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ahead of the curve

fig bulletin

a quarterly newsletter by cam financial institutions group

January to March, 2022

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I am pleased to share with you the second issue of *'Financial Institutions Group ("**FIG**") Bulletin'*, newsletter produced by our FIG practice.

The transformation of India's financial system is currently underway, with a move from the traditional paper-based physical financial model to the instant and cashless economy of the future. With market innovation at an all-time high in this space, the Reserve Bank of India ("**RBI**") continues to monitor the industry and proactively adopt measures to boost its growth.

The RBI's effort to develop an optimal regulatory framework that protects the interests of consumers and industry alike has seen key developments. Notable milestones in this growth story include significant changes to the Know-Your-Customer ("**KYC**") requirements which was a follow-up from the RBI Governor's speech of May 5, 2021, promising developments in the area of financial technology ("**FinTech**") and the RBI issuing a detailed regulatory regime for payment aggregators and payment gateways coupled with industry-wide data localisation requirements.

The RBI has also formed a standing external advisory committee to evaluate licence applications of universal banks and small finance banks. With the Union Budget 2021-22 setting up a fintech hub at the Gujarat Finance Tec-City, under the International Finance Services Centre ("**IFSC**"), this sector of the broader financial services industry will likely continue to be the key driver of innovation and disruption.

India has witnessed an upward trend in the use of technology in banking, financial services and the insurance sector. Indian fintech companies are building their operations as 'neo-banks', *i.e.* a bank which does not have a brick & mortar infrastructure.

Whilst the RBI has recognised the need for differentiated banking, the extant regulatory framework does not recognise digital-only banks, and therefore, fintech companies are required to tie up with traditional banks to provide neo-banking services. In this edition of our FIG Bulletin, we aim to discuss the present regulatory framework under which neo-banks operate in India, which includes insights from **Mr. Anand Sinha**, former Deputy Governor of the RBI and **Mrs. Lily Vadera**, former Executive Director of the RBI, now senior advisors with us along with other key updates.

We hope you enjoy reading this newsletter. Please feel free to send your comments, feedback and suggestions to cam.publications@cyrilshroff.com.

Regards,

Cyril Shroff

Managing Partner
Cyril Amarchand Mangaldas

India's leading law firm

MESSAGES FROM OUR FIG CO-HEADS

Message from Mr. B. Sriram, Senior Advisor

It is with great pleasure that I introduce you to the second issue of the FIG Bulletin, by our FIG practice.

We have observed regulators introducing measures to accelerate the digitisation of the Indian economy necessitated by the ongoing pandemic. The RBI's move to allow payment system operators to process NEFT and RTGS transactions is a good example that should benefit consumers greatly and more importantly, setting up of a dedicated FinTech department at the RBI to not only identify the challenges and opportunities associated with it and address them in a timely manner, but also to provide a framework for further research on the subject that can aid policy intervention by the RBI.

The newsletter contains insights into the nascent neo-banking industry in India, which has the potential to serve the unbanked and underbanked segments of the country. It suggests steps that regulators could take to harness the potential of neo-banks to bring forward the digital payments' revolution.

We hope you find this newsletter to be an insightful and engaging read. Please share any feedback or comments about the newsletter with us on cam.publications@cyrilshroff.com.

Regards,

B. Sriram
Senior Advisor

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Message from Partner and FIG Co-Head, Santosh Janakiram

I am happy to share with you the second issue of the FIG Bulletin, produced by our FIG practice.

The journey of FinTech in India is at all times high velocity, and the sector is witnessing various path breaking developments, whether it is the entry of fintech players in the formal banking sector (Bharat Pe setting up of Unity Small Finance Bank) or the RBI setting up a dedicated FinTech department by subsuming the FinTech Division of DPSS, CO.

Owing to improvements in public awareness and financing options in India, a reduction in asymmetric information through better information management systems and increased coordination amongst stakeholders could pave the way towards a greener and sustainable long-term economic growth. Therefore, the time has come for the RBI to step into green financing, in addition to catalysing the growth in the FinTech sector.

Additionally, from taxonomy perspective, making capital easier to access for bank and companies, in particular smaller borrowers/ MSMEs can be encouraging. The follow-on impacts of this can be tremendous. To that effect, the RBI has also released 'Framework for Facilitating Small Value Digital Payments in Offline Mode' to encourage technological innovations that enable small value digital transactions in offline mode.

The newsletter contains the perspective of our FIG practice on the recent developments in the FinTech sector. By introducing the requirement of interoperability for pre-paid instruments and allowing payment system operators to outsource non-core activities, the RBI is proactively looking to utilise FinTech sector's potential for the Indian economy, both during a pandemic and for the future.

We hope you enjoy reading the newsletter. Any feedback on the newsletter can be shared with us on santosh.janakiram@cyrilshroff.com.

Regards,

Santosh Janakiram
Partner,
Head – Projects and Co-Head – FIG

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RBI Working Group's Report on Digital Lending

Introduction:

The RBI had constituted a working group on digital lending, including digital lending through online platforms and mobile applications on January 13, 2021 ("**Working Group**"). This move came as a regulatory response to the rapidly evolving digital lending ecosystem in India, which is primarily driven by non-banking financial companies ("**NBFCs**") entering into strategic partnerships.

The Working Group's recommendations seek to enhance customer protection and safety, while encouraging responsible innovation. The Working Group approached the report with three overarching principles: (i) technology neutrality while encouraging competition, (ii) principle backed regulation instead of a rule-based regime, and (iii) limiting regulatory arbitrage between different sets of entities in the digital lending ecosystem.

The RBI has invited public comments to the report of the Working Group, by December 31, 2021.

Recommendations on key Unregulated Lending Structures:

Notably, the Working Group report suggests that Balance Sheet Lenders ("**BSLs**"), i.e., entities which take on credit risk while lending, should only be RBI Regulated Entities ("**REs**") or entities authorised under any other law to undertake the lending business. Lending Service Providers ("**LSPs**"), such as FinTech platforms (which enable NBFCs to lend to customer) should be subject to enhanced due diligence standards and monitoring by BSLs.

Industry players in the digital lending space have utilised structures such as First Loss Default Guarantees ("**FLDG**") to distribute the credit risk in case of defaults by customers. The Working Group recommends a prohibition on FLDG structures, with the rationale that these synthetic structures may lead to increased risk in the overall stability of the financial system.

The Working Group also recommends treating Buy Now Pay Later ("**BNPL**") arrangements, which allow consumers to purchase products on a deferred payment basis, as balance sheet lending. This classification may therefore require KYC and credit score checks to be conducted by online marketplaces, prior to extending BNPL options to their customers.

Key clarifications on the ambit of the Working Group's prohibition on loan origination from unregulated entities

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are awaited, especially in the context of BNPL arrangements that offer customers cashbacks on their purchases.

The Working Group has also recommended the enactment of a new legislation to prohibit illegal lending.

Increasing Regulatory Oversight:

The Working Group report suggests subjecting digital lending apps to a verification process by constituting a new nodal agency styled as the Digital Trust of India Agency (DIGITA), which will set up the minimum technical standards for digital lending apps, verify compliance and maintain a publicly available register of verified apps.

The Working Group also suggests all market participants to establish a Self-Regulatory Organisation (SRO). The SRO is recommended to maintain a 'negative list' of LSPs and formulate a standardised code of conduct for recovery practices (which were a major source of concern for the Working Group).

In line with its approach in other segments (such as payment aggregation), the RBI has recommended the formulation of baseline technology standards and compliance with these standards as a pre-condition for REs to offer digital lending. Technology standards are required to be reflected in the terms of services of the lending apps.

The Working Group further recommends that all data storage should be localised, and that data should be collected only with the explicit consent of the borrower.

Conclusion:

The Working Group's recommendations are primarily aimed at protecting borrowers and standardising the practices of digital lending applications. Digital lending has seen a significant uptick in recent years, with many retail borrowers turning to these paperless mechanisms. However, when these borrowers were unable to repay these loans, many were subjected to coercive recovery tactics.

With the measures to curb illegal activities and exploitative tactics, the digital lending ecosystem will likely see a boost in public confidence. This may prove critical as digital lending is slated to continue to increase its share in the overall availability of credit in India.

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Mandatory Interoperability for Prepaid Payment Instruments: A step for Greater Financial Inclusion & Boost to Digital Economy

Introduction:

The RBI has been vigilant of India's scarce financial technology infrastructure, actively promoted effective utilisation of payment instruments and repeatedly emphasised on the benefits of interoperability.

