

Regulatory Digest

October 29, 2024

THE FINANCIAL SERVICES BULLETIN

This is the second edition of Nishith Desai Associates' quarterly financial services newsletter in collaboration with US-India Business Council.

U.S.-India Business Council

INTRODUCTION

The Indian financial services ("FS") sector continues to show promise – with FS attracting private equity investments worth USD 931 million in the first quarter of FY 2024 (April-June 2024) itself.¹ Collectively, internet, software and FS have attracted nearly 50% of the market share for total private equity investments into India in the first half of calendar year 2024.²

Further to our previous publication (available [here](#)), Nishith Desai Associates ("NDA") and the US-India Business Council ("USIBC") are elated to present to you the second edition of our financial services quarterly roundup (for the months of July to September 2024). As always, through this publication, we aim to cull out key developments in the financial services industry that, in our view, "summarize the quarter". Our roundup has been meticulously curated to ensure that key developments relevant to our stakeholders are discussed briefly.

BANKING AND FINANCIAL SERVICES

Key contacts:



Viral Mehta (Mumbai-BKC)



Nishchal Joshipura (Mumbai-BKC)

1. Reserve Bank of India ("RBI") releases three Master Directions on Fraud Risk Management for regulated entities (July 2024)

In a critical development, on July 15, 2024, the RBI released three Master Directions aimed at strengthening and streamlining the framework for *prevention, early detection and reporting* of frauds respectively in: (i) non-banking financial companies ("NBFCs") and Housing Finance Companies ("HFCs");³ (ii) Urban Cooperative Banks, State Cooperative Banks, Central Cooperative Banks (CCBs);⁴ and (iii) Commercial Banks including Regional Rural Banks and All India Financial Institutions⁵ (collectively, the **Fraud Risk Management Directions**).

The Fraud Risk Management Directions cover a broad range of frauds such as misappropriation of funds, manipulation of books of accounts, fictitious accounts, forgery, fraudulent transactions involving foreign exchange, etc.

Set out below are certain important provisions that have been divided into the following three broad categories: prevention, detection, and reporting. Note that the language and scope of certain directions / provisions within the respective Master Directions varies slightly and we have accordingly only set out material concepts:

- **Prevention:** Regulated entities will now be required to create an organizational structure that institutionalizes fraud risk management (through creation of committees and board approved policies). Additionally, they also specify the role of senior management and officials (at the time of investigation of a complaint and otherwise) and the contents of whistleblower policies to be adopted by these entities.
- **Detection:** Regulated entities are required to now ensure continuous monitoring of credit facilities and transactions

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Audio

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October 31, 2024

Analysing SEBI's Consultation Paper

to detect fraudulent activities, through adoption of Early Warning Signals (“EWS”) that will analyze transactional data, financial performance, market intelligence and borrower conduct. The scope and indicators to be plugged into the EWS have also been set out in detail, along with audit procedures that may need to be followed in case a fraud is detected.

- **Reporting:** Regulated entities must now report frauds to Law Enforcement Agencies and the RBI through Fraud Monitoring Returns within 14 days of classifying the incident as fraud (reduced from the previous 21 day time period). Further, the Fraud Risk Management Directions specify the manner in which frauds are to be reported in the financial statements of regulated entities as well.

We have specifically analysed the Master Directions released for NBFCs (and provided a checklist for existing and incoming institutional investors) in our article [here](#).

2. RBI reviews existing norms for NBFC – Peer to Peer (P2P) Lending Platforms to clarify certain existing provisions (August 2024)

RBI released the “Review of Master Direction - Non-Banking Financial Company – Peer to Peer Lending Platform (Reserve Bank) Directions, 2017” (“**Review Directions**”) on August 16, 2024 to clarify certain provisions of the existing master directions applicable to NBFC-P2Ps (“**Existing Directions**”).⁶ The Review Directions come in the backdrop of the RBI’s recent crackdown of NBFC-P2Ps in the backdrop of multiple ponzi schemes, acceptance of deposits without authorization, and unauthorized fund transfer from escrow accounts within these entities.⁷

Certain key developments within the Review Directions include: (a) restriction on cross selling insurance products in the nature of a credit enhancement / credit guarantee (over and above existing restrictions on sale of products other than loan insurance products); (b) while the Existing Directions always required maintenance of two escrow accounts for borrowers and lenders (which are to be operated by a bank promoted trustee), it has now been expressly clarified in the Review Directions that funds from a lender escrow cannot be used to repay loans and those within a borrower escrow cannot be used for loan disbursement; (c) funds entering into escrow accounts may only remain therein for a day from the date of their entry into the account; and (d) NBFC-P2Ps must not promote peer to peer lending as though it is an investment product.

