cyril amarchand mangaldas

ahead of the curve

bulletin

a quarterly newsletter by cam financial institutions group

June to September 2022

Index

- **New Digital Lending Guidelines – Industry Implications**
  Page 03
- **Loading of PPIs through Credit Lines RBI's Circular and its Implications**
  Page 05
- **RBI Master Directions on Credit and Debit Cards**
  Page 07
- **Payment System Operators (PSOS) – New M&A Implications**
  Page 09
- **Payments Vision 2025 Department of Payment and Settlement Systems, Reserve Bank of India**
  Page 11
- **The RBI's Draft Master Direction on Outsourcing IT services**
  Page 13
- **RBI Regulatory Updates**
  Page 15
- **SEBI Regulatory Updates**
  Page 18
- **Market Updates**
  Page 20

It gives me a great deal of pleasure to share with you the third issue of 'Financial Institutions Group ("**FIG**") Bulletin', a quarterly newsletter produced by our FIG practice.

There has been a drastic change in the Indian financial system with a shift from physical finance to tech-based financing taking over the nation. The recent developments and updates in the second quarter of 2022 are reflective of a potential remarkable year ahead for the fintech industry. The quarter has witnessed the introduction and announcement of several key initiatives and changes by the Reserve Bank of India ("RBI"), with an aim to drive digitisation and enhance the outreach for digital payments in India. While this has increased the speed of transactions and spurred innovation, it has also brought with it a lot of unforeseen challenges which the regulatory entities have to deal with.

Considering the rapid growth of this sector in India, The Reserve Bank of India ("**RBI**") has been playing catch up with the constantly changing financial technology realm. It continuously attempts to keep up with and monitor the space effectively to protect the interests of customers and regulated entities. While it plays the role of a regulator and facilitator, it also acts as a catalyst to the development of the digital payments space and adopts new measures to boost the growth of the industry.

In this issue of the newsletter, we track some key developments this year including the Payments Vision 2025 released by the RBI which sought to create a safe, secure, fast, convenient, accessible, and affordable digital payment system in India. Prepaid Payment instruments and tokenization requirements have been in focus this year, with the Digital Lending Guidelines impacting the sector deeply.

We aim to discuss recent regulatory updates from RBI and SEBI and their impact on business and the market 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 FIG Co-Head, B. Sriram

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

The latest developments the second quarter of 2022 are reflective of a notable year ahead. The second quarter has witnessed the introduction and announcement of several key initiatives and changes by the Reserve Bank of India ("RBI"), with the focus to upgrade and enhance digitization and improve the outreach for digital payments. This issue further takes the readers through an array of regulatory developments in the fintech space, some of the key highlights and developments from the regulators are a) Payment System Operators - New Mergers and Acquisitions Implications b) the consolidation of the Credit Card and Debit Card - Issuance and Conduct Directions, 2022, - which has set out comprehensive instructions to card issuers on matters involving the issuance process and safeguards, telemarketing and strategic partnerships, among others. 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 FIG Co-Head, Santosh Janakiram

I am elated to present the third issue of the FIG Bulletin, by our FIG practice.

This issue contains perspective on recent developments in the FinTech sector and interesting insights into the implications of the RBI's updates for the quarter, including in relation to the RBI circular on loading of Prepaid Payment Instruments ("**PPI**") through credit lines. The newsletter contains an in-depth analysis of the PPI circular and its impact on fintech companies.

This issue of FIG Bulletin also analyses the RBI's new Payment Vision 2025 which seeks to make India a global powerhouse in digital payments. The readers will also be interested to read RBI and SEBI updates on matters such as tokenization, Introduction of 'On-Device wallet' - UPI Lite for Small Value Transactions, Modification of the Cyber Security and Cyber resilience framework of Qualified Registrars to an Issue and Share Transfer Agents ("**QRTAs**") etc. The RBI's Draft Master Direction on Outsourcing IT services is also being examined in this issue, which contains provisions on robust risk management, sets out minimum requirements in outsourcing agreements, exit strategies and focuses holistically on data flow, retention and destruction.