The RBI published the new Master Direction on Prepaid Payment Instruments (PPI) on August 27, 2021, providing new and simpler categories of PPIs: (i) Small PPIs which are instruments issued after receiving minimum details of the PPI holder, to be utilised only for the purchase of goods and services with a group of pre-identified merchants; (ii) Full-KYC PPIs which are instruments that are not restricted to an identified group of merchants, require the KYC process of PPI holders to be completed, and support fund transfers and cash withdrawals. It also mandates interoperability for all full-KYC PPIs with an exception created for PPIs issued by MTS and gift PPI issuers. To protect PPI holder funds, the direction also restricts the permissible debits and credits in the escrow account. It mandates PPI issuers to follow the new security mechanisms of two factor authentication compulsory for all PPI transactions, except for gift PPIs and PPIs used in MTS.

The RBI laid down the ambit of interoperability for PPIs vide its circular dated October 16, 2018, as, "a technical compatibility that enables a payment system to be used in conjunction with other payment systems. Interoperability allows PPI Issuers, System Providers and System Participants in different systems to undertake, clear and settle payment transactions across systems without participating in multiple systems."

In line with its innovative notion, the RBI published a circular on Prepaid Payment Instruments on May 19, 2021 ("**PPI Circular**").

The PPI Circular provides for: (a) mandatory interoperability to PPI issuers for fully know-your customers ("**KYC**") compliant PPIs through card network and unified payment interface ("**UPI**") and also extended the same to acceptance side; (b) increase in the maximum amount outstanding in respect to KYC-compliant PPIs to INR 2 lakh from INR 1 lakh; (c) permission to withdraw cash from full-KYC PPIs of non-bank PPI issuers subject to certain conditions including a maximum limit of INR 2,000 per transaction with an overall limit of INR 10,000 per PPI, authentication by an Additional Factor of Authentication ("**AFA**") / PIN for transactions performed using card/wallet and a cooling period upon loading/re-loading of funds into PPIs.

While framing the norms for interoperability, the RBI has exempted the interoperability to PPIs from Mass Transit Systems.

Further, such interoperability shall be enabled by March 31, 2022.

Effect of Interoperability:

PPI interoperability was a much-awaited step. It is likely to be a game changer for the payments industry, in addition to making the overall PPI ecosystem much more robust. The move is most likely to impact almost all the stakeholders of the payments ecosystem and will likely make the business environment more competitive and innovative, thus benefiting the end customer. Interoperability is also likely to reduce complexities for most of the stakeholders in terms of PPI deployment and usage.

(i) Effect on PPI issuers: PPI issuers with such interoperability will get better access to payment infrastructure and shall reduce the dependency on banks for assessment/settlement, etc. Further, interchange of UPI and prepaid cards may also aid in generating additional revenues;

(ii) Effect on merchants: Such interoperability is likely to help the merchants as well, as their customers using any PPIs will be able to make payments at merchants

acquired by another PPI issuer/bank and the merchant would not need to sign up with multiple PPI issuers to accept payments.

(iii) Effect on customers: Interoperability has been made mandatory keeping the best interest of customers in mind, as they would be: (a) able to transfer funds from one wallet to another and bank accounts, (b) able to make payments across the merchant network of any other bank/PPI issuer that embraces interoperability, (c) able to directly access the payment ecosystem without opening a bank account, and (d) equipped to also withdraw from full-KYC PPIs of non-bank PPI issuers.

Effect on Digital Payments and Greater Financial Inclusion:

Shri Shantikanta Das, the Governor of RBI, in his speech on July 15, 2021, acknowledged the fact that pandemic has accelerated the push towards digitalisation with greater adoption of digital payments. Further, India is among the leaders in the world with regard to development of state-of-the-art payment infrastructure and products leading to a wider adoption of digital payments. To give an example, the number of PPI increased at a compounded annual growth rate (CAGR) of 53 per cent from 41 crore in May 2017 to 226 crore in May 2021. The trends indicate that such instruments have become immensely popular for making small value payments.

The regulator's revised directions for PPIs may be considered as a step towards making them a crucial part of the financial services industry, on par with banks. Additionally, these directions will help in making the economy more financially inclusive. The efforts of the PPI industry towards building a reliable, secure and robust payments system have increased the confidence of the regulator and other stakeholders in the industry's ability to play a larger role in the financial services ecosystem. Interoperability is likely to transform the overall payments ecosystem in the near future, leading to the following changes: (a) provide easy access to payment products such as UPI and cards to unbanked and under-banked populations; (b) likely to increase financial inclusion and digital payment adoption across the country; (c) with UPI 2.0 already live, P2M transactions are likely to increase as PPI players have already acquired many merchants in tier 2–3 cities; and (d) the overall payments ecosystem will become more competitive, creating a level playing field for the PPI players.

Conclusion:

In an era where businesses have failed due to the unforeseen/ unexpected circumstances, the RBI, through its PPI Circular, has provided the perfect lifeline to the PPIs. Basis the relaxations furnished in the Circular, revival of the PPI industry seems viable than ever before. However, such an anticipation would be subject to effective implementation of the interoperability proposed.

Evolving Payment System Operators' Regulatory Regime

Introduction:

The RBI appears to be tightening its regulatory regime in preparation of the impending deadline for seeking authorisation as payment aggregators, a new developing sub-category of payment system operators ("**PSO**"). Industry members envisage nearly 200-300 odd applications from potential payment aggregators, and with this application stack building up for regulatory review, the RBI is (rightly) driven to tighten loose ends in its regulatory framework.

Taking inspiration (and the fundamental construct) adopted by the RBI in the NBFC framework, it has recently rolled out two key circulars as discussed below:

Investment in PSOs from FATF Non-compliant Jurisdictions:

On June 14, 2021, the RBI issued a notification on 'Investment in Entities from FATF Non-compliant Jurisdictions' and addressed it to all authorised PSOs. As per the directive, investments in PSOs from FATF non-compliant jurisdictions will not be treated at par with those from compliant jurisdictions.

Investors in existing PSOs holding investments prior to the classification of the source or intermediate jurisdiction as FATF non-compliant, are allowed to continue with the investments or bring in additional investments provided they are made with an objective of supporting continuity of business in India. While the ambit of 'supporting continuity of business' is itself vague at this stage, the RBI may consider this on a case-to-case basis, as long as the additional investment is triggered by a justifiable business rationale.

Separately, new investors (from or through FATF non-compliant jurisdictions) have been expressly prohibited from acquiring 'significant influence' in the PSOs (whether existing or seeking authorisation). While the RBI has indicated that the term 'significant influence' has to be defined as per the applicable accounting standards, RBI has also incorporated an additional statement for the sake of clarity – wherein it states that fresh investments from non-compliant FATF jurisdictions, in aggregate, should account for less than twenty per cent of the voting power (including potential voting power arising from convertibles and other contingent voting arrangements) of the PSO.

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However, this clarificatory statement only results in further ambiguity on account of its inconsistency with the accounting standards (which include other indicators such as board representation, participation in policymaking, and material transactions within 'significant influence')

While this regulatory requirement has been put together in consonance with the NBFC framework, we believe the few grey areas flagged above will help create further diverse investment models.

Framework for Outsourcing of Payment and Settlement Related Activities by PSOs:

On August 3, 2021, the RBI announced a framework for the PSOs with respect to outsourcing of payment and settlement activities to other third-party entities (whether within the same group or otherwise). Ancillary functions such as house-keeping or internal administration are kept outside the ambit of this framework.

As part of this stipulation, PSOs are restricted from outsourcing core management functions including risk management and internal audit; compliance and decision-making functions such as determining compliance with KYC norms, amongst others, related to payment and settlement functions. The PSOs have been accorded time until March 31, 2022 to align their operations with the guidelines prescribed by the RBI.

Key activities that existing and proposed PSOs have to implement at the earliest include:

(i) adopting an internal policy describing the criteria for selection of activities permissible to be outsourced and the service providers, and systems to monitor and review such activities;

(ii) aligning (through revised negotiations or amendments) contractual agreements with outsourced service providers to ensure that the PSO retains control over the outsourced activity, has the right to intervene to ensure compliance with its regulatory obligations, has access to all books and records and conduct an annual audit;

(iii) ensuring security and confidentiality of customer information, where staff members of the service provider have access on a need-to-know basis only, and the offshore regulator does not have access to Indian payments data simply on account of the service provider being located in that jurisdiction.

