BASILSTONE
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www.basilstone.com | connect@basilstone.com

Basilstone Consulting is pleased to present to you the **July 2021** issue of atharv, covering regulatory insights as well as discussion papers. This issue covers the following areas:

1. Regulatory updates & its expected impact

1.1. Securities & Exchange Board of India

1.1.1. Introduction of Expected Loss (EL) based rating scale and standardization of Rating scales used by Credit Rating Agencies (CRA)

The circular dated 16 July 2021 has been issued subsequent to discussions with various stakeholders introducing Expected Loss (EL) based rating scale that may be used by CRA's for ratings of projects/instruments associated with infrastructure sector to begin with. Further, CRA's are advised to standardise the usage of rating scales prescribed under the guidelines of respective financial regulator. The CRAs shall ensure compliance with the requirements of this circular, latest by March 31, 2022 and also place the compliance status of this circular before their Board of Directors. Further, the CRAs are advised to confirm compliance of this circular to SEBI latest by April 15, 2022.

1.1.2. Amendment to SEBI(AIF) Regulations, 2012

a. AIFs may invest in units of other AIFs without labelling themselves as Funds of AIF

b. Existing AIFs may also invest simultaneously in securities of investee companies and in units of other AIFs, subject to appropriate disclosures in the Private Placement Memorandum (PPM)

1.1.3. Informal Guidance on SEBI (Investment) Advisers Regulations, 2013 – IFAST Financial India Pvt Ltd

a. IA can undertake any activity of providing investment advice for a consideration and the same cannot be construed to include any referral fees.
b. An IA who is also a stockbroker cannot charge brokerage on equities traded through him as IA's are disallowed to charge any implementation fees for equity traded through him.
c. Persons including NRI/POI are not required to seek registration under the IA Regulations, if they provide investment advisory exclusively to clients based out of India (excluding NRI/PIO).
d. Foreign Citizen would include a PIO but not an NRI. Moreover, a foreign citizen and a NRI would be required to apply for an individual RIA registration and comply with provisions of IA regulations if he wishes to provide Investment advisory services to any persons based in India as per requirements of Regulation.
e. Any NRI/PIO intending to offer investment advisory services to clients in India, registration under Regulation 3 of IA regulations is mandatory. In such a case where NRI/PIO desires to join any non-individual IA as PAA, all clients onboarded by such Persons Associated with Investment Advice (PAA) shall be considered as clients of the non-individual IA and not of such NRI/PIO. Also non-individual IA shall ensure that advice provided to clients in compliance with IA regulations.
f. Foreign graduate degree will not satisfy the specified criteria for education qualification since it does not fulfil the eligibility criteria under IA regulations.

g. Existing Individual IA's above fifty years of age are not required to comply with qualification and experience requirements subject to such IA's holding NISM accredited certifications and complying with other conditions as specified in IA regulations at all times. However, the aforesaid exemption is not available to PAA associated with non-individual IAs.
h. An education qualification in law or course from ICWAI is eligible for qualification for IA's.

1.1.4. Informal Guidance – Waterfield Financial & Investment Advisers Private Limited

IA is required to render investment advice to its clients and not manage funds or securities on behalf of the client. Further grant of POA by client to an IA has neither been envisaged nor appears desirable for an IA.

1.2. Reserve Bank of India

1.2.1. Declaration of Dividend by NBFCs

a. Applicable to NBFCs as defined in Para 2(2) of the Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016 and Non-Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016.

b. These guidelines will be effective for declaration of dividend from profits of the financial year ending 31 March 2022 and onwards

c. The Board shall ensure that total dividends proposed for the financial year does not exceed ceilings specified in the guidelines and shall take into account the following aspects for considering the proposals of dividend:
   - Supervisory findings of Reserve Bank on divergence in classification and provisioning of NPAs
   - Qualifications in Auditor's Report to the financial statements
   - Long term growth plans of the NBFC

d. NBFC shall comply with minimum prudential requirements to be eligible to declare dividend
e. NBFCs eligible to declare dividend may pay dividend subject to ceiling on dividend payout ratios
f. Report shall be furnished by the NBFC declaring dividend in the prescribed format within 15 days of declaration of dividend.

Impact: These guidelines shall ensure transparency and uniformity in practice by all applicable NBFCs.