Another riveting development in this newsletter is the discussion on the impact of the new digital lending guidelines by the RBI on the digital lending sphere. The Guidelines largely mirror the approach highlighted by the RBI in an earlier press release on the subject and set out various compliances to be followed by banks and NBFCs while engaging with third party service providers.

We hope you enjoy reading this newsletter.

Regards,

Santosh Janakiram
Partner and Co-Head - FIG

New Digital Lending Guidelines – Industry Implications

Pursuant to the Report of the Reserve Bank of India ("**RBI**") Working Group on Digital Lending, issued on November 18, 2021, and the RBI Press Release on 'Recommendations of the Working Group on Digital Lending – Implementation', dated August 10, 2022 ("**August Press Release**"), the RBI released the Guidelines on Digital Lending on September 2, 2022 ("**Guidelines**"). Our Alert examines the key changes introduced and industry implications.

Analysis

i. The Regulated Entities, including banks and NBFCs ("**Res**"), are required to ensure that the Lending Services Provider ("**LSP**") engaged by them and the Digital Lending App ("**DLA**") (RE's or LSP's) comply with these Guidelines.

   As 'DLA' and 'LSP' is not exhaustively defined, it is likely to raise interpretation issues qua scope, including FDI treatment for such DLAs/ LSPs.

ii. The Guidelines apply to (a) existing customers availing fresh loans; and (b) new customers. REs have been given time till November 30, 2022, to ensure that existing digital loans are compliant with these Guidelines.

iii. **Loan Disbursal/ Servicing/ Repayment** – All loan disbursements must be made into the borrower's bank account and servicing/ repayment must be directly in the RE's bank account, without any pass-through account/ pool account of any third party.

   However, disbursals required under (i) statutory or regulatory mandate; (ii) money flow between REs for co-lending transactions; and (iii) disbursals for specific end use, directly into the end-beneficiary's bank account, are exempt. Under no circumstances is disbursal to a third-party account (including that of LSPs and DLAs) permitted.

   Above change may require clarity around digital lending business models, involving payment aggregatortie-ups and funds processing.

iv. **Fees/ Charges/ Disclosures** – Must be paid directly by REs to LSPs, and cannot be charged by the LSP to the borrower. Interest rate for digital loans must be disclosed upfront by REs. REs have to provide borrowers with key fact statement before contract execution for all digital loans, containing prescribed details.

v. **Digital Signature** – Prescribed documents must be digitally signed and flow automatically to the borrowers on digital loan registration, with email/ SMS verification upon loan execution.

   This has raised a debate in the industry as to whether the prescribed 'digital signature' requirements under the IT Act, 2000, are required to be followed.

vi. **Borrower Creditworthiness** – REs are required to assess the borrower's creditworthiness in an auditable way.

vii. **Free 'look-in' Period** – Borrower must be given an option to exit the digital loan by paying the principal and the pro-rata interest, without any penalty, during a Board prescribed cooling-off period.

viii. **Data Restrictions** – Data collection should be 'need-based', following basis explicit borrower consent with audit trail.

   One-time access permitted for onboarding/ KYC, with explicit borrower consent. However, REs must ensure that DLAs desist from accessing mobile phone resources such as file, media, contact list, call logs, telephony functions, etc. Detailed data protection/ privacy, storage, privacy policy and technology related provisions are prescribed.

ix. **Bureau Reporting** – REs are required to ensure that any lending through DLAs is reported to credit information companies.

x. **FLDG** – In a modification from the August Press Release, the Guidelines acknowledge the industry practice of offering FLDGs, where a third-party guarantees to compensate up to a certain percent of default in the RE's loan portfolio. However, the Guidelines 'advise' the REs to adhere to the Securitisation Master Directions, 2021 ("**Directions**"), especially the synthetic securitisation provisions in Para 6(c).

