BASILSTONE
CONSULTING PRIVATE LIMITED

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Basilstone Consulting is pleased to present to you the **September 2023** issue of atharv, covering regulatory insights as well as discussion papers. This issue covers the following areas:

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1. Regulatory updates & its expected impact

1.1. Securities & Exchange Board of India

1.1.1 Change in mode of Payment w.r.t. SEBI Investor Protection and Education Fund Bank A/c

a. Pursuant to SEBI Circular No. SEBI/HO/ISD/ISD/CIR/P/2020/135, dated July 23, 2020, it is mandated that all financial contributions must be directed to the SEBI Investor Protection and Education Fund (SEBI IPEF) exclusively through online means or via a demand draft payable to the Board, i.e., SEBI IEPF.

b. SEBI has established a new bank account to facilitate the ease of payment for market participants into the SEBI IPEF. In this regard, a hyperlink has been incorporated on the homepage of the SEBI official website (www.sebi.gov.in) under the section titled "Click here to make payment to SEBI IPEF." This hyperlink enables remitters to complete payments through various methods, including net banking, NEFT/RTGS, debit cards, and UPI.

c. When effecting online remittances through the aforementioned hyperlink, remitters are obligated to provide the essential information, which encompasses the payer's name, PAN, mobile number, email ID, the purpose for which the payment is intended, and the precise amount to be remitted.

Impact:
It outlines the key legal requirements and procedures for directing financial contributions to SEBI IPEF in accordance with the specified circular and SEBI's directives.

1.1.2 Mechanism for Sharing of Information by Credit Rating Agencies (CRAs) to Debenture Trustees (DTs).

a. SEBI (Credit Rating Agencies) Regulations, 1999 and related circulars mandate structured data submissions from CRAs to DTs due to high data volume and tight disclosure timelines.

b. An Excel template has been provided for daily rating revision submissions to DTs, as agreed upon with CRAs and DTs. CRAs must send these submissions to DTs on the same day as the rating revisions, using specified email addresses/URLs for regulatory purposes.

c. Effective from October 1, 2023, CRAs must report compliance with this circular, approved by their board of directors, to SEBI within a quarter. Monitoring aligns with CRA Regulations, including half-yearly internal audits as per Regulation 22 and SEBI circular.

Impact:
The SEBI necessitating structured data submissions by CRAs to DTs is expected to enhance regulatory efficiency. By standardizing data formats and requiring same-day submissions, the initiative improves transparency and accessibility, benefiting both CRAs and DTs in regulatory compliance.

1.1.3 New format of Abridged Prospectus for public issues of Non-Convertible Debt Securities and/or Non-convertible Redeemable Preference Shares

a. Section 2(1) of the Companies Act, 2013 defines an abridged prospectus and Section 33(1) of the Companies Act, 2013 requires that no application form for purchasing company securities can be issued without an accompanying abridged prospectus.

b. In accordance with Regulation 2(1)(a) of SEBI's NCS Regulations, an "abridged prospectus" for public issues is a document that includes specified prospectus highlights as determined by SEBI. Regulation 32(3) of the NCS Regulations mandates that the format of the abridged prospectus must adhere to Part B of Schedule I of these regulations.

c. The format for abridged prospectus disclosures has been updated for clarity and consistency. Details can be found in Annex-I of the Circular, with instructions for investors provided in Annex-II. This Circular applies to public issues starting from October 1, 2023, replacing the previous format from Part B of Schedule I in the NCS Regulations.

d. Issuers, merchant bankers, and syndicate members must display instructions to investors for completing application forms on their websites while a public issue is ongoing.

e. The abridged prospectus must be available on the issuer's, merchant bankers', and registrar to issuer's websites. A link to download the abridged prospectus should be included in issue advertisements.

f. QR codes must be added to the abridged prospectus, enabling quick access to the full prospectus when scanned. Issuers and merchant bankers must ensure that the abridged prospectus contains accurate and non-misleading information.

g. Qualitative statements in the abridged prospectus must be supported by quantitative data, and no unverifiable qualitative claims are permitted. Stock Exchanges are responsible for disseminating this Circular to listed entities and publishing it on their websites.

