BASILSTONE
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Basilstone Consulting is pleased to present to you the **September 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. Modalities for implementation of the framework for Accredited Investors

SEBI has approved the framework for Accredited Investors (AI) by amending the Alternative Investment Fund, Investment Advisers and Portfolio Managers Regulations. Accredited Investors may avail flexibility in minimum investment amount or concessions from specific regulatory requirements applicable to investment products, subject to conditions applicable for specific products/ services under the aforesaid Regulations.

Impact: This move expects to open up a new channel of raising funds from sophisticated investors. Individuals, HUFs, Family trusts, Sole proprietorships, partnership firms, trusts and Body Corporate can get accreditation based on financial parameters specified by SEBI. Under the framework, AIs may avail flexibility in minimum investment amount (lower ticket size) or concessions from specific regulatory requirements applicable to investment products.

1.1.2. Extension of Time for seeking memberships of BSE Administration & Supervision Limited

SEBI has granted recognition to BSE Administration & Supervision Limited ('BASL'), a wholly owned Subsidiary of BSE limited for the purpose of Administration and supervision of Investment Advisers for another 3 years till May 30, 2024. SEBI has decided to extend the timeline for seeking membership of BASL by existing Investment Advisers by a period of two months till October 31, 2021.

1.1.3. Alignment of interest of Asset Management Companies ('AMCs') with the unitholders of the Mutual Fund Schemes

SEBI has issued (Mutual Fund Amendment Regulations, 2021) and as per the amended regulations, asset management companies ('AMCs') are required to invest certain amount in such scheme of the mutual fund, based on the risk associated with the scheme, as may be specified by the Board from time to time.

Percentage of AUM to be invested in the scheme of Mutual Fund based on the risk value of the respective scheme

Risk Value	Risk Level as Per Risk-O-Meter	Minimum percentage of AUM to be invested in scheme
≤ 1	Low	0.03
> 1 to ≤ 2	Low to Moderate	0.05
> 2 to ≤ 3	Moderate	0.07
> 3 to ≤ 4	Moderately High	0.09
> 4 to ≤ 5	High	0.11
> 5	Very High	0.13

Impact: The new framework is aimed at aligning the interest of asset management companies with the unitholders of the mutual fund schemes. The regulator amended mutual fund rules, requiring fund houses to invest in their own schemes depending on the risk level to ensure 'Skin in the Game'.

1.1.4. Amendment pursuant to comprehensive review of Investor Grievance Redressal Mechanism

SEBI issued a circular and improving the mechanism for Investor Grievance Redressal by stating guidelines in matters for Place of Arbitration, speeding up grievance redressal mechanism, determination of legitimate claims from IPF for clients of the defaulter member, threshold limit for interim relief paid out of IPF in Stock Exchanges.

1.1.5. SEBI have introduced T+1 rolling settlement on an optional basis

A Stock Exchange may choose to offer T+1 settlement cycle on any of the scrips, after giving an advance notice of at least one month, regarding change in the settlement cycle, to all stakeholders, including the public at large, and also disseminating the same on its website.

Impact: A shortened time will not only reduce settlement time but also make the process faster. Another impact would be release of locked up capital and increased participation in the stock markets. Accelerating the settlement cycle will help reduce operational risk, liquidity needs, counterparty risk which would also reduce margin requirements and collateral requirements for broker-dealers. This step shall help the market be more efficient.

1.1.6. Alignment of interest of Key Employees of Asset Management Companies with the Unitholders of the Mutual Fund Schemes

SEBI has issued clarification on the following aspects:

(i) 'Key Employees' shall be read as 'Designated Employees'. Junior Employees also have to mandatorily invest in a phased manner.

(ii) Investments in units of the scheme shall be made on the day of payment of salary.

(iii) In the case of any closed ended schemes, the investment shall be made to any open-ended scheme having risk equivalent to or higher risk than the closed ended scheme.

1.1.7. SEBI Board Meeting Synopsis

The Board in its meeting held on 28th September has approved the following:

1. A Framework for Gold Exchange and SEBI (Vault Managers) Regulations, 2021.

2. Creation of the Social Stock Exchange.

3. It has amended the existing regulatory framework for delisting of equity shares pursuant to open offer under SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (Takeover Regulations).

4. Relaxed the eligibility requirements related to Superior Voting rights shares.

5. Board has issued amendments to SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, in relation to regulatory provisions on related party transactions.