While the assessment of criticality of processes to be outsourced lie with the PSO, the extent of service and nature of role outsourced to the third party will have to be balanced carefully by the PSO to ensure that it does not trip the comprehensive standards prescribed by the RBI, in terms of retaining control and ensuring ultimate decision-making continues to vest in the PSO itself.

Conclusion:

While every regulatory step introduced by the RBI works towards strengthening the framework for a customer-friendly and secure environment, the PSOs will have to now internally engage in re-evaluating their operational and business strategy, from a costs, compliance, capital and investor growth standpoint.

Digital KYC: Amendment to KYC Master Directions

Introduction:

In furtherance of the amendments introduced to the Prevention of Money Laundering (Maintenance of Records) Rules, 2005 by notification dated February 13, 2019 and the Prevention of Money Laundering Act, 2002 by the Aadhaar and Other Laws (Amendment) Ordinance, 2019, the RBI vide a notification dated May 29, 2019 ("**Notification 2019**") amended the Master Direction - Know Your Customer ("**KYC**") Directions, 2016 ("**KYC Master Direction**").

In light of the impact of COVID-19 pandemic on the economy, the RBI Governor, on May 5, 2021, announced several measures with a view to infuse liquidity in the economy, avoid another wave of borrower default and facilitate the ease of doing business during the lockdown. One of these measures was to simplify the KYC process which is the initial step of any lending transaction.

The RBI amended the Master Direction on KYC dated May 10, 2021, amending its master directions on KYC norms to further leverage the video-based customer identification process ("**V-CIP**"), while simplifying the process of periodic updation for bank customers.

Amended scope of V-CIP:

The RBI, *vide* this amendment, revised the definition of V-CIP. Accordingly, V-CIP is an alternate method of customer identification with facial recognition and customer due diligence ("**CDD**") by an authorised official of the regulated entity by undertaking seamless, secure, live, informed-consent based audio-visual interaction with the customer to obtain identification information required for CDD processes, and to ascertain the veracity of the information furnished by the customer through independent verification and maintaining audit trail of the process.

Accounts opened using a one-time password ("**OTP**") based e-KYC, in a non-face-to-face mode, may only be used for a year unless the more stringent KYC process is followed. Keeping this in mind, the REs are required to utilise V-CIP to onboard new customers, convert Aadhar OTP e-KYC based accounts and update existing customer details.

The minimum standards required for carrying out KYC through the V-CIP process have been divided into three aspects: V-CIP Infrastructure, V-CIP Procedure and V-CIP Records and Data Management.

V-CIP Infrastructure: The REs are required to comply with the RBI guidelines on minimum baseline cyber security and resilience framework for banks as well as other general guidelines on IT risks.

V-CIP Procedure: Each RE is required to formulate and follow a clear workflow and standard operating procedure for V-CIP, which must be operated only by officials of the RE specially trained for this purpose. The amendment adds the requirement to preserve an activity log along with the credentials of the official.

V-CIP Records and Data Management: The entire data and recordings of V-CIP are required to be stored in India, with data safety and integrity ensured.

Periodic Updation of KYC:

As global capital markets are witnessing burgeoning Previously, for the period for updating KYC followed a risk-based classification. The amendment changes the previous categorisation to separate processes and periods for individual customers and legal entities.

For individual customers, a self-declaration form has to be obtained if KYC information remains unchanged. REs may choose to collect officially valid documents ("**OVDs**") to update customer addresses in the periodic process. However, this is required to be specified in their board-approved internal KYC policy.

The amendment also clears ambiguity with respect to e-documents as proof. Though an amendment in January 2020 had allowed e-documents to be submitted as proof

for Aadhar OTP based V-CIP, it restricted it to documents issued by the authority itself or those submitted on Digilocker. This announcement clarifies that for other purposes, OVDs whose equivalent e-documents are not available, will require the REs to depend on other modes of KYC.

Additional Measures:

(i) REs are now required to ensure that the KYC documents of the customer as per the current CDD standards are available with them, even if there is no change in customer information. For documents with expired validity, the same process as on-boarding a new customer is to be followed.

(ii) The information/documents obtained from the customers at the time of periodic updation of KYC are to be promptly updated in the RE's database, with an intimation to the customer about the same.

(iii) The REs are required to adopt a risk-based approach with respect to periodic updation of KYC. Any additional and exceptional measures, which otherwise are not mandated under the above instructions, adopted by the REs shall be clearly specified in the internal KYC policy duly approved by the Board of Directors of REs or any committee of the Board to which power has been delegated.

Conclusion:

Dealing with the Coronavirus pandemic is the need of the hour and as a result, the government and allied organisations are trying to complete all the essential operations using the digital model and is attempting to make the country and the economy more technology driven. Presently, a large part of the Indian population has no access to financing and banking facilities due to lack of knowledge and awareness about the digital accessibility to financial services. The RBI Governor's statement as well as the government and its agencies' keen interest in promoting technology has been a push in the right direction for creating a more digitised economy and financial services.

Neo-Banking in India

Introduction:

In recent years, digitisation and the growing use of mobile technology has led to a seismic shift in the banking and payments industry, not only in India but throughout the world. 'Neo-banks', which exist on the cloud and have no physical branches, are new entrants in the expanding digital payments space.

Regulatory Regime:

On November 3, 2021, NITI Aayog released a discussion paper titled 'Digital Banks: A Proposal for Licensing & Regulatory Regime for India'. The discussion paper recommends regulatory innovations such as a digital bank licence that holds the promise of mitigating the challenges of financial deepening. The discussion paper highlights challenges presented by the partnership model of neo-banking that has emerged in India as a function of regulatory vacuum and in the absence of a Digital Bank licence. The discussion paper recommends a two-stage approach with a digital business bank licence to begin with, followed by a digital (universal) bank licence after policymakers and regulators have gained experience from the former.

In the Indian context, 'neo-banks', despite their nomenclature, are not directly regulated by India's banking regulator, the RBI, since RBI does not grant licences for operating virtual banks. However, it permits conventional banks to outsource certain functions under the Guidelines on 'Managing Risks and Code of Conduct in Outsourcing of Financial Services by banks' Banks' dated November 3, 2006 ("**Outsourcing Guidelines**").

Indian 'neo-banks' typically enter into outsourcing arrangements with conventional banks to provide a host of products and services including a digital platform for accessing banking services, co-branded cards, and payment solutions. Since banks are not allowed to outsource core management functions (such as internal audit, compliance function and decision-making functions like determining compliance with KYC norms, sanctioning loans, and management of investment portfolio), Indian 'neo-banks' are restricted from offering key banking services (unlike their global counterparts).

Similar to the Outsourcing Guidelines, the recently promulgated RBI Circular on outsourcing for co-operative banks has also limited the ability of co-operative banks to partner with neo-banks to serve the unbanked or under banked sectors by restricting outsourcing of core management functions.

While the outsourcing obligations will be governed by the contract, the ultimate responsibility for ensuring compliance with applicable law vests with the banks. Accordingly, we might see banks contractually push down compliance with the newly introduced 'Master Direction on Digital Payment Security Controls' (including PCI-DSS and PA-DSS certifications) on 'neo-banks', who must also comply with extant data protection regulations in their capacity of being an 'intermediary' under the Information Technology Act, 2000.

Product Offerings:

'Neo-banks' are targeting both retail and business users and help them in opening 'digital' savings/ current bank accounts. RBI's recent amendments to its KYC directive will provide impetus to 'neo-banks' to develop entirely virtual customer onboarding process. 'Neo-banks' also facilitate money transfer using existing payment rails and support international payments. Business neo-banking platforms also provide automated solutions for book-keeping and payment reconciliation.

'Neo-banks' may support their customers in availing credit lines and often act as Direct Selling Agents ("**DSA**") for financial institutions. As DSAs, 'neo-banks' are akin to independent marketing agents facilitating generation of leads and connecting such leads with the financial institutions.

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'Neo-banks' also typically offer co-branded credit, debit and prepaid cards in partnership with banks. As banks must ensure compliance with Outsourcing Guidelines while entering into co-branding arrangements, role of 'neo-banks' is limited to marketing/ distribution of such cards. Credit cards cater to the working capital requirements of small and medium enterprises who would have to otherwise follow cumbersome procedures to avail loans from conventional banks.

Challenges for Indian 'neo-banks':

(i) Regulatory ambiguity: The RBI does not recognise entirely virtual banks and accordingly does not regulate 'neo-banks'.