Impact:
The revised format for abridged prospectuses, effective from October 1, 2023, enhances clarity and consistency in disclosures. QR codes and online availability of abridged prospectuses improve accessibility for investors. Ensuring qualitative statements are substantiated with quantitative data strengthens the quality of information. This regulatory update promotes transparency and investor protection in the securities market.

1.1.4 Clarification regarding investment of Mutual Fund schemes in units of Corporate Debt Market Development Fund

a. With to previously issued circular regarding Investment by Mutual Fund Schemes and AMCs in units of Corporate Debt Market Development Fund (“CDMDF”).

b. AMFI has requested that for the calculation of asset allocation limits, the base may be considered as a net asset excluding investment in units of CDMDF. Therefore, it is clarified that for calculation of asset allocation limits of mutual fund schemes in terms of Part IV of Chapter 2 on ‘Categorization and Rationalization of Mutual Fund Schemes’ of Master Circular for Mutual Funds dated May 19, 2023, investment in units of CDMDF shall be excluded from the base of net assets.

1.1.5 Board Nomination Rights to Unitholders of Infrastructure Investment Trusts (InvITs).

a. Regulation 4(2)(h) of the InvIT Regulations mandates that unitholders owning at least ten percent of an InvIT's total outstanding units can either individually or collectively nominate a director on the Investment Manager's board.

b. Annexure-A specifies the framework for exercising board nomination rights by Eligible Unitholders which has been provided in the circular. The Investment Manager must review Eligible Unitholders' holdings monthly who have/hold the required number of units of InvITs and report their status to the Trustee of the InvITs.

1.1.6 Board Nomination Rights to Unitholders of Real Estate Investment Trust (REITs)

a. Regulation 4(2)(g) of the REITs Regulations mandates that unitholders owning at least ten percent of a REIT's total outstanding units can either individually or collectively nominate a director on the Investment Manager's board.

b. Annexure-A specifies the framework for exercising board nomination rights by Eligible Unitholders which has been provided in the circular. The Manager must review Eligible Unitholders' holdings monthly who have/hold the required number of units of REITs and report their status to the Trustee of the REITs.

1.1.7 Redressal of investor grievances through the SEBI Complaint Redressal (SCORES) Platform and linking it to Online Dispute Resolution platform.

a. SEBI Complaint Redressal System (SCORES) was established in 2011 to address grievances of investors against listed companies, registered intermediaries, and market infrastructure institutions. The process is currently governed by the Master Circular from November 07, 2022.

b. To enhance the grievance handling mechanism on SCORES, SEBI introduced the Securities and Exchange Board of India (Facilitation of Grievance Redressal Mechanism) (Amendment) Regulations, 2023. This amendment aims to make the process more efficient, reduce timelines, and introduce auto-routing and auto-escalation of complaints.

c. The revised framework for handling complaints through SCORES and monitoring by Designated Bodies is outlined in 'Annexure I' of the circular. A visual representation of the process can be found in 'Schedule III'. General provisions applicable to all Entities regarding the SCORES portal are detailed in 'Annexure II'.

d. Implementation of this circular mandates that Entities must submit an Action Taken Report (ATR) on SCORES within 21 calendar days of receiving a complaint. The provisions concerning processing of investor grievances and monitoring by Designated Bodies will be effective from December 04, 2023, and Designated Bodies must apply for SCORES Authentication and/or API integration to comply with these provisions by the same date.

e. This circular rescinds the previous Master Circular dated November 07, 2022, and any actions taken under the old circular will be deemed under the provisions of this new circular. All Entities and Designated Bodies must comply with this Circular, and Market Infrastructure Institutions and Designated Bodies must inform listed companies and registered intermediaries and publish the information on their respective websites.

Impact:
The SCORES system, revised through SEBI's 2023 amendment, streamlines investor grievance resolution. It introduces auto-routing and shorter timelines, bolstering investor confidence and accountability for Entities. Designated Bodies enhance monitoring for regulatory compliance and investor protection.