1.2.2. Roadmap for LIBOR transition

The Financial Conduct Authority, UK has announced on 05th March 2021 that LIBOR will either cease to be provided by administrator or no longer be a representative rate immediately after 31st December 2021 in the case of all Pound sterling, Euro, Swiss franc and Japanese yen settings, and the 1-week and 2-month US dollar settings AND Immediately after 30th June 2023, in the case of the remaining US dollar settings.

In order to address this transition's possible disruption, RBI notification has asked banks / financial institutions (including NBFCs and HFCs) to use a widely accepted Alternate Reference Rate, as well as encourage its customers to do so, latest by 31st December 2021, including for all US Dollar settings, even if their LIBOR is published till 30th June 2023. The notification requires banks / financial institutions to incorporate robust fallback clauses (For eg. Those prescribed by International Swaps and Derivatives Association, Indian Banks' Association, Loan Markets' Association, Asia Pacific Loan Markets Association and Bankers Association for Finance & Trade), preferably well before the respective cessation dates, in all financial contracts that reference LIBOR and the maturity of which is after the announced cessation date of the respective LIBOR settings.

Since MIFOR is referenced to LIBOR, RBI notification also mandates cessation of its use by 31st December 2021.

Impact: The cessation of publishing of LIBOR, also commonly known as Interest Rate Benchmark Reform, shall impact all transactions referenced to LIBOR / MIBOR and operative post 31st December 2021, that do not have robust fallback mechanism in its contractual terms. Another major impact that the industry currently is facing is identification / utilization of Alternative Reference Rate, since the same has not yet been prevalently used. The notification of RBI ensures that banks and financial institutions are better prepared for the transition.

1.2.3. New definition of Micro, Small and Medium Enterprises – Addition of Retail and Wholesale Trade

Ministry of Micro, Small and Medium Enterprises vide Office Memorandum (OM) No. 5/2(2)/2021-E/P & G/Policy dated 02nd July 2021, has decided to include Retail and Wholesale trade as MSMEs for the limited purpose of Priority Sector Lending and they would be allowed to be registered on Udyam Registration Portal for the following NIC Codes and activities mentioned against them:

45	Wholesale and retail trade and repair of motor vehicles and motorcycles
46	Wholesale trade except of motor vehicles and motorcycles
47	Retail trade except of motor vehicles and motorcycles

The existing Entrepreneurs Memorandum (EM) Part II and Udyog Aadhaar Memorandum (UAMs) of the MSMEs obtained till June 30, 2020 shall remain valid till December 31, 2021

Impact: The purpose of RBI notification is in implementing the policy decision of permitting Wholesale and Retail trade within the definition of MSME for Priority Sector Lending.

1.3. International Financial Services Authority

1.3.1. Issuance of Certificate of Deposits by IFSC Banking Units

IFSCA has prescribed guidelines for issuance of Certificate of Deposits by Banking Units located in IFSC. The important requirements are:

- Should be denominated in Freely Convertible Foreign Currency
- Minimum amount to be USD 2500 or equivalent
- May be issued at a discount on face value or on the basis of fixed or floating coupon rate
- Maintenance of Retail Deposit Reserve Ratio (RDRR) on the issue price of the CDs issued to individuals
- CDs in physical form are freely transferable by endorsement and delivery. CDs in demat form can be transferred as per the procedure laid down by the depository.
- Buyback of the CDs are permitted, post 7 days from date of issue

1.3.2. Framework for setting up of International Trade Financing Services Platform ('ITFS')

The framework lays down a new class of intermediary which permits its participants to undertake or participate in International Trade Finance related activities which includes Export Invoice Trade Financing, Reverse Trade Financing, Bill discounting under Letter of Credit, Supply Chain Finance for Exporters, Export Credit (Packing Credit), Insurance / Credit Guarantee, Factoring system and any other trade product. The framework additionally lays down the eligibility requirements for the platform and participants, On-Boarding and KYC & AML requirements, Minimum agreement standards, and illustrative process flows, etc.

Impact: The framework permits entities to setup a trade financing platform, which in turn is akin to TREDs platform issued by RBI, albeit, with operations in foreign currency. It opens a vast avenue for domestic financiers and fintech platforms to provide a solution to provide international finance related services on-shore in freely convertible foreign currency.

