable loan commitments (including sanctioned limits under revolving credit facilities), lease receivables, irrevocable financial guarantee contracts, and investments classified as held-to-maturity or available-for-sale, would be subject to the requirement for estimating impairment losses under the expected credit loss approach. The expected credit loss will be calculated as a probability-weighted estimate of credit losses (present value of all cash shortfalls) over the financial instrument's expected life.

Banks currently follow the incurred loss approach for provisioning on their loan assets, whereby provisions on loan assets are made after the stress has materialized. The framework will require banks to categorize financial assets (primarily loans, including irrevocable loan commitments, and investments classified as held-to-maturity or available-for-sale) into one of three categories - Stage 1, Stage 2, and Stage 3 - based on the assessed credit losses on them, both at the time of initial recognition and on each subsequent reporting date, and to make necessary provisions.

The regulator has proposed that each bank be allowed to devise and execute its own methodology for assessing loss provisions for expected credit losses. The expected credit loss models proposed by banks must be independently validated to ensure that they follow the RBI's guidance, are based on sound reasoning, and make use of relevant data that is available to the bank, and that proper back-testing and internal validation of the models have been performed to remove any bias, among other things.

### 2. RBI Discussion Paper on Securitisation of Stressed Assets Framework (SSAF)

The RBI has issued the Discussion Paper on Securitisation of Stressed Assets Framework (SSAF). The RBI had previously issued the revised framework for Securitisation of Standard Assets vide its Master Direction dated September 24, 2021 (SSA).

The discussion paper states that the main difference between the securitisation of stressed assets and the standard assets is relating to the lower degree of certainty of cash flows from the underlying pool in case of Stressed Assets.



The paper interprets the concept of securitisation and states that involves pooling of loans and selling them to a Special Purpose Entity (SPE), which then issues securities backed by the loan pool. Securitisation of Stressed Assets (SSAs) is a financial structure whereby an originator of Non-Performing Assets (NPAs) sells these to a Special Purpose Entity (SPE) that funds such an acquisition by issuing securitisation notes. The SPE, in turn, appoints a servicing entity to manage the stressed assets, typically with a fee structure that incentivises them to maximise recoveries on the underlying loans. Investors are paid based on the recovery from underlying assets, as per the waterfall mechanism depending upon the seniority of the tranches.

Currently there is no corresponding mechanism for securitisation of Non-Performing Assets (NPAs) through the Special Purpose Entity route. The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI) does provide for securitisation of NPAs but such securitisations have to be undertaken by Asset Reconstruction Companies (ARCs) licensed under the Act, in terms of the specifically laid down statutory/regulatory norms.

The Discussion paper broadly covers nine relevant areas of the framework including asset universe, asset eligibility, minimum risk retention, the regulatory framework for special purpose entity and resolution manager, access to finance for resolution manager, capital treatment, due diligence, credit enhancement, and valuation. The discussion paper further states that because Resolution Manager (RM) and Special Purpose Vehicle (SPV) are directly in charge of resolving and recovering the underlying stressed pools, it is preferable for them to fall under Reserve Bank's regulatory purview.

The RBI is focusing on what types of assets, such as term loans within the same asset universe, large-ticket loans above a certain threshold, or smaller-ticket loans, like commercial and residential mortgages, loans to MSMEs, and unsecured retail assets, should be eligible for securitization.

### **3. Assessing the Impact of RBI's Corporate Governance Guidelines on NBFCs**

Corporate governance has become a crucial aspect for any organization to ensure transparency, accountability, and ethical practices. The same applies to Non-Banking Financial Companies (NBFCs) as well, which have witnessed exponential growth in recent years. In India, the Reserve Bank of India (RBI) has been at the forefront of regulating and supervising the NBFC sector. The RBI has issued various guidelines and circulars, including specifying the committees required for corporate governance in NBFCs.

The Non-Banking Financial Companies - Corporate Governance (Reserve Bank) Directions, were issued by the RBI in July 2015. These provided detailed guidelines for corporate governance practices in NBFCs. The directions applied to every non-deposit accepting Non-Banking Financial Company with asset size of Rs.500 crore and above (NBFCs-ND-SI), as per and all deposit accepting Non-Banking Financial Companies (NBFCs-D). The circular prescribes the duties and responsibilities of directors, including oversight of risk management, compliance with regulations, and internal controls.



The circular stipulated that NBFCs shall create and establish a clear organizational structure, including clearly defined roles and responsibilities for key management personnel. The circular also mandated the establishment of a comprehensive system of risk management, including identification, measurement, and management of various types of risks, such as credit, market, liquidity, and operational risks. It also emphasized the importance of internal controls, such as internal audit, accounting policies, and procedures.

It also recognized the unique risks faced by NBFCs like liquidity risk and asset-liability management risk. The circular mandated the establishment of a liquidity risk management framework to manage liquidity risk effectively.

The Master Circular was a significant step towards strengthening the corporate governance practices of NBFCs in India. The circular's provisions, such as the establishment of a comprehensive system of risk management, were critical to ensure sound functioning of NBFCs.