1.1.8 SEBI Board Meeting- Press Release

The 202nd SEBI Board meeting in Mumbai discussed securities market trends, particularly in technology, and SEBI's proactive planning for the future.

a. The SEBI Board approved enhancements to the framework for Large Corporates (LCs) to facilitate their debt financing needs. These changes include raising the monetary threshold for LC classification, reducing the number of qualifying entities, removing penalties for LCs unable to raise a specific percentage of incremental borrowing from the debt market, and introducing incentives and moderated disincentives.

b. To simplify compliance and promote ease of doing business, the Board maintains the requirement that LCs must meet the framework over a contiguous three-year period. Additionally, the obligation for LCs to file statements identifying themselves as LCs and confirming compliance with the framework has been eliminated.

c. SEBI has approved amendments to streamline the framework for crediting unclaimed investor amounts in listed entities, excluding companies, REITS, and InvITs, to the Investor Protection and Education Fund (IPEF), alongside the process for refunds from the IPEF.

d. These changes aim to provide a consistent and simplified process for claiming unclaimed amounts, enhancing investor convenience by allowing them to approach the relevant debt-listed entity, REIT, or InvIT for their unclaimed funds. This ensures a smoother claim process.

e. Additionally, a regulatory framework has been introduced for the segregation of unclaimed investor amounts in the IPEF, enabling efficient utilization and processing in accordance with SEBI's guidelines.

f. SEBI has extended the deadline for compliance with the enhanced qualification and experience requirements for Investment Advisers from September 30, 2023, to September 30, 2025, in response to industry feedback and evolving dynamics in the investment advice sector.

Impact:
SEBI's changes to the LC framework aim to simplify debt financing for larger firms, reducing regulatory hurdles. Streamlined unclaimed investor fund processes will boost investor trust and convenience. The extension of the Investment Adviser compliance deadline reflects SEBI's adaptability to industry feedback.

1.1.9 Extension of timelines (i) for nomination in eligible demat accounts and (ii) for submission of PAN, Nomination and KYC details by physical security holders; and voluntary nomination for trading accounts.

a. SEBI, through its July 23, 2021 circular, mandated that trading and demat accounts without a 'choice of nomination' by September 30, 2023, would be frozen.

b. Based on industry feedback, SEBI has made the following decisions: Choice of nomination' for trading accounts is now voluntary for improved ease of doing business. The deadline for submission of 'choice of nomination' for demat accounts has been extended to December 31, 2023.

c. For physical securities, SEBI's March 16, 2023 circular required PAN, Nomination, contact details, Bank A/c details, and Specimen signature submission by holders by September 30, 2023, or else folios would be frozen. In response to feedback, SEBI extended the deadline for submission of these details for corresponding folio numbers to December 31, 2023.

d. Stock Exchanges, Depositories, RTAs, and Listed Companies are instructed to implement these provisions, notify their constituents, disseminate this circular, report the implementation status to SEBI, and ensure compliance. This circular is effective immediately, supersedes prior provisions, and aligns with SEBI's directives for Stock Brokers and Registrars to an Issue and Share Transfer Agents issued on May 17, 2023.

Impact:
SEBI's decision to extend deadlines for 'choice of nomination' in trading and demat accounts and for PAN, contact details, and more in physical securities simplifies procedures and enhances the ease of doing business.

1.1.10 Master Circular for Merchant Bankers Registered with SEBI

SEBI has been, from time to time, issuing various circulars/directions to Merchant Bankers under the relevant provisions of the Securities and Exchange Board of India (Merchant Bankers) Regulations, 1992 (“Merchant Bankers Regulations 1992”) and extant securities laws.

In order to enable the stakeholders to have access to all such circulars at one place, this Master Circular in respect of Merchant Bankers has been prepared.

With the issuance of this Master Circular, all directions/instructions contained in the circulars listed out in the Appendix in the Master Circular shall stand rescinded to the extent they relate to the Merchant Bankers.