3. Release of Master Direction on Treatment of Wilful Defaulters and Large Defaulters (“WD Directions”) (July 2024)

The WD Directions were released on July 30, 2024 to create a framework for the identification and consequences of borrowers who intentionally and deliberately default on loans and borrowings provided to them by regulated entities.⁸ As per the WD Directions, a “wilful defaulter” essentially refers to a borrower / guarantor that has committed a wilful default of INR 25 Lakhs (approximately USD 30,000). The WD Directions are applicable to all regulated entities within 90 days from their date of issuance (i.e. October 30, 2024).

The WD Directions can broadly be classified into three sub-categories: (a) identification and treatment of wilful defaulters; (b) reporting of wilful defaulters; and (c) preventive measures.

Regulated entities are now required to set up an “Identification Committee” to review and ascertain evidence of wilful default. Through the examination of submissions of the relevant impugned person, the Identification Committee is to make a proposal to the Review Committee for classification / non-classification as wilful defaulter (with reasons in writing). The decision will finally be taken by the Review Committee through issuance of a similar written order. Upon classification as a wilful defaulter, the WD Directions prescribe certain penal consequences, such as operation of a bar on additional credit facilities to such defaulter, initiation of criminal proceedings (if applicable), and ineligibility for restructuring of credit facilities.

Along with this, regulated entities are required to report the occurrence of a wilful default to the RBI in the prescribed manner and ensure that the appropriate preventive measures specified therein (including but not limited to monitoring of end use of funds). Importantly, regulated entities are now able to report statutory auditors to the National Financial Reporting Authority (NFRA) / Institute of Chartered Accountants of India (ICAI) in case deficiency is observed in their services during conduct of the audit.

By defining the actions and penalties for wilful defaulters, the WD Directions are a positive step towards preserving the integrity of the financial system. Along with the Fraud Risk Management Directions, this creates a holistic mechanism for treatment of wilful defaults and frauds in regulated entities and is certainly a welcome development.

4. Harmonisation of regulations applicable to Housing Finance Companies (“HFCs”) with other NBFCs (August 2024)

Since the transfer of regulation of HFCs from the National Housing Bank (NHB) to Reserve Bank with effect from August 9, 2019, different regulations have been published to create parity in the regulations applicable to HFCs and NBFCs. While specialized master directions were released by the RBI in 2021, HFCs continued to enjoy a relaxed prudential framework compared to similarly sized NBFCs.

In lieu of the above and with the intent of harmonisation, the RBI released a “Review of regulatory framework for HFCs and harmonization of regulations applicable to HFCs and NBFCs” on August 12, 2024 (which is to become effective from January 2025) (the “**Harmonisation Directions**”).⁹ Through the Harmonisation Directions, the RBI has: (a) increased minimum percentage of liquid assets to be maintained by the HFCs from 13% to 15% (to be adopted in a phase-wise manner); (b) reduced the ceiling on quantum deposits from 3 to 1.5 times of the net owned funds; (c) prescribed the manner in which HFCs can participate in credit default swaps; and (d) clarified that public deposits accepted or renewed by the HFC should be repayable at any time after 12 months but not later than 60 months (as opposed to the current 120 months).

5. Bajaj Housing Finance filed for an initial public offering (“IPO”) further to RBI regulations (September 2024)

Recently, Bajaj Housing Finance (“**Bajaj**”) filed for an IPO on September 9, 2024 to comply with the RBI’s diktat. As per the scale based framework that is now applicable to NBFCs, NBFCs that are classified in the “Upper Layer” (“**NBFC-UL**”) are required to mandatorily list on the public markets within 3 years from their classification as an NBFC-

UL. Considering that Bajaj was so classified through an RBI circular in September 2022, it was supposed to list on or before September 30, 2025.

The IPO was oversubscribed by 63.61 times (collecting over INR 3 lakh crores), making this one of the highest ever bids received from an IPO.¹⁰

Currently, there are 15 NBFCs that have been classified as an NBFC-UL by the RBI.¹¹ While a large number of these NBFCs are already listed on the public markets, the balance NBFC-ULs are exploring interesting routes to ensure compliance with this requirement.

We have analysed these structures (and the potential reasons for such structures being adopted) in detail in our "Deal Talk", available [here](#).

