BASILSTONE
CONSULTING PRIVATE LIMITED

# atharv

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Basilstone Consulting is pleased to present to you the **July 2022** 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. Consultation Paper on applicability of SEBI (Prohibition of Insider Trading), Regulations, 2015 to Mutual Fund (MF) units

The units of mutual funds are specifically excluded from the purview of PIT Regulations. In order to harmonise the provisions in PIT Regulations to initiate serious enforcement actions against those who misuse the sensitive non-public information pertaining to scheme of Mutual fund, directly or indirectly, which they have access, by virtue of their fiduciary capacity. It is considered to include a separate chapter in PIT Regulations, specifically to cover transactions in the units of Mutual Fund schemes, both close ended and open ended, so as to avoid complexities and such unintended consequences. In view of the same, public comments have been invited for various issues under consideration for PIT regulations.

**Impact:**
With the proposed plan of applicability of SEBI(PIT) Regulations, 2015 to Mutual Fund Units, it will result in in harmonization of the regulations governing trading in securities, while in possession of Unpublished Price Sensitive Information (UPSI).

### 1.1.2. Informal Guidance- Deepak Nitrite Limited

In case of a pending QIP issue, its pricing and probable impact on share capital of the company is considered to be UPSI. Further, PIT Regulations provide an option to the person who are perpetually in the possession of UPSI, to trade by formulating a trading plan in compliance with procedure mentioned in the regulation.

### 1.1.3. Declaration of Zero Coupon Zero Principal as Securities under Securities Contracts (Regulation) Act, 1956

"zero coupon zero principal instrument" means an instrument issued by a Not for Profit Organisation which shall be registered with Social Stock Exchange segment of a recognised Stock Exchange in accordance with the regulations made by the Securities and Exchange Board of India. Such instruments shall be considered as securities under the Securities Contract (Regulation) Act, 1956.

### 1.1.4. Key Highlights of SEBI Board Meeting – 29 June 2022

a. FPI's are allowed to participate in Exchange Traded Commodities Derivative Market
b. The Limited Purpose Clearing Corporation (LPCC) shall put in place a mechanism for infusion of additional capital in a phased manner, in line with the risk management and increasing trading volumes in order to meet the net worth requirements under the Payments & Settlement Systems Act, 2007 (PSS)
c. SEBI, in consultation with RBI, will review the outsourcing agreements of the LPCC in relation to its core and critical IT support infrastructure / activities for running the core activities (transaction process, clearing and settlement) after two or three years.
d. The Board approved to remove the applicability of the definition of "associate" as per SEBI (MF) Regulations, 1996 to such sponsors, which invest in various companies on behalf of the

beneficiaries of insurance policies or such other schemes as may be specified by the Board from time to time.

e. The Board approved the amendment to SEBI (Portfolio Managers) Regulations, 2020, to enhance prudential norms for investments by portfolio managers including investments in associates/ related parties.

## 1.2. Reserve Bank of India

### 1.2.1. Bank Finance to Government Owned entities

The banks having failed to assess the viability, repayment capability and tracking the end use of the infrastructure/housing projects the RBI draws the attention of all banks to adhere strictly to the regulations for *"Criteria for Financing", "Appraisal", "Bridge Loans against receivables from Government", Para 2(B)(ix)-"restriction on bank finance" as per the respective para highlighted in the corresponding Master Circular stated therewith.*

### 1.2.2. Restriction on Storage of Actual Card Data [i.e. Card-on-File (CoF)]

The RBI had recommended the tokenization of cards in the payment chain to avoid data spillage to multiple entities in the transaction/payment chain.

While the mechanism is in place it is yet to gain full traction, the RBI has clarified that the only card issuers and/or card networks shall store the CoF data and any other entity with the past data shall be considered as purged.

Timeline provided for the implementation of the instruction to payment system providers and payment system participants is till 30 September 2022

**Impact:**
This shall recede the sale of customer data by intermediaries and additional providing additional security and customer confidence in the payment system. RBI is encouraging customers to tokenize their cards, hence the same is voluntary at end of the customers for which awareness is important

### 1.2.3. Provisioning for Investment in Security Receipts (SRs) of ARC

Investment in SRs/PTC/Other instruments leads to retention of the transferred loan exposures in the books of Transferor. RBI has prescribed a mechanism to value these investments in its Master Direction – Reserve Bank of India (Transfer of Loan Exposures) Directions, 2021, whereby the valuation is to be done at Realisable Value based on NAV declared by ARC or Net Book Value, at the time of sale of exposure.

The RBI has permitted the initial difference between the current valuation and the carrying value of the securities prior to the directions is permitted to be deferred over a period of 5 years, from FY 2020-21 to FY 2025-26.