1.1.11 Nomination for Mutual Fund Unit Holders – Extension of Timelines

a. SEBI Circulars dated June 15, 2022, July 29, 2022, and March 28, 2023 mandated that existing individual mutual fund unit holders, whether sole or joint, must nominate or opt out of the nomination by September 30, 2023, or their folios would be frozen for debits.

b. Due to representations from market participants, the provision regarding the freezing of folios as per the June 15, 2022 Circular will now be enforced from January 01, 2024, instead of September 30, 2023.

c. Asset Management Companies (AMCs) and Registrar and Transfer Agents (RTAs) are required to regularly communicate with non-compliant unit holders through emails and SMS, guiding them on the nomination or opting-out process, while all other provisions of the aforementioned circulars remain unchanged.

1.1.12 Informal Guidance Sought by Guardian Asset Management Private Limited regarding SEBI (Portfolio Managers) Regulations, 2020

As per the informal guidance, Investment advisory service by portfolio managers include service to client related to securities and does not include any advice to client related to identification and investment in other PMS.

1.2. Reserve Bank of India

1.2.1 RBI's Responsible Lending Conduct Guidelines

The RBI has issued new guidelines as part of its responsible lending conduct for regulated entities (REs), which include banks, non-banking finance companies (NBFCs), and asset reconstruction companies (ARCs). These guidelines focus on the timely release of original movable/immovable property documents to borrowers following the full repayment or settlement of loan accounts. These Directions shall be applicable to all cases where release of original movable / immovable property documents falls due on or after December 1, 2023.

Key Highlights of the Guidelines:

1. Timely Document Release: Lenders are required to release all original movable/immovable property documents and remove charges registered with any registry within 30 days after full repayment or settlement of the loan account.

2. Borrower's Choice: Borrowers will have the option to collect their property documents from the branch where the loan account was serviced or any other office of the lender, based on their preference.

3. Communication and Transparency: Lenders must clearly mention the timeline and place of document return in the loan sanction letters issued on or after the effective date.

4. Procedures for Legal Heirs: In the event of the demise of the sole borrower or joint borrowers, lenders are required to have well-defined procedures for returning property documents to legal heirs, which must be displayed on their websites for customer information.

5. Penalties for Delays: If there is a delay in releasing property documents or failing to file charge satisfaction forms beyond 30 days after full repayment, the lender must communicate the reasons for the delay. If the delay is attributable to the lender, they must compensate the borrower at the rate of ₹5,000 for each day of delay.

6. Loss/Damage Compensation: In cases of loss or damage to original documents, lenders must assist borrowers in obtaining duplicate or certified copies and bear the associated costs. An additional 30-day period is allowed for this process, and penalties will be calculated thereafter (i.e., after a total period of 60 days). It's important to note that the compensation provided under these guidelines does not affect the borrower's rights to seek additional compensation as per applicable laws.

Impact:

These RBI guidelines aim to ensure a smoother and more transparent process for borrowers in obtaining their property documents after loan repayment.

1.2.2 Data Quality Index for Commercial and Microfinance Segments by Credit Information Companies

In June 2014, the RBI issued circular DBOD.No.CID.BC.127/20.16.056/2013-14, which introduced a common DQI for assessing data quality in the consumer segment and improving it over time. Now, the RBI is extending this framework to include Commercial and Microfinance segments as well.

Key Highlights:

1. DQI Expansion: CICs are now required to develop DQIs for the Commercial and Microfinance segments, as outlined in Annex I and II of the RBI circular. Deadline: CICs must provide DQIs for Commercial and Microfinance segments to all CIs by March 31, 2024.

2. Monthly Reporting: CICs will provide numeric DQI scores on a monthly basis to member credit institutions. These scores will be calculated at both CI and file levels.

3. Industry-Level DQIs: CICs will compute industry-level DQIs for each of the three reporting segments (e.g., Public Sector Banks, Private Sector Banks, Foreign Banks, Co-operative Banks, RRBs, NBFCs, etc.) on a monthly basis. Additionally, a half-yearly Industry Benchmark will be established based on the rolling average of the preceding six months' Industry-level DQI scores for each category of CIs.