Some 'neo-banks' choose to act as Business Correspondents ("**BC**") of conventional banks. Interestingly, BCs are typically viewed as entities furthering financial inclusion in remote areas and often through face-to-face interaction with customers. Additionally, to act as BCs, companies are expected to have large and widespread retail outlets!

(ii) Technology and Security: Conventional banks would expect infrastructure and security practices of 'neo-banks' to comply with internationally accepted standards before partnering with them. For instance, the RBI has now laid down minimum standards to carry on a video KYC verification. 'Neo-banks' would have to upgrade their systems and processes to not only expand the suite of products offered but to continue offering certain services.

(iii) Data Privacy: Ensuring data privacy is the cornerstone of any successful digital offering. Given the low charges for traditional product offerings, 'neo-banks' would depend on customer data and the ability to cross-sell products to stay afloat. Such ability may be affected with the passing of the Personal Data Protection Bill, India's GDPR equivalent.

Future of Indian 'neo-banks':

In 2014, the RBI introduced 'payments banks' to further financial inclusion through a "secured technology-driven environment" by providing (a) small savings accounts, and (b) payments/remittance services to underbanked segment of the Indian population. Even then, the RBI clarified that it does not envisage payments banks to be virtual banks or branchless banks.

Jurisdictions such as Singapore and Taiwan have already made headway in creating framework for virtual banks. Payments ecosystem is undergoing an overhaul globally, and 'neo-banks' can play a pivotal role in furthering financial inclusion and expanding credit access to unbanked and underbanked segments.

The RBI has already recognised the need for niche banking in India. Given the onslaught of COVID-19 pandemic, the RBI should consider fully embracing a virtual/ branchless banking model and directly regulating the upcoming 'neo-banks'. Direct regulation would enable provision of a wider range of banking services, and also subject such services to appropriate checks and balances with RBI's regulatory oversight.

Dividend Declaration by Non-Banking Financial Companies (NBFCs)

Introduction:

The RBI prescribed guidelines on declaration of dividends by NBFCs through its Circular on 'Declaration of Dividends by NBFCs' dated June 24, 2021 ("**Dividend Circular**") to promote transparency. The Dividend Circular applies to declaration of dividends by all NBFCs regulated by the RBI from financial year ("**FY**") 2021-22 onwards.

Oversight of the Board of Directors:

In addition to ensuring that the quantum of dividend is paid in accordance with the Dividend Circular, the board of directors of an NBFC is required to consider the following while evaluating dividend declaration:

(i) the supervisory findings of the regulator on divergence in classifying and provisioning for Non-Performing Assets ("**NPAs**");

(ii) qualifications in the Auditors' Report (if any); and

(iii) the long-term growth plans of the NBFC.

Eligibility Criteria:

The Circular lists the following minimum prudential norms for the NBFCs to declare a dividend:

Capital Adequacy:

(i) The NBFCs, except Standalone Primary Dealers ("**SPDs**"), should meet the applicable regulatory capital requirement (i.e. in relation to leverage ratio, capital adequacy ratio, Tier I/ II Capital, etc.) for the three preceding FYs, including the FY for which the dividend is proposed.

(ii) SPDs should have a minimum Capital to Risk-Weighted Assets Ratio ("**CRAR**") of 20% in all four quarters of the FY for which the dividend is proposed.

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Other Criteria:

(i) Net NPA ratio should be below 6% in the preceding three FYs, including the FY for which dividend is proposed to be declared.

(ii) The NBFCs should comply with the provision for creation of/transfer of profits to 'reserve fund'.

(iii) The NBFCs should not be explicitly restricted from declaring dividends by the regulator.

(iv) The NBFCs should comply with the extant regulatory framework.

Quantum of Dividend Payable:

The Circular prescribes conditions with respect to the quantum of dividend payable by an NBFC, in terms of the maximum Dividend Payout Ratio ("**DPR**"). A DPR is the ratio of the proposed dividend (on equity shares and compulsorily convertible preference shares) to the net profit for that FY (excluding any exceptional or extra-ordinary profits/income).

Maximum DPR:

(i) Core Investment Companies ("**CIC**") and SPDs can have a DPR of up to 60%;

(ii) No maximum DPR has been prescribed in respect of the NBFCs that do not accept public funds and do not have any customer interface;

(iii) Other NBFCs can have a DPR of up to 50%.

Failure to meet Eligibility Criteria:

An NBFC, except SPD, which does not meet the minimum prudential norms listed above for each of the last three FYs may declare a dividend (capped at 10% DPR) if it:

(i) meets the applicable capital adequacy requirement in the FY for which dividend is proposed; and

(ii) has a net NPA ratio of less than 4% in the FY for which divided is proposed.

If an SPD has a CRAR of 15–20% during each of the four quarters of the previous financial year, then it may declare dividends (capped at 33.3% DPR), subject to compliance with the relevant Master Direction issued by the RBI.

Reporting System:

Deposit taking NFBCs, non-deposit taking and systemically important NBFCs, Housing Finance Companies and CICs are required to report details of dividends declared during the FY within a fortnight, in the prescribed format.

Conclusion:

Until the introduction of the Circular, there were no guidelines in place with regard to distribution of dividends by NBFCs. Given the increasing significance of NBFCs in the financial system and their interlinkages with different segments, the RBI has formulated these guidelines on dividend distribution by NBFCs to promote uniformity in practice.

Customer Due Diligence for transactions in Virtual Currencies

Introduction:

On April 6, 2018, the RBI issued a circular on the 'Prohibition on dealing in Virtual Currencies ("**Vcs**")' ("**2018 Circular**"). In it, the RBI prohibited all regulated entities to deal in virtual currencies ("**VCs**") or provide services to facilitate any person or entity dealing with or settling VCs, with a three-month period of exit for those entities already providing such services. The 2018 Circular was set aside with the judgment of the Hon'ble Supreme Court of India in *Internet and Mobile Association of India v. RBI* (Writ Petition No. 528 of 2018) ("**IMAI Judgment**"), as being disproportionate.

Therefore, the prohibition was no longer valid from the date of the IMAI judgment, i.e. March 04, 2020. Banks and other regulated entities were free to continue providing services related to VCs. With this in mind, on May 31, 2021, the RBI issued a circular on 'Customer Due Diligence for transactions in VCs' ("**2021 Circular**"), noting media reports that suggested certain banks and other entities have been cautioning their customers against dealing in VCs, by making a reference to the 2018 Circular. The 2021 Circular explicitly states that such references to the 2018 Circular are incorrect due to the IMAI Judgment setting it aside. Additionally, the 2021 Circular also states that banks and other entities transacting with customers should carry customer due diligence processes, in line with the following regulations:

(i) Regulations governing standards for KYC;

(ii) Regulations governing standards for Anti-Money Laundering ("**AML**");

(iii) Regulations governing standards for Combating of Financing of Terrorism ("**CFT**");

(iv) Obligations under the Prevention of Money Laundering Act, 2002 ("**PMLA**"); and

(v) Obligations under the Foreign Exchange Management Act, 1999 ("**FEMA**") for overseas remittances.

Reversal of *Status Quo Ante*:

Recent reports had suggested that banks were refusing to transact with crypto-exchanges and other entities involved in the VC industry out of concerns over the likelihood of regulators continuing their reservations on private cryptocurrencies. The 2021 Circular should directly address these concerns and generate confidence in the banks to

resume transactions, as it explicitly notes that IMAI Judgment has rendered the prohibition in the 2018 Circular invalid.

Indicating Intent to Regulate:

With this circular, the RBI may be signaling its intent towards regulating private cryptocurrencies in the country, as opposed to a ban. This intent could be in line with the eventual approach taken by the legislature, which is uncertain at the moment. The Banning of Cryptocurrency and Regulation of Official Digital Currency Bill, 2019, ("**2019 Bill**"), which intended to ban cryptocurrencies in India has been replaced by The Cryptocurrency and Regulation of Official Digital Currency Bill, 2021 ("**2021 Bill**"). The text of the 2021 Bill is not publicly available; however, notably, its title has dropped the words "Banning of". It must be noted, however, that the Lok Sabha Bulletin lists the purport of the 2021 Bill to include: (i) the creation of an official digital currency to be issued by the RBI, (ii) the prohibition of all private cryptocurrencies in India and (iii) the creation of exceptions to promote the underlying technology of cryptocurrency and its uses.