However, the above point is raising multiple industry questions:

i. are third-party FLDGs banned;

ii. does 'advised' mean mandatory or is it a recommendation?;

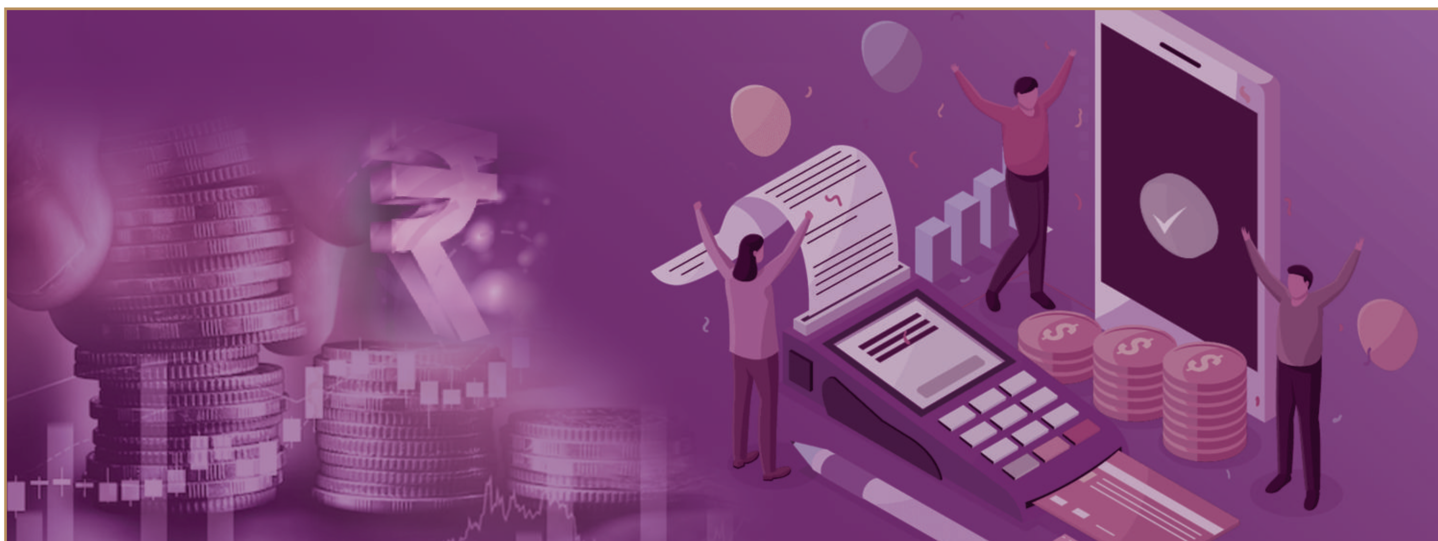
iii. if mandatory, given the spirit, and the language in Annex-2, August Press Release, is compliance required only with Para 6(c), or the entire Directions, which may raise unintended consequences;

iv. implications for NBFC to NBFC/ Bank FLDG models – would the FLDG provider NBFC be considered a 'third party'

Conclusion

Given the above issues, it may be useful if the RBI issues clarificatory FAQs to avoid multiple interpretations by the industry, which includes most banks, NBFCs and many fintech players in India and globally.

The public debate and ongoing investigations around 'digital lending' has resulted in a fair bit of industry confusion this year. Given the number of players affected and investments in the fintech/ tech sector in recent years, including in the digital lending space, which cuts across most fintechs/ aggregator platforms; a definitive position on this issue is required.



Loading of PPIs through Credit Lines RBI's Circular and its Implications

Background

Prepaid Payment Instruments ("**PPIs**") are payment instruments that allow purchase of products and services with cash saved in or on the instrument. PPIs include payment wallets, smart cards, magnetized chips, vouchers, mobile wallets, etc., where consumers can load money, to be redeemed against goods and services, at a subsequent point in time.