4. Reasons for Decline: CICs will provide reasons for score declines to each CI if either the CI's level score has decreased compared to the previous month or if it falls below the half-yearly industry benchmark.

5. Data Reporting to RBI: CICs will share monthly data of CI-level DQIs and industry-level DQIs for all segments with the Department of Supervision, Reserve Bank of India, Central Office, at half-yearly intervals (as of September 30 and March 31) for information and monitoring purposes.

6. CICs are advised to conduct a half-yearly review of the DQI for all segments to improve data quality submitted to CICs. Corrective measures taken in response to any identified issues should be reported to the top management of each CIC within two months from the end of that half-year.

Impact:
This initiative underscores the RBI's commitment to promoting data accuracy and transparency in the financial sector, ultimately benefiting borrowers and lenders alike.

1.3. International Financial Services Centre Authority

1.3.1 Authorisation of Scheme file under IFSCA (Fund Management) Regulations 2022

All the schemes filed under Chapter III (Schemes for Fund Management), Chapter IV (Exchange Traded Funds) and Chapter V (Scheme related to ESG) shall seek authorisation from IFSCA.

Impact:
Operational clarity has been provided on the process for registration of schemes under IFSCA (Fund Management) Regulations 2022.

2. Discussion Papers

Securitization of Stressed Assets by RBI

Introduction

To bolster the development of a resilient securitization market in India, the Reserve Bank had introduced a revised framework for the Securitization of Standard Assets, outlined in the Master Direction issued on September 24, 2021 (referred to as "SSA"). The primary objective of this framework was to promote a simpler structure for securitization while aligning the regulatory guidelines with the Basel standards, which became effective on January 1, 2018. This alignment with international standards aims to enhance the stability and effectiveness of the securitization market in India.

Securitization entails the consolidation of loans, which are subsequently sold to a special purpose entity (SPE). This SPE then issues securities that are backed by the pooled loans. The establishment of a well-functioning securitization market serves multiple purposes, including the creation of a market-driven mechanism for managing credit risk within financial institutions and the facilitation of a secondary loan market.

Presently, there exists no equivalent mechanism for the securitization of non-performing assets (NPAs) through the Special Purpose Entity (SPE) route. The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (commonly known as SARFAESI), does indeed provide provisions for NPA securitization, but such transactions must be carried out by Asset Reconstruction Companies (ARCs) that hold licenses under the Act, adhering strictly to the statutory and regulatory norms prescribed therein.

In light of extensive market input and consultations with stakeholders, a decision was made to extend the possibility of securitizing NPAs through the SPE channel, mirroring the securitization process for standard assets.

Consequently, as part of the ongoing initiatives, the Reserve Bank of India unveiled its intention in the Statement on Developmental and Regulatory Policies, disclosed on September 30, 2022, to release a comprehensive Discussion Paper (DP). This DP serves as a comprehensive document outlining the key parameters of the proposed framework for securitization of stressed assets, often referred to as SSAF (Securitization of Stressed Assets Framework).

The process of Securitization of Stressed Assets represents a financial arrangement in which the originator of non-performing assets (NPAs) transfers these assets to a Special Purpose Entity (SPE). This transfer is financed by the issuance of securitization notes. Subsequently, the SPE designates a servicing entity to oversee and administer the management of these stressed assets. This servicing entity typically operates under a fee structure that provides incentives to maximize the recovery of value from the underlying loans.

Investors in this securitization arrangement receive their returns based on the recovery achieved from the underlying assets. These returns are determined through a structured mechanism known as the waterfall mechanism, which allocates payments in accordance with the seniority of the tranches or layers of securities involved in the securitization.

In both types of securitization structures, de-recognition and bankruptcy remoteness serve as foundational principles. However, the primary distinction between securitization of stressed assets and standard assets lies in the level of predictability regarding cash flows originating from the underlying pool, particularly in the case of stressed assets. Additionally, the degree of involvement of third-party expert entities, often referred to as 'Resolution Managers,' and their role in resolving the underlying assets are key differentiating factors.