1.3.3. Alternative Investment Funds in IFSC

IFSCA has issued amendments to AIF norms prevalent, covering majorly two aspects;
(i) Continuing Interest by Manager / Sponsor in AIF - the continuing interest requirement by the Manager or Sponsor in the AIF provided under para 8 of the Annexure to the operating guidelines for AIFs in IFSC dated November 26, 2018 shall be voluntary;

(ii) Investment in Mutual Fund - AIF in IFSC is permitted to invest in units of schemes launched by mutual fund regulated in FATF compliant jurisdiction (including India).

Impact: The circular is an essential requirement to promote relocation of funds established or incorporated or registered outside India to IFSC, as well as allows Indian investors an opportunity to invest in securities abroad via the IFSC route, subject to FEMA restrictions.

1.3.4. Global / Regional Treasury Centre activities by Finance Company / Units

The IFSCA framework now permits Finance Company / Unit to operate as a Global / Regional Treasury Centre from IFSC, which shall perform such Treasury Activities and / or provide Treasury Services exclusively to its Group Entities. The permitted treasury services and activities have been prescribed in detail.

Impact: The framework opens up a wide variety of activities and services for Indian entities to tap into the global market, including raising funds, intra-group financing, guarantee-related services, investing in prescribed financial instruments, etc.

2. Discussion Papers

2.1. Core Investment Companies – An Introduction

In general parlance, a CIC refers to a kind of holding company in a hierarchical structure of group entities that primarily invests in / lends to the entities of its group. While the general parlance prevalent is true to the phrase 'Core Investment Company', the regulatory requirements for identification of a Company as a CIC is very specific:

Core Investment Company (CIC) is a non-banking financial company carrying on the business of acquisition of shares and securities and which satisfies the following conditions as on the date of the last audited balance sheet:-

(i) it holds not less than 90% of its net assets in the form of investment in equity shares, preference shares, bonds, debentures, debt or loans in group companies;
(ii) its investments in the equity shares (including instruments compulsorily convertible into equity shares within a period not exceeding 10 years from the date of issue) in group companies and units of Infrastructure Investment Trust only as sponsor constitute not less than 60% of its net assets;

Provided that the exposure of such CICs towards InvITs shall be limited to their holdings as sponsors and shall not, at any point in time, exceed the minimum holding of units and tenor prescribed in this regard by SEBI (Infrastructure Investment Trusts) Regulations, 2014, as amended from time to time.

(iii) *It does not trade in its investments in shares, bonds, debentures, debt or loans in group companies except through block sale for the purpose of dilution or disinvestment;*

(iv) *It does not carry on any other financial activity referred to in Section 45I(c) and 45I (f) of the Reserve Bank of India Act, 1934 except:*

   a. *investment in*

      (i) *bank deposits,*

      (ii) *money market instruments, including money market mutual funds that make investments in debt/money market instruments with a maturity of up to 1 year*

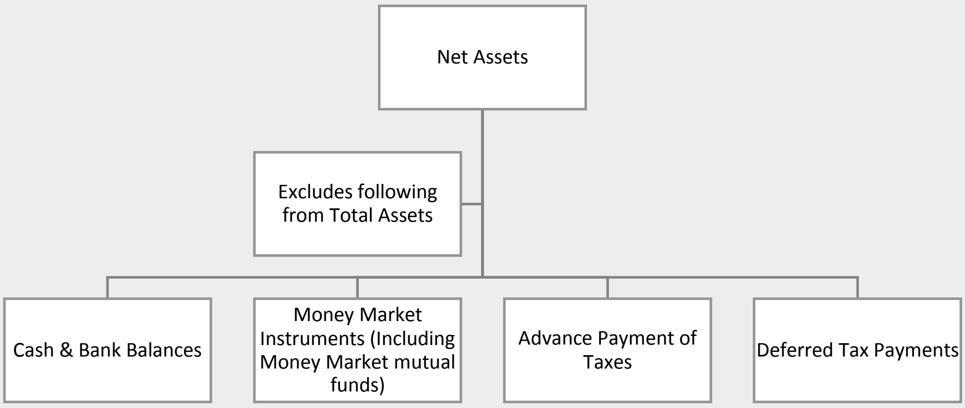
      (iii) *government securities, and*

      (iv) *bonds or debentures issued by group companies,*

   b. *granting of loans to group companies and*

   c. *issuing guarantees on behalf of group companies.*

The definition of Net Assets is essential for the purpose of identification of a CIC. The Core Investment Companies (Reserve Bank) Directions, 2016 states as under:



Therefore, only when substantial portion of assets of a Company is invested in equity component of the group, a company is classified as CIC. A deeper analysis also responds in negative, to the question of whether trading in shares and securities of Group Company is permitted.