6. The Board has considered an Investor Charter of SEBI for investors in the securities market. The Investor Charter would include the Vision statement, mission statement, rights and responsibilities, and so on.

7. The Board has released an amendment to SEBI (Alternative Investment Funds) Regulations, 2012 allowing Category III AIFs to calculate concentration norms based on Net Asset Value of the fund instead of investable funds for investment in listed equities of investee companies.

8. There is an amendment to SEBI (Mutual Funds) Regulations, 1996 to enable the introduction of Silver Exchange Traded Funds.

9. The Board has issued an amendment to the SEBI (Portfolio Managers) Regulations, 2020 and the SEBI (Alternative Investment Funds) Regulations, 2012 to facilitate Co-investment by investors of Alternative Investment Funds through portfolio management route. The Portfolio Manager providing Co-investment services to investors of AIFs shall invest 100% of the assets under their management in unlisted securities and shall be exempted from certain requirements under SEBI (Portfolio Managers) Regulations, 2020, including minimum investment amount, minimum net-worth etc.

10. The Board has considered and approved the proposal to amend the SEBI (Foreign Portfolio Investors) Regulations, 2019 for permitting Resident Indians (other than individuals) to become constituents of FPIs that are registered as AIFs in IFSCs.

11. There has been an Amendment to Schedule II of Securities and Exchange Board of India (Intermediaries) Regulations, 2008 which states regarding Criteria for determining 'Fit and Proper Person'

12. The Board has approved and authorised practicing cost accountants under provisions of SEBI (Depositories and Participants) Regulations and Rules to carry out share reconciliation audit of issuer companies.

1.2. Reserve Bank of India

1.2.1. Permitting Card-on-File Tokenisation (CoFT) Services

RBI has extended applicability of device-based tokenisation to Card on File tokenisation as well, and has permitted card issuers to offer card tokenisation services as Token Service Providers. It has also further clarified that with effect from January 1, 2022, no entity in the card transaction / payment chain, other than the card issuers and / or card networks, shall store the actual card data.

Impact: The circular extends the regulatory ambit of device-based tokenisation to Card on File tokenisation. It also shows resolve of the regulator towards privacy and security related risks of storing card details.

1.2.2. Aadhaar e-KYC Authentication Licence for NBFCs etc.

RBI has permitted Non-Banking Finance Companies (NBFCs), Payment System Providers and Payment System Participants to obtain Aadhaar Authentication License - KYC User Agency (KUA) License or sub-KUA License (to perform authentication through a KUA), issued by the UIDAI.

Impact: NBFCs extending loans in the digital space, especially those coupled with Fintech platforms, would now be permitted to undertake e-KYC, paving way for completely virtual customer onboarding / other KYC related processes.

1.2.3. RBI (Market-makers in OTC Derivatives) Directions, 2021

RBI has issued new Directions governing the Market-makers of OTC derivatives (including those traded on electronic trading platforms). Overall restriction has been placed on having underlying as Derivatives (Synthetic Derivatives). The Master Direction lays emphasis on Governance, Products, Due-Diligence, Pricing & Valuation, Trade Conduct, Risk Management etc.

1.2.4. Securitisation of Standard Assets & Transfer of Loan Exposures Directions

RBI has issued revised Directions, in line with the draft directions issued earlier, making securitisation of Standard Assets and Transfer of non-performing loan exposures similar across lending entities regulated by it. The outlook of the regulator as hinted - "Prudentially structured securitisation transactions can be an important facilitator in a well-functioning financial market in that it improves risk distribution and liquidity of lenders in originating fresh loan exposures" - is definitely a bigger welcome.

Impact: Loan transfers are resorted to by lending institutions for various reasons, ranging from rebalancing their exposures, strategic sales, liquidity management, etc. and a robust secondary market in loans will help in creating additional avenues for raising liquidity, as well as a demand-driven price discovery, making the lending market more efficient.

1.2.5. Use of any ARR in place of LIBOR for interest payable in respect of export / import transactions

RBI has eased Regulation 15 under FEMA 23(R)/2015-RB dated January 12, 2016 pertaining to interest payable in respect of export/import transactions, which were previously linked to LIBOR. Now, any widely accepted/Alternative reference rate in the currency concerned for such transactions is permitted.