The underlying pool of assets in Securitization of Stressed Assets Framework (SSAF) differs from the pools of Securitization of Standard Assets (SSA) in terms of credit risk. For SSA, investors in securitization notes assume the credit risk associated with the borrower. In contrast, in SSAF, the assets are already in a state of default or non-performing, or they are designated as such.

These assets are securitized at a discounted value relative to their nominal worth, reflecting the market's assessment of these underlying assets after accounting for portfolio losses and the likelihood that the resolution of these assets may generate adequate recoveries to cover the net value of non-performing exposures. Consequently, investors are exposed to the risk that the resolution process may not yield sufficient recoveries to cover the net value of the transferred underlying assets.

Key Aspects of the Discussion Paper on Securitization of Stressed Assets

1. Scope of Stressed Assets: The paper deliberates on whether the definition of "stressed assets" should solely encompass "non-performing assets" (NPAs) or if it should extend to include standard assets facing varying degrees of stress. While including standard assets could provide some certainty in cash flows, it also introduces the risk of regulatory arbitrage and complexity in asset resolution.

2. Restrictions on Securitization of Standard Assets: The existing framework for standard assets imposes limitations on securitizing certain asset types, such as revolving loans and loans with bullet payment structures. However, the paper acknowledges that such restrictions might not be entirely suitable, considering factors like enforcement, resolution, and pricing. It also highlights potential challenges in securitizing large corporate loans, including uncertain cash flows, dependency on creditor committee decisions, and potential issues related to representation priorities.

3. Minimum Retention Requirements (MRR): The paper discusses the relevance of MRR, which ensures economic alignment between originators and investors in securitization structures. Given that the stressed assets have already experienced defaults, the discussion paper acknowledges that the originator may have limited influence over the potential for recovery. Consequently, the economic interests of the originator may not always align with those of the investors. Therefore, the discussion paper outlines three potential options.

The first option is to allow the market to determine the specifics through contractual terms within the securitization structure. This approach would leave the determination of risk retention to negotiation between parties involved.

The second option involves regulatory guidelines that dictate the distribution of minimum risk retention between the originator bank and the resolution manager. This approach aims to establish a standardized allocation to ensure alignment of interests.

The third option suggests the implementation of a recovery-based fee structure for both the originator and the resolution manager. Under this approach, resolution managers would be incentivized based on early resolution and achieving higher recovery rates, moving away from a traditional fee-based model. This realignment of incentives may be supported by requiring resolution managers to invest in securitization notes, thereby sharing in the risk.

4. Credit Enhancement: Credit enhancement plays a vital role in securitization by bridging the gap between investor expectations and uncertainties in cash flows. The paper considered whether credit enhancement should be limited to senior tranches only. Given that the underlying assets are stressed, traditional ceilings on credit enhancement may not be practical. It suggests that, in such cases, the Reserve Bank of India (RBI) could consider removing these ceilings as long as the originator does not provide the necessary credit enhancement.

5. Valuation: The framework proposes a risk-sensitive write-down approach for the valuation of stressed assets in securitization. This approach takes into account the inherent risks associated with the resolution of stressed assets in the Indian context. Under this proposed approach valuation involves a graded form of write-downs. This means that a portion of the outstanding value of unamortized notes would be reduced annually.
   Specifically, it suggests a minimum annual write-down of 20% of the outstanding value of unamortized notes. This gradual reduction in the value of notes reflects the uncertainty and potential loss associated with the resolution process.
   The write-down process would continue annually until a full write-down is achieved. The maximum duration for this process is set at five years. This risk-sensitive write-down approach is designed to account for the evolving nature of stressed asset resolution and the potential for varying recovery outcomes over time. It aims to provide a mechanism for aligning the valuation of securitized stressed assets with their actual performance and the progress of resolution efforts

Conclusion

Introducing a new regulatory framework for stressed assets alongside the existing patchwork of regulations can indeed add complexity to the financial markets. While such an initiative has the potential to deepen financial markets and enhance the resolution of stressed assets, its success largely hinges on the effectiveness of enforcement mechanisms.

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.

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

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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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