PPIs are being widely adopted and the number of transactions through it is rising at a steep pace. The Reserve Bank of India ("**RBI**") in Payments Vision 2025, which details RBI's vision for payment systems till 2025, has estimated 150% growth in the number of PPI transactions till 2025.

Prepaid Payment Instruments

The RBI on August 27, 2021, issued the Master Direction on PPIs ("**Master Direction on PPIs**"), wherein a PPI has been defined as *"instruments that facilitate purchase of goods and services, financial services, remittance facilities, etc., against the value stored therein"*.

There are three kinds of PPIs under the Master Direction on PPIs:

i. **Closed System PPIs**, wherein the value stored in the PPI can only be used to avail goods and services from the entity issuing such a PPI, meaning they cannot be used for payment and settlement for third-party goods and services nor can they be used to withdraw cash;

ii **Small PPIs**, which are issued by banks and non-banks after obtaining minimum details of the PPI holder, but funds transfer or cash withdrawal from such PPIs is not permitted. Small PPIs can be used at a group of clearly identified merchant locations/ establishments which have a specific contract with the issuer of the PPI.

iii **Full-KYC PPIs**, these are issued by authorised entities like banks/ non-banking financial companies ("**NBFC**") after completing Know Your Customer ("**KYC**") checks of the proposed PPI holder. In addition to the features of a Small PPI, funds transfer and withdrawal of cash is permitted for Full-KYC PPIs. Closed System PPIs are not regulated by the RBI under the Master Direction on PPIs.

Cards issued by merchants such as Reliance Fresh, Starbucks and the App Store Wallet operated by Apple Inc. are examples of Closed System PPIs. The aforesaid PPIs can only be used in the stores, online or physical, of the respective entities that have issued the PPIs and cannot be used for transferring funds or for withdrawing cash. HDFC Bank's PayZapp and State Bank of India's YONO are Small PPIs and can only be used for purchasing goods and services at merchant locations/ online platforms that have an agreement with the PPI issuers. These PPIs cannot be used for withdrawing cash or transferring funds. Paytm, Amazon Pay are examples of Full-KYC PPIs which can be used for purchasing goods and services, transferring funds and withdrawing cash. PPIs are also allowed to be issued under a co-branding arrangement where a bank/ NBFC partners with a FinTech entity to issue a PPI.

FinTech entities in the Buy Now Pay Later ("**BNPL**") segment in India utilize this co-branding route and tie up with banks/ NBFCs that provide credit underwriting and hold PPI licences, while the FinTech entities market such co-branding arrangements and provide access to the PPI and services offered. A BNPL product allows a customer to avail credit facility through the use of a physical/ virtual card at point-of-sale machines or online payment gateways of partnering sellers of the BNPL provider. LazyPay, OLA Postpaid Wallet, Simpl and Slice are BNPL examples of platforms where the PPI issuer has partnered with a bank/ NBFC who underwrites the credit and holds the PPI licence. PPIs in the form of BNPL provide great ease and efficiency in making payments, which can then be paid off at a lower interest rate over a short span of time. These BNPL products which provide PPI to the users are usually loaded through a credit line provided by the partner bank/ NBFC.

The Master Direction on PPIs under Clause 7.5 permits loading of PPIs by cash, debit to a bank account, credit and debit cards, PPIs (as permitted from time to time) and other payment instruments issued by regulated entities in India. These shall be in INR only. On June 20, 2022, RBI had issued the Circular on Loading of PPIs Through Credit Lines ("**PPI Circular**") to non-banks whereby, the RBI had clarified that PPIs cannot be loaded through credit lines and if such practice is being followed by non-banks, it must be stopped immediately.