6. India gets its first fintech self-regulatory organization ("SRO") (August 2024)

In furtherance of our last quarterly update reporting the finalization of a framework for SROs in the fintech industry (available [here](#)), RBI has approved the "*Fintech Association for Consumer Empowerment (FACE)*", making it India's first fintech SRO. FACE was selected amongst three other applications for SRO that were also simultaneously received by RBI.¹²

RBI governor Shaktikanta Das has also publicly announced that RBI will be approving more SRO applications going forward, and that the functioning of SROs may assist in obtaining a balance between innovation and regulation can be achieved through these (specifically in the fintech space).¹³

INSURANCE

Key contacts:



Nishchal Joshipura (Mumbai-BKC)



Parul Jain (Delhi)



Harshita Srivastava (Mumbai-BKC)

1. Insurance Regulatory and Development Authority of India ("IRDAI") releases a Master Circular for policyholders' interests (September 2024)

On September 5, 2024, the IRDAI released a "Master Circular on Protection of Policyholders' Interests"¹⁴ under the IRDAI (Protection of Policyholders' Interests, Operations, and Allied Matters of Insurers) Regulations, 2024 ("**Circular**") outlining the rights of insurance policyholders. This is the second of two master circulars issued under these regulations.

The Circular replaces 30 other circulars and attempts to consolidate policyholder entitlements. Broadly, it deals with the manner of settlement of claims, details to be specified in the policy documents, requirement of integration with Digilocker, premium deposit requirements for insurance policies, etc.

FOREIGN PORTFOLIO INVESTMENT AND FOREIGN VENTURE CAPITAL INVESTMENT

Key contacts:



Kishore Joshi (Mumbai-BKC)



Prakhar Dua (Mumbai-BKC)

1. The Securities and Exchange Board of India ("SEBI") releases a circular amending SEBI circular of August 2023 on additional disclosures by Foreign Portfolio Investors ("FPIs") ("August 2023 Circular")¹⁵ (August 2024)

On August 01, 2024, SEBI released a circular titled "*Amendment to Circular for mandating additional disclosures by FPIs that fulfil certain objective criteria*" ("**Amendment Circular**")¹⁶. The Amendment Circular adds University Funds and University-related Endowments as an exempt category, i.e., these entities which shall not be required to make the additional disclosures upon breach of the threshold/s prescribed under the August 2023 circular, *provided*

that they fulfil the following additional conditions:

- Indian equity AUM being less than 25% of global AUM;
- Global AUM being more than INR 10,000 crore equivalent; and
- Appropriate return/filing to the respective tax authorities in their home jurisdiction to evidence the nature of a non-profit organisation exempt from tax.

2. Harmonisation of Foreign Venture Capital Investors ("FVCI") governing regime with that of FPIs (September 2024)

On September 5, 2024, SEBI released the SEBI (FVCI) (Amendment) Regulations, 2024 ("**Amendment Regulations**")¹⁷, amending the SEBI (FVCI) Regulations, 2000 ("**FVCI Regulations**").¹⁸ The Amendment Regulations seek to streamline the registration process of FVCIs by putting the responsibility of processing registration applications and conducting due diligence upon the Designated Depository Participants ("**DDPs**") registered with SEBI. This shift aligns the FVCI registration framework with the existing FPI framework. The Amendment Regulations come into effect on January 1, 2025.

Few of the key amendments include: (a) application for registration to be made to the DDP and the certificate of registration to be issued by the DDP, as opposed to SEBI (under the erstwhile regime); (b) eligibility criteria for FVCIs getting aligned with the criteria prescribed for FPIs; (c) FVCIs required to provide details of their beneficial owners to the DDP; and (e) registration form made similar to the Common Application Form used for FPI registration.

Further, to ensure a smooth transition and provide clarity on certain procedural aspects, SEBI also issued the Operational Guidelines for FVCIs and DDPs ("**Operational Guidelines**") on September 26, 2024.¹⁹

3. SEBI releases a circular providing for a new quarterly report format to be submitted by FVCIs (September 2024)

On September 13, 2024, SEBI released the "*Reporting by Foreign Venture Capital Investors*" circular.²⁰ This circular provides for an updated format for quarterly reports to be submitted by FVCIs, required as per Regulation 13(1) of the FVCI Regulations.

MISCELLANEOUS

1. Competition Commission of India ("CCI") overhauls the Indian merger control regime (September 2024)

On September 9, 2024, the CCI and the Ministry of Corporate affairs introduced a series of rules and regulations that collectively amended the extant merger control regime. Along with this, the Competition (Amendment) Act, 2023 has also been notified (collectively, "**Updated Merger Control Regime**").