Impact: It is a regulatory step further towards addressing the possible risks that may arise on cessation of utilization of LIBOR. Transaction would now have to be linked to ARR, resulting in a re-visit to existing material contracts.

1.3. Ministry of Corporate Affairs

1.3.1. Frequently Asked Questions (FAQ's) on Corporate Social Responsibility (CSR)

Ministry has issued amendment to CSR Rules in 22nd January 2021 with an aim to strengthen the CSR ecosystem, by improving disclosures and by simplifying compliances. MCA has further released FAQ's on 25th August, 2021 which relates to the same and by issuing various clarifications and framework.

Coverage: The FAQ's have covered details about Applicability, Framework related to CSR committee, Assistance in pursuant to CSR expenditure, Eligible CSR Activities, Manner of CSR Implementation, Ongoing Projects, Treatment of unspent CSR Amount, CSR Enforcement, Impact Assessment and CSR Reporting & Disclosure Requirements.

1.4. International Financial Services Authority

1.4.1. Bullion Trading Member and Clearing Members in GIFT-IFSC

IFSCA has permitted all members of the stock exchanges and clearing corporations in GIFT-IFSC to be enabled as Bullion Trading/Clearing Members subject to the fulfilment of requisite net worth criteria. Criteria of new applications have also been prescribed.

The circular lays down following minimum Net Worth and Base Minimum Capital requirements:

S. No.	Category	Net Worth	
		Entities incorporated in India (including IFSC)	Foreign Entities
1	Trading member	As specified by the Bullion Exchange	As specified by the Bullion Exchange, subject to a minimum of USD 135,000
2	Clearing Member	As specified by the Bullion Clearing Corporation	As specified by the Bullion Clearing Corporation, subject to minimum of USD 1,350,000
3	Trading and Clearing member	As specified by the Bullion Clearing Corporation	As specified by the Bullion Clearing Corporation, subject to minimum of USD 1,350,000
4	Self-Clearing Member	As specified by the Bullion Clearing Corporation	As specified by the Bullion Clearing Corporation, subject to minimum of USD 675,000

S. No.	Category	Base Minimum Capital	
		Entities incorporated in India (including IFSC)	Foreign Entities
1	Trading member	As specified by the Bullion Exchange	As specified by the Bullion Exchange, subject to a minimum of USD 75,000
2	Clearing Member	As specified by the Bullion Clearing Corporation	As specified by the Bullion Clearing Corporation, subject to minimum of USD 75,000
3	Trading and Clearing member	As specified by the Bullion Clearing Corporation	As specified by the Bullion Clearing Corporation, subject to minimum of USD 75,000
4	Self-Clearing Member	As specified by recognized Bullion Clearing Corporation	As specified by the Bullion Clearing Corporation, subject to minimum of USD 75,000

2. Discussion Paper

2.1. Regulatory Sandbox

Introduction:

'Fintech' is the name given to start-ups who are actively integrating with technology to make financial services more effective and efficient. They have changed whole way of global financial landscape over the past four to five years.

The innovation in this domain has been so dynamic and there is a void in terms of regulations to cover all these start-ups and Modern age Finance companies. Therefore, to be an active enabler in this scenario, a tool of sandbox comes to help for the Regulators.

The word 'Sandbox' originally referred to the small box filled with sand where children play in a controlled environment. The meaning has evolved and in the computer science world, a sandbox is a closed testing environment designed for experimenting safely with web or software projects.

The concept is also being used in the digital economy arena, to refer to regulatory sandboxes (RS): testing grounds for new business models that are not protected by current regulation, or supervised by regulatory institutions. These testing grounds are especially relevant in the fintech world, where there is a growing need to develop regulatory frameworks for emerging business models. The purpose of the sandbox is to adapt compliance with strict financial regulations to the growth and pace of the most innovative companies, in a way that doesn't hold back the fintech sector with rules, but also doesn't diminish consumer protection.

Both Reserve Bank of India (RBI) and Securities and Exchange Board of India (SEBI) have understood the need for it and have taken active steps to provide the framework of Regulatory Sandbox to companies. What steps have been taken by both these regulators is been mentioned separately below:

A. RBI's Regulatory Sandbox

The RBI has set up an inter-regulatory Working Group to look into and report on the granular aspects of Fintech and its implications so as to review the regulatory framework and respond to the dynamics of the rapidly evolving Fintech scenario. They received a proposal for setting up clear principles and role of the proposed 'Regulatory Sandbox'.