The 2021 Circular also requires banks and other regulated entities to ensure compliance with KYC, AML and CFT standards, in addition to ensuring compliance with PMLA, 2002 and FEMA, 1999 wherever required. This may be viewed as a move by the RBI to introduce regulations that banks and other regulated entities can enforce for customers dealing in VCs, which was previously unregulated.

Conclusion:

Given the reports suggesting that banks and other regulated entities were refusing to transact with customers dealing in VCs based on the 2018 Circular, which has been set aside by the IMAI Judgment, the 2021 Circular is a logical step by the RBI to bring clarity for companies transacting in VCs. Additionally, the 2021 Circular may be considered as a signal from the RBI to regulate VCs rather than prohibit their transactions entirely, by requiring banks to comply with KYC, AML and CFT standards.

SEBI Circular on Mandatory Applicability of Electronic Book Provider Platform

Introduction:

SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 ("**ICDR Regulations**"), *inter alia* governs the issuance of non-convertible debt instruments ("**NCDs**") and warrants through qualified institutional placement (QIPs) for subscription by an investor in two ways: (a) NCDs and warrants being offered as attached to each other or in a combined manner; or (b) each of NCDs and warrants being offered separately.

The securities market regulator of India, Securities and Exchange Board of India ("**SEBI**") has recently repealed the SEBI (Issue and Listing of Debt Securities) Regulations, 2008 (SEBI ILDS Regulations, 2008) and SEBI (Issue and Listing of Non-Convertible Redeemable Preference Shares) Regulations, 2013 (SEBI NCRPS Regulations, 2013) and merged them into a consolidated framework of SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021 ("**SEBI NCS Regulations**").[1] The SEBI NCS Regulations provides for the issue and listing of non-convertible securities, on a recognised stock exchange and provides for Electronic Book Provider Platform ("**EBP**"). EBP is a platform for private placement of non-convertible securities provided by a recognised stock exchange(s) or a recognised depository (pursuant to obtaining approval from SEBI) for facilitating efficient and transparent price discovery mechanism.

In a recent change, basis the feedback received by SEBI on the consultation paper regarding 'NCDs with warrants' as a product and applicability of EBP on the 'NCDs portion' of the same, SEBI has issued a circular on August 13, 2021 making EBP "mandatory" for 'NCDs portion' of the issue (for both stapled and segregated offer) ("**Circular**").[2] As set out in the Circular, this decision has been taken to streamline the procedure of issuance and applicability of EBP on the 'NCDs portion' of the issue. The Circular further clarifies that the issuer will be required to comply with the provisions of SEBI NCS Regulations and circulars issued

1 Vide notification no. SEBI/LAD-NRO/GN/2021/39 dated August 09, 2021, Available at: https://www.sebi.gov.in/legal/regulations/aug-2021/securities-and-exchange-board-of-india-issue-and-listing-of-non-convertible-securities-regulations-2021_51764.html

2 Vide circular No. SEBI/HO/CFD/DIL/CIR/P/2021/614, Available at: https://www.sebi.gov.in/legal/circulars/aug-2021/guidelines-on-issuance-of-non-convertible-debt-instruments-along-with-warrants-ncds-with-warrants-in-terms-of-chapter-vi-qualified-institutions-placement-of-sebi-issue-of-capital-and-disclosure-_51827.html

thereunder in relation to the non-convertible debt securities, whereas, warrants shall continue to be governed under the ICDR Regulations.

On a combined reading of point 5 and 6 of the Circular, it is pertinent to note the Circular shall be applicable to all issues of 'NCDs with warrants' under the ICDR Regulations on or after the date of Circular i.e. August 13, 2021. Additionally, the mandatory requirement of EBP for 'NCDs portion' shall be appliable for issues wherein the size of 'NCDs portion' is above the threshold specified under SEBI NCS Regulations and the circulars thereunder.

The threshold specified under consolidated operating circular (effective from August 16, 2021)[3] ("**SEBI NCS Circular**") issued pursuant to SEBI NCS Regulations for issuance of securities through EBP is as follows:

(a) A private placement of debt securities and NCRPS as per the provisions of SEBI NCS Regulations, 2021, if it is:

    (i) a single issue, inclusive of green shoe option, if any, of INR 100 crore or more;

    (ii) a shelf issue, consisting of multiple tranches, which cumulatively amounts to INR 100 crore or more, in a financial year; and

    (iii) a subsequent issue, where aggregate of all previous issues by an issuer in a financial year equals or exceeds INR 100 crore.

(b) The issuance of debt securities and NCRPS on private placement basis, irrespective of issue size, by issuers who are in existence for less than three years, in accordance with Clause 2.3.8 c. of Schedule II to the SEBI NCS Regulations.

(c) The issuance of PDIs, PNCPS, PCPS, RNCPS, and instruments of similar nature which are essentially non-equity regulatory instruments, forming part of a bank's or NBFC's capital, issued as per RBI stipulations and listed under Chapter V of the SEBI NCS Regulations, 2021, irrespective of the issue size.

Chapter VI of the SEBI NCS Circular also provides for detailed compliance requirements for all stakeholders who wish to deal on the EBP inter alia related to eligible participants (i.e. bidders), obligations of the issuers and book providers, bidding process, requirement of escrow bank account, KYC compliance etc. It would be important for the relevant stakeholders to be aware of what these compliances are and ensure that the same are duly followed.

Further, the Circular also provides that of the 'total issue size' i.e. combined size of NCDs and the aggregate size of the warrants, including their conversion price, at least 40% shall consist of the 'warrants' portion. Additionally, it has also been clarified that each of the segregated offer or stapled offer of NCDs along with the warrants shall be exempted from the requirements as prescribed under the Regulations 175(3), 179(2) (a), 180(1), and 180(2) of the ICDR Regulations.

3 Vide circular no. SEBI/HO/DDHS/P/CIR/2021/613 dated August 10, 2021, Available at: https://www.sebi.gov.in/legal/circulars/aug-2021/operational-circular-for-issue-and-listing-of-non-convertible-securities-ncs-securitised-debt-instruments-sdi-security-receipts-sr-municipal-debt-securities-and-commercial-paper-cp-_51761.html

Ahead of the Curve
Recent Regulatory Updates

Introduction:

(i) RBI Extends Timeline for Entities to Purge Card Data:

Through a circular dated December 23, 2021, the RBI extended the timeline for compliance with its September 7, 2021 circular, which stated that *"no entity in the card transaction / payment chain, other than the card issuers and / or card networks, shall store the actual card data. Any such data stored previously shall be purged."* The timeline to purge card data has been extended by six months, i.e., till June 30, 2022.

Further, in addition to tokenisation, the RBI suggested industry stakeholders to develop alternate mechanisms to handle various use-cases (such as recurring transactions) and post-transaction activity (such as chargebacks and dispute resolution), which currently require storage of actual card data by entities.

CAM Thought: The extension is well-timed by the regulator, given the industry's requirements to ensure compliance with the September 7, 2021 circular, and the lack of industry consensus on the treatment of specific use-cases and certain types of transactions.

(ii) RBI Creates Integrated Ombudsman Scheme:

On November 12, 2021, the RBI integrated existing Ombudsman schemes of RBI namely, (i) the Banking Ombudsman Scheme, 2006; (ii) the Ombudsman Scheme for Non-Banking Financial Companies, 2018; and (iii) the Ombudsman Scheme for Digital Transactions, 2019 into the 'Integrated Ombudsman Scheme'.[4] The scheme also includes under its ambit non-scheduled primary co-operative banks with a deposit size of INR 50 crore and above. The scheme adopts a 'one nation one ombudsman' approach by making the RBI ombudsman mechanism jurisdiction neutral.

Non-scheduled primary co-operative banks with deposits of at least INR 50 crore will be covered under the scheme. The scheme allows any consumer who has been aggrieved by a deficiency in service delivery by regulated firms (such as banks and non-banking financial companies) to register a complaint. For any loss suffered by the complainant, the ombudsman will have the authority to award compensation of up to INR 20 lakh. It may also award further compensation of up to INR 1 lakh for the complainant's lost time and expenses.

CAM Thought: The harmonisation of the ombudsman schemes of the RBI into an integrated scheme may prove to be an important step in efficiently and cost-effectively resolving customer grievances.