The Master Direction - NBFC-SI-Non-Deposit taking and Deposit taking Directions, 2016 prescribed various committees that have to be formed by an NBFC:

- I. **Audit Committee:** The Audit Committee is one of the most important committees specified by the RBI for NBFCs. The primary responsibility of this committee is to oversee the financial reporting process, ensure the integrity of financial statements, and assess the effectiveness of internal controls.  
Another duty of the Audit Committee is to ensure that an information system audit of the internal systems and processes is conducted at least once in two years to assess operational risks that may be faced by NBFCs.
- II. **Nomination and Remuneration Committee:** The Nomination and Remuneration Committee is responsible for identifying and selecting candidates for appointment as directors and key managerial personnel. The committee also determines the remuneration packages for directors and senior management personnel. The Chairman of this committee must be an independent director, and at least one member of the committee must have expertise in the field of human resources.
- III. **Risk Management Committee:** The Risk Management Committee is responsible for overseeing the risk management framework of the NBFC. The committee is responsible for identifying, measuring, monitoring, and managing the risks faced by the NBFC. The Chairman of this committee must be an independent director with expertise in risk management.

The RBI also specified that a Chief Risk Officer (CRO) shall be appointed by Non-Deposit taking systemically important NBFCs (ND-SI-NBFCs) and deposit-taking NBFCs (NBFC-Ds) with asset size of Rs. 5,000 crore and above.

The CRO shall be responsible for the following:

- I. Identifying, assessing and monitoring various risks faced by the NBFC, including credit, market, liquidity, operational, legal and regulatory risks.



2. Developing risk management policies and procedures for the NBFC, and ensuring that they are followed.
3. Developing and maintaining a comprehensive risk management framework, including policies, procedures and systems for identifying, measuring, monitoring and controlling risks.
4. Ensuring compliance with regulatory requirements related to risk management.

The RBI recently notified the Scale Based regulation for NBFC's considering the rapid growth of NBFCs in India thereby dividing NBFCs in 4 layers: NBFC- Base layer, Middle Layer, Upper layer and Top layer. The additional changes in the corporate governance framework such as the constitution of risk management committees, disclosure requirements, loans to directors, their relatives and senior officers have been brought in by the RBI.

The RBI has brought out the following major changes with regards to corporate governance:

1. Grant of loans to employees and their relatives- All NBFCs shall have a Board approved policy for granting loans to directors, senior officers, and relatives of directors as well as in the entities where such directors or their relatives have major shareholding.
2. Disclosure requirements- The RBI shall notify minimum disclosures to be made by all NBFCs in their financial statements, including related party transactions, loans to directors and senior officers, types of exposure, customer complaints, etc.
3. Disclosure requirements- RBI shall notify minimum disclosures to be made by all NBFCs in their financial statements, including on matters like related party transactions, loans to directors and senior officers, types of exposure, customer complaints, etc. NBFCs in the Middle and Upper layers will be subjected to additional disclosure requirements from 31<sup>st</sup> March 2023, under which such NBFCs shall disclose in their Annual Financial Statements certain prescribed information including report on Corporate Governance, details of breaches under financing documents, views of the management on audit qualifications, etc.
4. Restrictions on KMPs- In the Middle and Upper Layer NBFCs Key managerial personnel shall not hold any office in any other NBFCs in such layers other than taking up directorship positions in subsidiaries of the NBFCs they are employed with.
5. Chief compliance officer- NBFCs in the Middle and Upper layers must mandatorily appoint a Chief Compliance Officer who would be in charge of an independent compliance function. Such NBFCs must adopt a Board approved policy on the roles and responsibilities of such chief compliance officer
6. Whistle-blower Mechanism- NBFCs in the Middle and Upper layers must adopt a whistle-blower mechanism for whistle blowers to report genuine concerns and mishandling within the NBFC.
7. Mandatory listing requirement- NBFCs in the Upper Layer must be mandatorily listed within three years from its identification as an NBFC-UL. Such NBFCs must also be





subject to additional disclosure requirements (akin to those applicable to a listed company) prior to the actual listing of its securities on the stock exchange.

The impact of RBI's Corporate Governance regulations on NBFCs in India is significant. The regulations aim to improve the overall governance and risk management practices of NBFCs, which can lead to better business outcomes, increased investor confidence, and improved reputation.

**Firstly**, the implementation of these regulations will require NBFCs to strengthen their internal controls, risk management systems, and compliance functions. This will result in a more robust risk management framework, which can help mitigate the risks associated with lending and investment activities. By having a stronger control environment, NBFCs can avoid any legal or regulatory issues that may arise due to non-compliance or inadequate risk management.

**Secondly**, the regulations mandate the establishment of various committees, such as the Audit Committee, Risk Management Committee, and Nomination and Remuneration Committee. The composition of these committees includes independent directors, which can provide an unbiased and objective viewpoint to the decision-making process of NBFCs. This will help improve the transparency and accountability of NBFCs, which is a critical aspect of good corporate governance.

**Thirdly**, the regulations mandate the appointment of a Chief Compliance Officer. The Chief Compliance Officer (CCO) would be the nodal point of contact between an NBFC and the regulators and supervisors and would be playing a key role in the structured and other discussions held with RBI. The CCO is also responsible for first identifying, coordinating and thereafter effective management of the compliance risk.

The corporate governance framework will help NBFCs in the long run by identifying, measuring, monitoring, and controlling risks associated with their operations, which will lead to better risk management and decision-making in the organization. These regulations aim at establishing a robust framework for corporate governance of NBFCs and to ensure their sound functioning.

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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:

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<b>Strong</b> Processes	<b>In-Depth</b> Knowledge	<b>Invaluable</b> Experience	<b>Deep-Rooted</b> 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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