### 1.2.4. Extension of timeline for implementation of certain provisions of Master Direction – Credit Card and Debit Card

The applicability of the following provisions laid down in master direction have been deferred to 01 October 2022:

a. Para 6(a)(vi): OTP-based consent to be taken for activating credit card within 30 days, in case of failure of activation, the credit card account shall be closed within 7 working days without any charges to customer
b. Para 6(b)(v): ensure that sanction limit is not breached during anytime
c. Para 9(b)(ii): Interest not to be levied on capitalized figures pertaining to penalties/taxes/unpaid charges.

### 1.2.5. Prior approval in case of takeover / acquisition of control of non-bank Payment System Operators [PSO's]

The Regulator has put forth the requirement of prior approval for takeover/acquisition of control of Non-bank PSO's through:

a. change in management/director and
b. sale/transfer of payment activity to an entity not authorized for undertaking similar activity

The Procedure and details required for prior approval has been laid down in the notification.

An intimation within 15 days shall be required, and not prior approval, if:

a. the takeover/acquisition does not result in change in management
b. Sale/transfer of payment is to an entity authorized for conducting similar activity

### 1.2.6. Draft Master Direction on Outsourcing of IT Services

Pursuant to developments in the IT related offering, RBI sought the necessity for dedicated Outsourcing guidelines for IT services. The directions shall be applicable from the date suggested by the stakeholders for all material outsourcing arrangements (both domestic as well as foreign) as has been defined in the directions. The regulator also prescribes adherence to the guidelines in case of non-material outsourcing arrangements.

The directions shall be applicable to all Regulated entities (except for base layer NBFC and Primary (Urban) Co-operative Bank below asset size of 1000 Cr). The outsourcing can be in any form such as IT Infrastructure (including Payment System Infrastructure), Network and Security Solutions, Application Development, Data Retrieval and Storage Centres, Cloud Computing, etc.

The directions highlight the below-mentioned key points:

a. RE's Role in outsourcing of IT services-to ensure that RE's have complete oversight of the activities outsourced and determine its role and the service provider's responsibility adequately.

b. Strong internal governance and monitoring-
Requirement of board participation and approval, IT function (committee) responsibility, effective monitoring, etc.
c. Evaluation and engagement of Service Providers-
benchmark due diligence procedures, laid down by RBI, for selection of service providers commensurate to RE's operations.
d. Outsourcing Agreements
Agreements to adhere to minimum quality standard as prescribed by the RBI
e. Risk Management
Identify and manage the risks arising from the arrangement and performance of the service providers
f. BCP and DRP and exit strategies
Evaluation and management of impact on the business of RE, post discontinuation or exit from the arrangement to documented. Alternate providers,
g. Additional checks in case of Conglomerate/ Group and cross-border outsourcing
h. Specific instructions and diligence for

**Impact:**
IT outsourcing has been the norm for new era financial service providers. While outsourcing guidelines have been prescribed for the entities regulated by RBI, the regulator seeks to formalize the IT outsourcing function and the risk involved with it.

The Regulations shall ensure that all the RE's which involve a large public interest have a common mechanism and to bring into regulatory purview in the third party and the intermediaries involved in service providing.

## 1.3. International Financial Services Centre Authority

### 1.3.1. Refund of security deposit to Broker Dealers on surrender of membership

The regulator has permitted the refund of Security Deposits, by the exchange, on approval of application of surrender of Broker Dealers membership within:

a. Within 12 months from approval
b. Within 6 months from approval if engaged only in proprietary trading for the last three years prior to the date of application of surrender

### 1.3.2. Committees at Market Infrastructure Institutions (MIIs)

MII's i.e., stock exchanges, clearing corporation, depository have been mandatorily prescribed the constitution of the committees, such as:

i. Functional Committees
    a. Member Selection Committee

b. Investor Grievance Redressal Committee
c. Nomination and Remuneration Committee

j. Overnight Committees
  a. Standing Committee on Technology
  b. Advisory Committee
  c. Audit Committee
  d. Regulatory Oversight Committee
  e. Risk Management Committee

The functions of the committee have been further highlighted vide the document, however, few common points for all the committees (except for Grievance Redressal) are prescribed empowering the public interest directors (including their meetings), independent external person in committees and the role of the MIIs.

### 1.3.3. Consultation Paper on Proposed IFSCA (Setting up and Operation of International Branch Campuses and Offshore Education Centres) Regulations, 2022

IFSCA has vide the mentioned paper proposed to on-board foreign universities and institutions through setting up of International Branch Campuses/Off-Shore Education Centres.

The Foreign Institutions shall fulfil the eligibility criteria and shall offer permissible subject areas as shall be finalized in the directions.

### 1.3.4. Angel Funds under IFSCA (Fund Management) Regulations, 2022

IFSCA has laid down specific regulations for fund managers (angel investors) providing early-stage financing to start-ups (angel schemes), these regulations are to be followed in addition to the other provisions applicable to Fund Management Entities.
Eligible investment: “early-stage venture capital undertaking” means an incorporated entity which:

a. is incorporated not more than 10 (ten) years before the date of investment,
b. does not have annual turnover in excess of USD 20,000,000 since its incorporation,
c. is working towards innovation, development or improvement of products, processes or services, and
d. is not promoted or sponsored by or related to an industrial group with a group turnover more than USD 50,000,000

No investment shall be made in entity, which is connected to angel investor.