(iii) Enabling Small Value Transactions: (a) RBI's new framework for facilitating small value digital payments in offline mode and (b) New Aadhar (authentication and offline verification) regulations, 2021

The RBI issued a notification titled 'Framework for Facilitating Small Value Digital Payments in Offline Mode' dated January 3, 2022. This was an attempt to encourage technological innovations that enable small value digital transactions in offline mode. An offline payment means a transaction which does not require internet or telecom connectivity to take effect. The framework enables Authorised Payment System Operators (PSOs) and Payment System Participants (PSPs) – Acquirers and Issuers (banks and non-banks) to undertake these transactions, while complying with several requirements such as (i) offering a mode of offline payments through any channel or instrument like cards, wallets, mobile devices, etc.; (ii) allowing offline payments in proximity (face-to-face) mode only; (iii) offering offline payment transactions without Additional Factor of Authentication.

4 https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=52549

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The Unique Identification Authority of India ("**UIDAI**") released the Aadhaar (Authentication and Offline Verification) Regulations, 2021 on November 8, 2021. The regulations enable offline Aadhar verification for e-KYC process by sharing a digitally signed document generated by UIDAI which will contain only the last four digits of the Aadhar number. The offline verification mechanisms include (i) QR code verification; (ii) Aadhaar paperless offline e-KYC verification; (iii) e-Aadhaar verification; (iv) offline paper based verification, and (v) any other type of offline verification introduced by the UIDAI periodically.

CAM Thought: Such a move by RBI will further catalyse the growth the digital transactions and aid in digital economy even in the remote corners of the country.

(iv) Eligibility Criteria for Entities to be Categorised as a 'Specified User' under the Credit Information Companies (Amendment) Regulations, 2021 to Allow all Entities Including NBFCs and Banks to Reach Out to Credit Bureaus:

The RBI issued a Press Release dated January 5, 2022 on 'Eligibility criteria for entities to be categorised as Specified User under clause (j) of Regulation 3 of the Credit Information Companies (Amendment) Regulations, 2021'. The eligibility criteria includes: (i) the entity shall be a company incorporated in India or a Statutory Corporation established in India; (ii) the governing statute of the Statutory Corporation or Memorandum of Association of the Company, as the case may be, should allow the business/activity of processing of information for the support or benefit of credit institutions; (iii) in the case of a company, it should have a networth of not less than INR 2 crore as per the latest audited balance sheet, and shall meet the requirement on a continuing basis; (iv) in case of a company, it shall be owned and controlled by resident Indian citizens/Indian company owned and controlled by resident Indian citizens; (v) the ownership of the company shall be well diversified; (vi) in the case of a company, it shall have not less than three (3) years of experience in running the business/activity of processing information for the support or benefit of credit institutions and shall have a clean track record; (vii) neither the company, nor its promoter(s) or any director(s) should have at any time in the past been convicted of any offence involving moral turpitude or any economic offence; (viii) the entity should have a certification from CISA certified auditor that it has a robust and secure Information Technology system in place for preserving and protecting the data relating to the credit information as per the provision of the Credit Information Companies (Regulation) Act, 2005 and Rules and Regulations framed thereunder, and any other applicable Regulations, Guidelines in this regard.

CAM Thought: This move would allow the accessibility of the FinTech companies to the credit information companies, which was erstwhile restricted to only a particular category of companies as listed in the Credit Information Companies Regulations, 2006.

(v) SEBI Contemplates Responsible Investment Policies for Mutual Fund Schemes:

SEBI released a consultation paper on disclosure norms for environment, social and governance based ("**ESG**") mutual fund schemes on October 26, 2021.[5] SEBI stated, while all mutual fund schemes are subject to disclosure norms, disclosures in case of ESG schemes gain further significance.

Disclosures of the name of the scheme, investment objectives and policy, disclosure of material risk, asset allocation, benchmark, disclosure etc. are proposed to be mandated for disclosure in the Scheme Information Documents ("**SIDs**") for mutual funds which launch ESG schemes. AMCs are also required to undertake periodic monitor and evaluate the investments in terms of key performance indicators, real world outcomes, active engagement and stewardship activities with investee companies and ESG policy related to investments among other requirements.

5 https://www.sebi.gov.in/reports-and-statistics/reports/oct-2021/consultation-paper-on-introducing-disclosure-norms-for-esg-mutual-fund-schemes_53500.html

SEBI has proposed that AMCs, under the responsible investment policy commencing October 1, 2022, invest only in securities that have Business Responsibility and Sustainability Report ("**BRSR**") disclosures, while the existing investments in schemes without BRSR disclosures remain exempted until September 30, 2023. BRSR disclosures reveal a company's commitment to ESG factors.

CAM Thought: Through this consultation paper, SEBI is pushing the goal of sustainable and responsible investment and building on its previous steps such as BRSR disclosures.

(vi) RBI Revises Regulatory Framework for NBFCs to a Scale Based Regulation ("SBR"):

Through a press release dated October 22, 2021,[6] the RBI announced the SBR framework that encompasses different facets of regulation for NBFCs covering capital requirements, governance standards, prudential regulation, etc. the framework provides for four Scale-based classification of the NBFCs, which are classified as Base Layer, Middle Layer, Upper Layer and Top Layer on the basis of their size, activity and perceived risks.

The RBI mandates NBFCs to maintain a minimum net owned funds (NOF), which includes equity capital and reserves. This limit shall be kept at INR 2 crore for NBFCs registered as investment and credit companies, and INR 5 crore for NBFCs registered as micro finance institutions and factors (involved in bill discounting). The regulatory minimum NOF for NBFCs registered as investment and credit companies, micro finance institutions, and factors (involved in bill discounting) has been raised to INR 10 crore under the amended framework. This new limit will be phased in over time. The guidelines shall be effective from October 1, 2022.

CAM Thought: With a few prominent lenders going bust in recent years, the non-banking finance sector's reputation has taken a hit. The RBI regulations attempt to restore trust in the industry by ensuring that only a few entities or activities create vulnerabilities that lead to systemic risk.

(vii) The RBI extends scope of permitted devices for card tokenisation and permits card-on-file tokenisation ("CoFT") services:

On September 07, 2021, the RBI permitted CoFT services, recognising the convenience provided by card on file transaction for consumers.[7] On March 31, 2021, the RBI had prohibited the storage of customer card credentials for payment aggregators and merchants, also known as card-on-file.

However, recognising the security of tokenised card transactions, as well as the consumer convenience of card-on-file transactions, the RBI has now extended the tokenisation framework to include CoFT, and permitted card issuers are permitted to offer card tokenisation services as token service providers, only for the cards issued by or affiliated with them.

No entity in the payment chain may store actual card data with effect from January 01, 2022, other than card issuers and authorized card networks. Previously stored data is required to be purged by this deadline. However, RBI owing to demands from various industry players on December 23, 2021 extended the said timeline to June 30, 2022. Further, the RBI has advised that in addition to tokenisation, stakeholders may devise alternate mechanisms to handle any use case (including recurring e- mandates, EMI option, etc.) or post-transaction activity (such as chargeback handling/ dispute resolution/ reward/ loyalty programme, etc.) that currently involves / requires storage of card on file data.

6 https://rbi.org.in/Scripts/NotificationUser.aspx?Id=12179&Mode=0
7 https://www.rbi.org.in/Scripts/BS_CircularIndexDisplay.aspx?Id=12159

Additionally, through a notification dated August 25, 2021, the RBI extended card tokenisation for devices beyond mobile phones and tablets.[8] Earlier, authorised card networks were permitted to provide card tokenisation services for transactions of interested card holders only on these devices.

However, noticing an uptick in tokenised card transactions, the RBI has broadened the scope of permitted devices to include consumer devices such as laptops, desktops, wearables (including watches) and internet-of-things devices.

CAM Thought: The RBI's decisions to permit card tokenisation beyond mobile phones and tablets and permitted CoFT services reflect market changes and may prove to be a boost to make card transactions more secure and convenient for consumers.

(viii) SEBI decides to develop blockchain-based platform for security and covenant monitoring

SEBI, through a circular dated August 13, 2021, has mandated the development of a security and covenant monitoring system, based on distributed ledger technology, to be hosted by depositories. This platform will be utilised, inter alia, to monitor the process of security creation, asset cover and covenants (including due diligence and creation of charge), for continuous monitoring of covenants by debenture trustees, interest and redemption payments, and credit rating information.

The platform is slated to come into effect on April 01, 2022. However, to ensure smooth functioning, SEBI has decided to begin testing the platform beginning January 01, 2022. Depositories have been advised by SEBI to formulate operational guidelines after consultation with relevant stakeholders.