RBI plans to run RS for a few cohorts (end-to-end sandbox process), with a limited number of entities in each cohort testing their products during a stipulated period. The RS shall be based on thematic cohorts focussing on financial inclusion, payments and lending, digital KYC, etc. An indicative list of innovative products/services/technology which could be considered for testing under RS is given below:

- Innovative Products/Services
  - Retail payments,
  - Money transfer services,
  - Marketplace lending,

- Digital KYC,
- Financial advisory services,
- Wealth management services,
- Digital identification services,
- Smart contracts,
- Financial inclusion products and
- Cyber security products

- Innovative Technology
  - Mobile technology applications (payments, digital identity, etc.),
  - Data Analytics,
  - Application Program Interface (APIs) services,
  - Applications under block chain technologies and
  - Artificial Intelligence and Machine Learning applications

The Regulatory Sandbox Process and its Stages

End-to-End Sandbox Process: A detailed end-to-end sandbox process, including the testing of the products/innovations by Fintech entities, shall be overseen by the Fintech Unit (FTU) under overall guidance of the Inter Departmental Group (IDG) of RBI with participation of domain experts.

The Sandbox Process: Stages and Timelines each cohort of the RS shall have the following five stages and timeline:

- **Preliminary Screening**: This phase may last for 4 weeks from the closure of application window. The applications shall be received by the FTU and evaluated to shortlist applicants meeting the eligibility criteria. The FTU shall ensure that the applicant clearly understands the objective and principles of the RS and conforms to them.

- **Test Design**: This phase may last for 4 weeks. The FTU shall finalize the test design through an iterative engagement with the applicants and identify outcome metrics for evaluating evidence of benefits and risks.

- **Application Assessment**: This phase may last for 3 weeks. The FTU shall vet the test design and propose regulatory modifications, if any. Enabling Framework for Regulatory Sandbox

- **Testing**: This phase may last for a maximum of 12 weeks. The FTU shall generate empirical evidence to assess the tests by close monitoring

- **Evaluation**: This phase may last for 4 weeks. The final outcome of the testing of products/services/technology as per the expected parameters including viability/ acceptability under the RS shall be confirmed by the RBI. The FTU shall assess the outcome reports on the test and decide on whether the product/service is viable and acceptable under the RS.

RBI currently has 3 cohorts:

- **Retail Payments**: It was launched on November 2019 and it has received application from 32 entities of which 6 has been chosen for 'Test Phase' and post which they have found all the products well within the boundaries of regulations and can be considered for adoption by regulated entities.

- **Cross-Border Payments**: This cohort was launched in December 2020, RBI have started accepting applications for this theme and RBI have explained the rationale behind choosing 'Cross Border Payments' as next theme for RS and

- **MSME Lending**: In December 2020 circular RBI has stated that it has chosen the theme for the Third cohort and it shall accept application for the same from October 1 to 14 November, 2021.

RBI in coming period shall make more themes available for entities, such that it can be a part of this framework. And there are more progressive steps taken in this direction.

B. SEBI's Regulatory Sandbox:

SEBI has issued a framework for Regulatory Sandbox on June 14, 2021. Where there are two stages in Sandbox testing as below:

- **Stage-I:** SEBI will approve the limited set of users as proposed by the applicant for testing in first stage. During the first stage testing, applicant shall use limited and identified set of users with maximum cap on users based on the requirement of the applicant duly approved by SEBI on case-to-case basis. These users will be required to provide positive consent including their understanding of the risks of using the solution.

- **Stage-II**: During the stage-II testing, applicant shall test with larger set of identified users with maximum cap on users based on the requirement of the applicant duly approved by SEBI on case-to-case basis. These users will be required to provide positive consent including their understanding of the risks of using the solution.

The stages basically are divided in Accepting Application and Evaluation of each application on case to case to basis, based on its individual merit. Unlike RBI where the regulator is accepting application on theme-to-theme basis SEBI has been more robust and has created a separate platform where entities can share the product and have SEBI's response.

In entirety 'Regulatory Sandbox' is a great tool at the disposal of the 'Regulators' and 'Fintech'. There exist differing views among the regulator and Entities and now that focus has shifted to collaboration. The regulatory sandbox proposal is definitely an exciting opportunity for India's innovative fintech community, but it not a substitute for compromising on compliance.

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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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