The Updated Merger Control Regime introduces landmark concepts such as:

- **Introduction of "deal value threshold"**: In case the "value of the transaction" exceeds INR 2,000 crores (i.e. approximately USD 238.4 million) and the target enterprise has "substantial business operations"²¹ in India, such transaction will be subject to prior approval of the CCI (regardless of availability of the de-minimis target exemptions under the existing merger control regime).
- **Relaxation of requirements for open offers and open market purchases**: In case an acquirer wishes to purchase shares via an open market purchase or pursuant to an open offer, the acquirer will be permitted to do so, so long as voting rights are not exercised for these securities until the CCI grants its approval.

In addition to this, the exemptions available to transactions (from the notifiability requirements under the Competition Act, 2002 have been significantly amended. The Updated Merger Control Regime will need to be assessed in the context of all deals, specifically high-value deals and / or digital market deals where the consideration may be ascribed to non-monetary factors for targets involved in these sectors.

We have provided a broad overview of the major developments in our hotline available [here](#). We have also analysed the interpretation, calculation and impact of introduction of the deal value threshold (along with certain use cases) in our "Deal Talk" [here](#).

CONCLUSION

In conclusion, the second quarter of the financial year 2024 has been a transformational period for the Indian banking, FS and insurance sectors alike, marked by a whirlwind of regulatory activity with significant legal restructuring and reforms. The third quarter of the financial year is expected to follow with this series of developments, as can be observed via increased regulatory scrutiny and consultation papers released by various regulatory authorities.

- Ashwin Singh, Parina Muchhala, Prakhar Dua and Nishchal Joshipura

You can direct your queries or comments to the relevant member.

¹<https://www.thehindubusinessline.com/economy/india-sees-75-spike-in-pe-investments-to-364-billion-in-q1/article68396111.ece>.

²Ibid.

³<https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=12704&Mode=0>.

⁴<https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=12703&Mode=0#2>.

⁵<https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=12702&Mode=0>.

⁶https://www.pdicai.org/Docs/RBI-2024-25-63_1782024135242193.pdf.

⁷<https://www.business-standard.com/economy/news/ponzi-like-model-of-p2p-lenders-prompt-crackdown-rbi-found-high-npa->

⁸<https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=12713&Mode=0#2>.

⁹<https://www.fidcindia.org.in/wp-content/uploads/2024/08/RBI-HARMONISATION-OF-HFCs-REULATIONS-12-08-24.pdf>.

¹⁰<https://www.thehindubusinessline.com/markets/bajaj-finance-ipo-gets-record-subscription-of-324-lakh-crore/article68630820.ece>.

¹¹https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=56373.

¹²<https://www.cnbctv18.com/business/finance/rbi-approves-face-as-the-first-fintech-sro-sets-new-standard-for-self-regulation-19467243.htm>.

¹³<https://economictimes.indiatimes.com/industry/banking/finance/banking/rbi-recognises-face-as-self-regulatory-organisation-in-fintech-sector/articleshow/112871697.cms?from=mdr>.

¹⁴<https://irdai.gov.in/document-detail?documentId=5625747>.

¹⁵Circular no. SEBI/HO/AFD/AFD-PoD-2/CIR/P/2023/148, dated August 24, 2023.

¹⁶https://www.sebi.gov.in/legal/circulars/aug-2024/amendment-to-circular-for-mandating-additional-disclosures-by-fpis-that-fulfil-certain-objective-criteria_85371.html.

¹⁷https://www.sebi.gov.in/legal/regulations/sep-2024/securities-and-exchange-board-of-india-foreign-venture-capital-investors-amendment-regulations-2024_86505.html.

¹⁸https://www.sebi.gov.in/legal/regulations/feb-2023/securities-and-exchange-board-of-india-foreign-venture-capital-investor-regulations-2000-last-amended-on-february-07-2023-_69489.html.

¹⁹https://www.sebi.gov.in/legal/circulars/sep-2024/operational-guidelines-for-foreign-venture-capital-investors-fvcis-and-designated-depository-participants-ddps-_87032.html.

²⁰https://www.sebi.gov.in/legal/circulars/sep-2024/reporting-by-foreign-venture-capital-investors_86680.html.

²¹An enterprise is said to have "substantial business operations" in India, in case if either of the conditions set out below are met:

- For digital services provided, the business users / end users in India should be 10% or more of the total global users; *Or*
- The gross merchandise value for 12 months preceding the relevant date must be: (a) 10% or more of the total global gross merchandise value; and (b) more than INR 500 crores (i.e. approximately USD 59.5 million) (and this part (b) not applying to digital services); *Or*
- The turnover during the preceding financial year in India is: (a) 10% or more of the global turnover derived from all products and services; and (b) more than INR 500 crores (i.e. approximately USD 59.5 million) (and this part (b) not applying to digital services).

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