CAM Thought: SEBI's decision to develop a platform based on distributed ledger technology represents a key driver in the adoption of Regtech (regulatory technology) in India. In the future, India may witness an uptick in the adoption of technology-based solutions for regulatory compliance requirements.

(ix) SEBI Changes Minimum Investment Requirements in MF schemes by AMCs and Modifies Current Bank Account Management:

On August 05, 2021, SEBI notified a change in its mutual fund regulations, which alters the minimum investment amount in mutual fund schemes by asset management companies.[9] Currently, the minimum investment amount is the lower of 1% of the amount raised in the new fund offer and INR 50,00,000. However, effective 270 days from August 5, 2021, the minimum investment amount will be based on the risk associated with each scheme.

SEBI also announced changes in the requirements of mutual funds to maintain current accounts on August 04, 2021.[10] Prior to this announcement, mutual funds maintained current accounts in multiple bank accounts, beyond those in the top 30 cities, to facilitate receiving subscription amounts and payment of redemption proceeds, dividends, brokerage and commissions.

The mutual fund industry had made representations to SEBI stating that having open ended mutual fund schemes is comparable to a situation of a continuing new fund offering and redemption of units of mutual fund schemes is analogous to a share buyback.

Based on these representations, SEBI has directed mutual funds to maintain current accounts in an appropriate number of banks to receive subscription

8 https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=12152
9 https://www.sebi.gov.in/legal/regulations/aug-2021/securities-and-exchange-board-of-india-mutual-funds-second-amendment-regulations-2021_51695.html
10 https://www.sebi.gov.in/legal/circulars/aug-2021/maintenance-of-current-accounts-in-multiple-banks-by-mutual-funds_51630.html

amounts, and to pay redemption proceeds, dividends, brokerage, and commissions, to increase financial inclusion and convenience of investors.

CAM Thought: SEBI's announcements reflect the incorporation of feedback from the mutual fund industry, wherein it changed the minimum investment cap according to the risk involved and dictated mutual funds to maintain an appropriate number of current accounts to increase investor convenience.

(x) Framework for Outsourcing of Payment and Settlement-related Activities by PSOs:

On August 03, 2021, the RBI issued a framework for outsourcing of payment and settlement-related activities by payment system operators ("**PSO Outsourcing Framework**").[11] This framework is applicable to non-bank payment system operators ("**PSOs**") insofar as it relates to their payment and/or settlement-related activities, and does not apply to their internal administration, housekeeping or related functions. Key facets of the PSO Outsourcing Framework are enumerated hereinbelow:

(a) Outsourcing: The PSO Outsourcing Framework defines outsourcing as any activity wherein a third-party service provider (located in India or elsewhere) is engaged by the PSO to perform activities on a continuing basis that would normally be undertaken by the PSO itself. Outsourcing must happen under a written agreement between the PSO and service provider, vetted by the PSO's legal counsel for their legal effect and enforceability.

(b) Activities that cannot be outsourced: The PSO Outsourcing Framework prevents PSOs from outsourcing core management functions including risk management and internal audit, compliance, and decision-making functions, such as determining compliance with KYC norms.

(c) Continuing Obligations: PSOs, their boards and senior management continue to have the same obligations they had prior to any outsourcing. They continue to be ultimately responsible for all outsourced activities and, as such, are liable for their service providers' actions. Customers also continue to have the same rights against the PSO.

(d) Outsourcing within a group/conglomerate: A PSO, basis its board approved outsourcing policy, may enter into back office and service arrangements / agreements with group entities such as sharing of premises, legal and other professional services, or hardware and software applications. In cases where multiple group entities are involved or any cross-selling is observed, customers are required to be informed about the actual entity offering the product/service.

(e) Additional requirements for off-shore outsourcing: To manage country risks, a PSO is required to closely monitor government policies and the political, social, economic and legal conditions in countries where the service provider is based, both during the risk assessment process and on a continuous basis, and establish sound procedures for dealing with country risks. PSOs may only enter into agreements with offshore service provider located in jurisdictions which uphold confidentiality clauses and agreements.

CAM Thought: By virtue of their business models, PSOs generally outsource payment and settlement-related activities to other entities. The PSO Outsourcing Framework lays down important regulatory safeguards to ensure customer protection.

(xi) RBI Allows non-bank Payment System Providers Access to Centralised Payment Systems

On July 28, 2021, the RBI announced a phased introduction of non-bank payment system providers

11 https://rbidocs.rbi.org.in/rdocs/notification/PDFs/NOT765729DDE076804962B2A6A35CA343D2F2.PDF

("**PSPs**") to centralised payment systems ("**CPS**"), *viz.* real time gross settlement ("**RTGS**") and national electronic fund transfer ("**NEFT**").[12] In the first phase, three categories of non-bank PSPs are eligible:

(a) Pre-paid instrument issuers;

(b) Card networks; and

(c) White label automated teller machine ("**ATM**") operators.

The annexure to the circular contains the eligibility criteria that non-bank PSPs must fulfill to access CPS. These include, *inter alia*, the issuance of a valid Certificate of Authorisation ("**CoA**") from the RBI under the Payment and Settlement Systems Act, 2007, a minimum networth of INR 25 crore or as prescribed in the CoA, whichever is higher, valid incorporation under the Companies Act, 1956 or the Companies Act, 2013 of the entity or its Indian subsidiary/associate, the implementation of centralised processing systems and compliance with the RBI regulations.

CAM Thought: The RBI's announcement to extend CPS access to non-bank PSPs is a key part of its impetus to digital payments in India. Increased competition and innovation in the space should prove beneficial to consumers.

(xii) Guidelines for Managing Risk in Outsourcing of Financial Services by Co-operative Banks:

On June 28, 2021, the RBI notified guidelines for co-operative banks to manage risk in outsourcing financial services ("**Co-operative Bank Outsourcing Guidelines**"), with the aim to ensure that outsourcing arrangements do not diminish the obligations co-operative banks have towards the RBI.[13] Key takeaways from the Co-operative Bank Outsourcing Guidelines are enumerated hereinbelow:

(a) Co-operative banks are not permitted to outsource core management functions such as policy formulation, internal audit, and compliance functions to third parties.

(b) Co-operative banks, their boards and management continue to have the ultimate responsibility for outsourced activities, and as such, are responsible for the actions of their service providers.

(c) Co-operative banks are required to have prepared a board-approved outsourcing policy that covers the criteria for selecting service providers and the activities to be outsourced. The board of directors and senior management are responsible to review risks associated with and effectiveness of outsourced activities, including protecting the confidentiality of customer information.

The Co-operative Bank Outsourcing Guidelines have implications for the neo-banking sector, which serves the unbanked and underbanked segments of the population. Neo-banks typically partner with conventional banks to provide different products and services; however, the Co-operative Bank Outsourcing Guidelines limit the ability of neo-banks to partner with co-operative banks.

As co-operative banks are prevented from outsourcing core management functions, such as internal auditing, compliance functions, and decision-making functions, including KYC compliance, sanctioning loans, and managing investment portfolios, neo-banks are restricted from offering key banking services.

CAM Thought: The Co-operative Bank Outsourcing Guidelines clarify the that co-operative banks need to comply with the procedures while outsourcing financial services. However, these guidelines have the effect of limiting the ability of neo-banks in providing banking services to the underserved segments of the population.

12 https://rbidocs.rbi.org.in/rdocs/notification/PDFs/NT73EDEE40AF1C2C4B5FBE3EE35521E90DFF.PDF
13 https://rbidocs.rbi.org.in/rdocs/notification/PDFs/NT642C29DCE69C264AC198E4BDE2C671F7F2.PDF

(xiii) Relaxation in Timeline for Compliance with Payment System requirements

Recognising difficulties caused by the second wave of the COVID-19 pandemic, the RBI vide a notification dated May 21, 2021 decided to extend the timelines prescribed for compliance with payment system requirements, as enumerated below[14]:

(a) Non-bank PPI issuers have been given a six-month extension till September 30, 2021 to meet the minimum positive networth requirement of INR 1,50,00,000.

(b) Turnaround times and the timelines to compensate customers for failed transactions using authorised payment systems have been changed, which should now be read as "working days" instead of "calendar days" until September 30, 2021.

(c) The deadline for authorised payment system operators to furnish their system audit reports has been extended until September 30, 2021.

(d) Non-bank entities already offering payment aggregator services can now apply for authorisation until September 30, 2021.