Implications of the PPI Circular

The PPI Circular poses a compliance issue for the aforesaid BNPL segment as these are usually loaded by the BNPL provider through a credit line provided by a partner NBFC. These BNPL products play an important role in filling credit availability gaps by catering to the financial needs of customers who do not have access to traditional forms of credit available to well banked individuals. Indian customers have whole-heartedly accepted such flexible credit models. The total number of loans disbursed that can be classified as BNPL up to December 30, 2020 stood at 36,00,646 for Scheduled Commercial Banks and 36,28,970 for NBFCs. These translate to INR 822 crore and INR 487 crore disbursed by Scheduled Commercial Banks and NBFCs, respectively, as per the RBI's Report of Working Group on Digital Lending published on November 18, 2021.

The PPI Circular was issued to non-banks only and it is still unclear whether loading of bank-issued PPIs through a credit line would be permissible under the Master Direction on PPIs. Another grey area is what constitutes a credit line as per the RBI. The RBI, in its circular on XBRL Returns – Harmonisation of Banking Statistics, dated January 04, 2018, had defined a "credit line" as a "formalised arrangement in which the counterparty has the right, but not the obligation to draw funds to a specified limit." However, clarification on what constitutes a credit line is still necessary as the abovesaid definition is not a part of the regulatory framework. Further, Clause 7.5 of the Master Direction on PPIs allows PPIs to be loaded through a credit card, which is a form of credit and thus, clarification by the RBI regarding which credit instruments can be used to load a PPI is necessary. The BNPL sector would be greatly affected by the PPI Circular if the aforesaid clarification is not provided by the RBI. The Master Direction on PPIs under Clause 7.5 permits loading of PPIs by cash, debit to a bank account, credit and debit cards, PPIs (as permitted from time to time) and other payment instruments issued by regulated entities in India.

RBI Master Directions on Credit and Debit Cards

Background

The Reserve Bank of India ("**RBI**") issued RBI (Credit Card and Debit Card - Issuance and Conduct) Directions, 2022 ("**Master Directions**"), in April 21, 2022 to consolidate the existing guidelines on regulations of credit cards, debit cards, and charge cards, which were principally governed by Master Circular on Credit Card, Debit Card and Rupee Denominated Co-Branded Pre-paid Card Operations of Banks and Credit Card issuing NBFCs dated July 1, 2015 ("**Master Circular 2015**"). The Master Directions came into effect from July 1, 2022, but the RBI has extended the timeline for implementation of certain provisions of the Master Directions to October 1, 2022.

Implications

Regulatory clarity: The Master Directions have brought about greater clarity by providing definitions on what is a credit card, credit limit and other related terminologies. Although these terms were used in Master Circular 2015, a clear definition evaded these terms. A 'credit card' is defined as a payment instrument that carries a means of identification (of the user), issued with a pre-approved revolving credit limit that can be used to purchase goods and services or draw cash advances, subject to prescribed terms and conditions. Credit limit is defined as the maximum amount of revolving credit determined and notified to the cardholder to transact in the credit card account. A 'charge card' is a deferred payment option where rolling over of credit to next billing cycle is not permitted. Whereas, a 'co-branded card' is a card issued jointly by card-issuer and co-branding entity, bearing the names of the partnering entities.

Scope of co-branding arrangements: The Master Directions have significant implications on co-branding arrangements between a card-issuer and a 'co-branding partner'. The Master Circular 2015 limited the role of the co-branding partner to marketing and distribution of the cards and providing access to the cardholder for the goods and services that were offered. However, the Master Directions have gone a step ahead to specify that the co-branding partners shall not have access to information relating to transactions and neither shall they be involved in any of the processes or controls relating to the co-branded card, except for being the initial point of contact in case of grievances.

Card-issuers under the Master Directions are RBI regulated entities and can outsource various activities to outsourced partners such as fintechs etc. However, such a regulated entity shall be bound to strictly abide by the guidelines on 'Managing Risks and Code of Conduct in Outsourcing of Financial Services by Banks', as amended from time to time. RBI has recently issued the draft RBI (Outsourcing of IT Services) Directions, 2022 which seeks to set out specific responsibilities and obligations on both regulated entities as well as firms they are outsourcing IT activities to.