How is CIC different from other NBFCs?

A NBFC is primarily involved in investment / lending activities to non-group entities, apart from other specified activities such as Micro-Finance, Account Aggregation, Peer to Peer Lending platform, Housing Finance, etc.

A CIC, however, is primarily involved in investment / lending activities limited to its group. Unlike an NBFC, a CIC is prohibited from lending to others / investing in other entities outside the group.

The permissible leveraging limits are also different, whereby an NBFC's leveraging may be upto approximately 85% of CRAR (approximately 7 times its core capital), that of CIC is limited to outside liabilities being 2.5 times its Adjusted Net Worth. Therefore, NBFCs are permitted to leverage their books higher than CICs on prima facie reading. However, the benefit of 50% of appreciation between market value and book value is permitted under Adjusted Net Worth to CICs, but not NBFCs.

A peculiar case of a comparison exists between a recently introduced Type-I NBFC and CIC, since both primarily deal with Investments.

CIC V/s. Type I NBFC

Type-I NBFCs are a form of non-deposit accepting NBFCs that solely invest in securities from its own funds. Such companies mainly invest in securities of non-group listed / unlisted companies. Investments within the group by such NBFCs would result in deduction from Net Owned Funds amounts that the NBFC is required to maintain. No form of access to funding, except equity and near equity sources are permitted. CICs on the other hand, are permitted to leverage their books, as well as invest and lend, but only to the group companies, and that too within prescribed limits.

Therefore, while one is meant to provide an easier solution for investors investing in capital markets in a corporate form, the other is meant to act as a holding company of a corporate structure.

Registration Requirements and Exemptions

RBI has prescribed registration requirement under section 45-IA of Reserve Bank of India Act, 1934 for NBFCs, which include CICs that have asset size exceeding INR 1 Billion and having access to public funds. A critical reading of the regulation implies that CICs having asset size less than INR 1 Billion, with or without access to public funds, are exempt from the registration requirement.

RBI has also exempted applicability of Section 45-IA(1)(b) pertaining to maintenance of minimum Net Owned Funds [“NOF”] requirements, subject to certain conditions.

Conclusion

CICs provide Corporate Houses permissibility to have a layered holding company structure, which brings with itself the benefits of operational flexibilities, demarcations, execution of controls, taxation planning, etc. CICs not only act as a mechanism for ring-fencing assets, but may also act as a tool in efficient estate planning of promoter houses.

About Basilstone

Basilstone Consulting Private Limited ('Basilstone") has been promoted to partner with the society and its businesses to achieve their true potential and help realize their vision. We work closely with our clients and enrich their growth by offering them solution driven consultancy services in the areas of strategic planning, incubation, impact analysis, idea validation, product validation, feasibility study, synergy evaluations, fund raising, restructuring, transaction advisory, representation – guiding on regulatory / non-regulatory meetings, succession planning, Inbound and outbound investment, due diligence, dealing with regulatory / statutory authorities, etc.

We, at Basilstone aim to position ourselves as the 'Go to Consultants' for **Simple Solutions & Value Creation** recognised by our clients for delivering ultimate desired results.

The Purpose of Basilstone is to provide simple solutions and create value backed by:

Strong	**In-Depth**	**Invaluable**	**Deep-Rooted**
Processes	Knowledge	Experience	Values

We clearly resonate ourselves with the ever-growing Basil, inspiring us to imbibe the quality of being natural and pure while we adapt to changing conditions and innovation. The rock-solid Stone is representative of our endurance, stability, permanence and our determination, paving the path of value creation for our clients and our firm allegiance to our principles.

Basilstone is the quintessential blend of traditional values and modern thoughts which are echoed in the experience, enthusiasm and energy of its people and translated in the services rendered to its clients.

Contact Us

connect@basilstone.com | www.basilstone.com | +91 22 4017 2050
8A-2, Chander Mukhi, Plot No. 316, Rajani Patel Marg, Nariman Point, Mumbai 400 021, MH, India