CAM Thought: The RBI's move to relax timelines to comply with payment system requirements is much-needed relief for all entities operating in this space and should mitigate the damage caused by the second wave of COVID-19.

14 https://rbidocs.rbi.org.in/rdocs/notification/PDFs/DPSSTI6B55CB8123BE4DB588A16CA23A91C1 EC.PDF

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Key Market Updates

(i) RBI Imposes Fines on PSOs:

On December 23, 2021, the RBI imposed a penalty of INR 1 crore on One Mobikwik Systems Private Limited and Spice Money Limited for non-compliance with networth requirements to operate Bharat Bill Payment Operating Units. Both PSOs were fined post opportunities for written and oral submissions.

On October 20, 2021, the RBI imposed fines on Payments Bank Limited (“**PPBL**”) and Western Union Financial Services Incorporated (“**WUFSI**”). With respect to PPBL, the RBI noted that information submitted by it at the time of applying for its Certificate of Authorisation was factually incorrect and imposed a penalty of INR 1 crore. WUFSI had filed a compounding application for breaching the limit of 30 remittances per beneficiary in calendar years 2019 and 2020, which resulted in a penalty of ~INR 28 lakhs.

(ii) National Payments Corporation of India (“NPCI”) Launches Platform for Card Tokenisation

On October 20, 2021, the NPCI Tokenisation System (“**NTS**”) was launched by NPCI to support tokenisation of RuPay cards. Acquiring banks, aggregators, merchants, and other participants require certification with the NPCI to participate in the NTS and the NPCI’s Token Reference on File system as Token Requestors, and to save the token reference number against all saved card numbers. This CoFT platform will compete with the recently-launched CoFT service of Visa as well as those of other players.

(iii) Account Aggregator Network goes Live

On September 02, 2021, the RBI Deputy Governor, at a launch event for an account aggregator (“**AA**”) network pointed out that though nascent, the AA ecosystem has huge potential going ahead for India to democratise data. Eight major banks in India joined this network on September 02, which together represent 40% of all bank accounts in India.

The chair of the RBI’s committee on deepening digital payments remarked that the AA framework will aim to replicate the success of the unified payments interface (“**UPI**”). He noted that once the tools and infrastructure for the UPI were set in place, industry activity took off, and the same uptick in industry activity is hoped to be achieved with respect to account aggregation.

AAs are non-banking financial companies which provide a contractual service to retrieve or collect customer financial information. AAs enable customers to choose financial data to be shared to speed up financial information flow and reduce the need for physical travel to ensure information sharing among different financial institutions. AAs are regulated by the RBI’s September 02, 2016 master direction on Aas.

(iv) RBI Invites Suggestions and Feedback from Regulated Entities on Regulatory Prescriptions, Constitutes Advisory Group:

In a press release dated April 15, 2021, the RBI announced that it was setting up Regulations Review Authority 2.0 (“**RRA 2.0**”) to internally review and seek suggestions from regulated entities and other stakeholders on its regulatory prescriptions, for a period of one year beginning May 01, 2021.

To this end, on May 07, 2021, the RBI announced that RRA 2.0 has constituted an advisory group which is seeking feedback and suggestions from all regulated entities, industry bodies and other stakeholders by June 15, 2021.

(v) Key Investments in the FinTech Sector: May – December, 2021

India continues to lead the Asia Pacific region in FinTech investments, with USD 1.93 billion raised in 66 deals in Q3, 2021, per a report by S&P Global Market Intelligence. Key market transactions and listings are enumerated hereinbelow:

(a) On October 19, 2021, FinTech platform CRED was reported to have raised INR 1,878 crore in a Series E round co-led by Tiger Global and Falcon Edge at a valuation of USD 4.01 billion.

(b) On August 02, 2021, Policybazaar filed papers to raise INR 6,017.5 crore through an initial public offering, of which INR 3,750 crore was a fresh issue of shares and INR 2,267.5 crore formed part of an offer for sale.

(c) On July 15, 2021, Paytm parent One97 Communications Ltd. filed for an initial public offering for INR 16,600 crore, of which INR 8,300 crore was raised through the issue of new shares and INR 8,300 crore formed part of an offer for sale.

(d) On July 12, 2021, Mobikwik filed papers to raise INR 1,900 crore, of which INR 1,500 crore is a fresh issue of shares and INR 400 crore is part of an offer for sale.

(e) Mark Cuban is reported to have invested an undisclosed sum in Polygon, an Indian crypto platform which aims to reduce the costs and time in transactions on the Ethereum blockchain. On May 18, 2021, Polygon reached a market capitalisation of USD 13 billion.

(f) Groww parent Nextbillion Technology has made its first acquisition in the form of Indiabulls Housing Finance's mutual funds business for INR 175 crore, following SEBI's announcement to allow digital platforms to enter the mutual funds business.

(vi) Various Sectors in the FinTech Industry see new Unicorns:

The period between May, 2021 and December, 2021 also saw Indian FinTech companies enter the unicorn club, which are enumerated below:

(a) In May 2021, banking tech company Zeta reached an evaluation of USD 1.4 billion post a series D funding round of USD 250 million backed by SoftBank Vision Fund 2. Zeta provides customers with a full stack neo-banking platform.

(b) Gurgaon based business-to-business commerce platform OfBusiness was valued at USD 1.5 billion post a USD 160 million funding round led by SoftBank Vision Fund 2.

(c) Merchant payments and financial services provider BharatPe, based in New Delhi, reached a valuation of USD 2.85 billion after raising USD 370 million in a series E funding round of USD 370 million led by Tiger Global Management.

(d) CoinDCX became India's first crypto exchange unicorn by reaching a valuation of USD 1.1 billion in August 2021 after raising USD 90 million in a series C funding round led by Eduardo Saverin's B Capital.

(e) Crypto exchange CoinSwitch Kuber reached a valuation of USD 1.9 billion on October 08, 2021, after raising USD 260 million in a Series C funding round led by venture capital firms a16z and Coinbase Ventures.

(f) Insurance platform Acko reached a valuation of USD 1.1 billion in October, post a raise of USD 255 million led by General Atlantic and Multiples Private Equity.

(g) Online stockbroking platform Upstox was valued at USD 3 billion in November after a Tiger Global-led raise of USD 25 million.

(h) Credit card issuer Slice crossed USD 1 billion in value post a Series B fundraise of USD 220 million, led by Tiger Global and Insight Partners.

CAM's FIG/ Technology Practice: 'Thought Leadership'

(i) FIG Papers (No. 1): RBI Working Group on Digital Lending – Policy Suggestions: Digital lending activities to be regulated? (here).

(ii) FIG Papers (No. 2): RBI's Revised Regulatory Framework for NBFCs: NBFCs to be classified into four types - base layer, middle layer, upper lawyer and a top layer? (here).

(iii) FIG Papers (No. 3, Series – 1): Indian Mutual Funds – M&A Wave: relaxations introduced by SEBI in the mutual fund space (here).

(iv) FIG Papers (No. 4, Series – 2): Indian Mutual Funds – New M&A Rules!: revamp of norms governing mutual funds space (here).

(v) FIG Papers (No. 5, Series – 1): RBI Payment Regulations – 2009 to 2021: Bank 'nodals' to PA/ PG licenses: regulation and norms governing payment aggregators in India (here).

(vi) Investor's Guide to Indian Fintech landscape published on Conventus Leadership: Legislative and regulatory framework applicable to fintech space in India (here).

(vii) Journey of payment regulations from nodals to licences (here).

(viii) FIG Papers (No. 6, Series 2): RBI Clarifications to the PA/ PG Guidelines: Clearing the Air!: Clarification issued on RBI's PA/ PG Guidelines on March 31, 2021 (here).

(ix) Investor's Guide to Indian Fintech landscape published on Conventus Leadership: Legislative and regulatory framework applicable to fintech space in India – Partner Q&A (here).

(x) RBI clears air around PA/PG guidelines (here).

(xi) FIG Papers (No. 7): Cryptocurrency in India! issued on May 27, 2021 (here).

(xii) Navigating banking and finance in India from a fintech perspective: How technology and changed the sector (here).

(xiii) Challenges and future for India's neo-banks (here).

(xiv) Blockchain technology in Indian financial services (here).

(xv) FIG Paper (No. 8) – New Master Directions for PPI: A Fresh Look at Prepaid Payment Instruments! issued on September 2, 2021 (here).

(xvi) Suggested framework for digital assets in India (here).

(xvii) Will AA's revolutionise India's financial services? (here).

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