Consumer protection: Card-issuers are also now required to seek an OTP-based consent to activate their credit cards. If this is not initiated by the cardholder within 30 days from the date of issuance of the card, the card-issuer is required to close the credit card account within 7 working days from the date of seeking confirmation from the customer. Card-issuers also require express consent from the cardholder for any breach in the credit limit at any time beyond the limit sanctioned and informed to the cardholder.

In instances of co-branding arrangements between a card-issuer and a co-branding partner, information related to revenue-sharing between the two entities must be indicated to the cardholder and displayed on the website of the card-issuer.

Impact on NBFCs: The provisions for seeking prior approval to undertake credit card business were there earlier as well, in the Master Directions on NBFCs. Despite these enabling provisions, NBFCs were not granted permission to undertake credit card business, except for a few legacy

entities. The view is that NBFCs need to have good governance practices, sound risk management systems, robust IT systems etc., in the absence of which, concerns relating to NBFCs undertaking credit card business would always remain. Perhaps on a case-to-case basis, the RBI may consider such requests from NBFCs, based on their supervisory track record, sound financial performance, good governance etc.

Buy Now Pay Later: RBI's definitional clarity on the term 'credit cards', could now cover certain buy now pay later ("**BNPL**") business models. BNPL products that operate as a payment instrument carrying a means of identification (of the user) and providing a pre-approved revolving credit limit are now likely to be treated as credit cards.

The definition of credit card could give rise to a differentiated regulatory treatment between different kinds of BNPL products – depending on the form of the BNPL offering and its potential to fall within the definition of credit cards, while in effect the different BNPL products on either side of the definition may be functionally similar.

Conclusion

Once the scale-based regulations for NBFCs become operational in October this year, it is likely that some of the NBFCs, such as those in the upper layer, may be examined for permission to undertake credit card business. These NBFCs would be subject to more bank-like regulations relating to governance, exposure norms, Internal Capital Adequacy Assessment Process, etc. Further, RBI's directive on information related to revenue-sharing being shared with the cardholder could adversely affect market behavior and competition among card-issuers.

Payment System Operators (PSOs) – New Mergers and Acquisitions Implications

Background

On July 4, 2022, the Reserve Bank of India ("**RBI**") clarified to all banks and non-bank Payment System Operators ("**PSOs**") that its prior approval would be required for any (a) takeover/ acquisition of control, which may/ may not result in change of management; and (b) sale/ transfer of payment activity to an entity not authorised for undertaking similar activity. ("**Circular**").

With this clarification, the approach to and considerations involving Mergers and Acquisitions ("**M&A**") in the PSO space, will see a change.

Earlier, PSOs were required to only intimate the RBI upon a change of control, usually within 15 days. Transferring entities are now required to make an application to the Department of Payment and Settlement Systems ("**DPSS**"), RBI, in a prescribed form:

i. for acquisition of control (including for new directors and new shareholders); and

ii. for sale/ transfer of payment activity to another entity.

If the transfer is to an entity not already authorised for the same activity, the applicant (**including** a bank) will be treated as a fresh applicant for authorisation.

Implications

Currently, the RBI has notified eight categories of PSOs, aggregating to 68 licensed players. Therefore, going forward, any M&A involving each of these players will be impacted, including new payment aggregator licensees (some accounts suggest more than 200 applications made) and any new players licensed as a PSO.

The Circular (and the timing thereof) is raising interesting questions, including by PSOs. A school of thought suggests that the impending payment aggregator licenses were the trigger behind the Circular. Also, recent experience with M&A activity in the PPI/ wallet space where many global tech/ fintech players acquired smaller fintech players, raised 'backdoor' entry related concerns.