**Impact:**
The regularisation of start-up space shall ensure that the FME's invest in the entities with thorough diligence. Further, the investments limits have been defined to ensure that FME's don't over expose the investor's money over few entities

## 2. Discussion Papers

### Fintech-The Next revolution?

'FinTech' is a consortium of two words finance and technology. In simple words, FinTech can be stated as a term used to describe any new technology that aims to improve and automate the use and delivery of financial service. With the advent of growing IT technologies, the impact of IT sector on the financial sector can be described as revolutionary.

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

Moreover, the acceptance of the new normal by the society can largely be traced to the changing demand for financial products and competition in financial services. The acceptance of the products large can be narrowed to be based on three attributes; namely:

a. ease of transacting,
b. speed of transacting, and
c. security

Whereby the speed and ease have been firmly established, security is yet an area which needs to be strengthened the burden of which has been assumed by the regulatory sector

### Indian Scenario

India is on the way to becoming Asia's top financial technology (FinTech) hub with 87 per cent FinTech adoption rate as against the global average of 64 per cent. The regulators are intensively involved in developing an ecosystem, which would not only nurture the future technologies, but also stimulate the technological aspirations of the financial community. Indian fintech market is expected to reach approx USD 160 billion in valuation by 2025 as suggested by some experts. India has been a vital contributor to the evolution of payment systems with the introduction of Unified Payment Interface. The FinTech Innovations has disrupted the existing financial markets and offered up solutions challenging the physical business. Output of Fintech Innovation are seen in sectors such as:

a. Payments, Clearing & Settlement
b. Deposits, Lending, Capital Raising
c. Insurance
d. Investment Management
e. Contracting and Liaisoning

### Impact on Business

The Finance industry has seen a lot of start-ups and new products, marking the growth of FinTech Eco-system. The visible impact perceived by the business can be seen in:

a. Customer Acquisition Cost ["CAC"]

The CAC has gone down drastically due to digitized customer on-boarding process. The accessibility to various parts of the country has improved without having full-fledged branches by simply having a single person touch point.

b. Leverage
The business at forefront in the FinTech adoption has gained synergy to leverage the FinTech Infrastructure to venture into other Financial Services Business.

c. Documentation
Regulatory recognition of FinTech benefits has resulted in acceptance of e-documents and centralized lockers for customer's documents.

d. Customer interface
Customer Interface has been updated to be app/virtual based eliminating the requirement to have a physical customer interface

e. Security and Infrastructure
This connects individual financial sector participants to collectively the customers at larger. Many of these infrastructures still face inefficiencies due to, for example, limited operating hours and interoperability constraints. Further, until recently, non-banks typically could not access these infrastructures directly and were therefore reliant on banks.

f. Special Purpose Vehicle
Deploying customer deposits (or other sources of funds) into productive loans (and other uses of funds) through balance sheet intermediation is one of the oldest functions in finance. Business of financial institutions are subject to a variety of requirements and constraints. However, certain types of financial institutions – eg payment service providers, mutual fund managers, and more recently P2P or marketplace lenders – do not create customer liabilities and assets on their own balance sheets, thus minimizing the regulatory burden

g. Competition
Implications for market entry Digital innovation has reduced cost barriers, allowing new and smaller players to enter. The elimination of many fixed costs and a reduction in variable and switching costs makes it possible for low-cost providers to enter the market.

**Government and Regulatory Contribution**

While Government has extended a noteworthy support to start-ups and FinTech promotion in the form of initiative such as Digital India, Start-up India, India Stack, E-RUPI, license for payments banks, Jan Dhan Yojana, National Common Mobility Card (NCMC), FinTech hub in gift city, it is the regulators who have deliberated in consonance with the market players to enable efficient and safe products in the market few of which are AI based trading, P2P-NBFC, Digital Lending, TReDS, rbiretaildirect (for Retail bond market), Digital KYC, etc.

The Regulators SEBI, IRDA and RBI have been nurturing the innovation through their Regulatory Sandbox which provides a guided path to the innovators for expanding their products into a structure product. The RBI's Payment Vision 2025 (discussed in Atharva June 2022) and Innovation Hub (RBIH) lays down the path for the changes encouraged by the regulator in its regulatory eco-system.

Lastly, the Covid-19 pandemic is an unsung hero in the success story of FinTech. While the world had been paralyzed with the disease, the necessity to stay at home gave rise to an invention which has taken over the world. Change has always been a norm of the nature, however, if the direction of the change is not monitored closely it can lead to catastrophic failures. Therefore, we shall be witnessing a completely unrecognizable financial system at the end of the road or a crisis.

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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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