In particular, the Circular is raising the following questions:

i. There is no grandfathering provision in the Circular. What happens to PSO related transactions announced, but yet to be closed as of July 4, 2022?

ii. PSOs under the categories of card networks and MTSS need not have an India licensed entity - this Circular is silent on the treatment of such M&A.

iii. What happens to indirect change of control, say at a 2nd/ 3rd level up the holding chain, involving an Indian PSO entity/ global PSO licensed with the RBI?

iv. Given past experiences with deal approval timelines, can one expect the prescribed timeframe to be met, or should a significant delay be expected? If so, this may trigger a separate India carve-out from global closings.

v. For a PSO business transfer, the Circular says the buyer (bank/ non-bank) PSO is required to comply with any RBI action taken before closing - this will require revisiting the approach of due diligence in such transactions, and consequently, the nature of representations, warranties and indemnities sought.

vi. The definition of control is as per the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, which had its own history qua SEBI and Indian courts on how to interpret 'acquisition of control' and absent an objective threshold, will raise interpretational issues on triggering change of control.

vii. Bank PSOs are exempt under the Payments and Settlements Systems Act, 2007 ("**PSSA**"), so why the need for them to comply with the Circular (as a PSO business transfer where the acquirer is a bank requires an application to the DPSS), which is issued under the PSSA?

viii. The 15-day prior notice requirement involves not just a public notice, but also to all stakeholders (agents, bankers, customers, merchants, etc.) of the change 15 days before closing, which makes this a more onerous obligation than a bank/ NBFC change of control.

ix. In relation to the declaration required for new shareholders of a PSO:

(a) The present form asks for previous payment systems experience. What about non-strategic acquirers, including funds?

(b) The form asks for the manner in which new investors shall recover their investments/ earn income. Also, how is this likely to affect the approval process?

(c) The form also requires details of the ultimate beneficial ownership ("**UBO**") of each foreign investor in the acquirer, which may require disclosure of confidential limited partner details in fund situations. Also, this may force the acquirer to take subjective calls on UBO, given prior experience with UBO laws in other areas, for e.g. foreign direct investment laws and significant beneficial owners under the Companies Act, 2013.

x. The 15-day intimation to the RBI post change in management/ directors and detailed declaration requirement by such directors would raise worries in relation to non-acceptance of such directors, in case the RBI does not find them 'fit and proper' post-appointment.

Conclusion

PSO M&A was the last remaining 'free bastion' in the RBI world, as prior approval requirements were present for change of control involving NBFCs (26% shareholding or 30% director change) and banks (more than 5% or 10% approval). Therefore, an RBI FAQ on this Circular, addressing some or all of the above concerns will be useful.

Payments Vision 2025
Department of Payment and Settlement Systems, Reserve Bank of India

Introduction

The Reserve Bank of India ("**RBI**") published on June 17, 2022, the latest of the payments vision documents titled 'Payments Vision 2025', with a view to build on the recent success in the digital payments space in India and the successful implementation of Payments Vision 2021. Payments Vision 2025 outlines the thought process of the RBI for the period up to December 2025. Payments Vision 2025 aims to ensure safe, secure, reliable, accessible, affordable, and efficient payment systems.

Implications

The main theme as set out by the RBI revolves around 4 Es, which are E-payments for everyone, everywhere, every time. Further, the RBI has identified 5 (five) anchor goalposts: integrity, inclusion, innovation, institutionalisation, and internalisation. Specific directions have been provided for the same under the Payments Vision 2025.

Integrity

i. The RBI in Payments Vision 2025 looks to further the directions issued to Central Counterparties ("**CCPs**") with respect to governance, net worth requirements, ownership, fit and proper criteria for directors, governance standards, etc., and bring such directions at par with the requirements laid out for banks.

ii. The RBI uses e-Kuber and Real Time Gross Settlement for settlement of payments, the RBI will consider exploring the possibility of building a liquidity bridge between the two systems. This would allow transfer of funds from one system to another without intervention from members. National Electronic Funds Transfer ("**NEFT**") currently operates in half-hourly batches but the RBI wants to review the frequency of batches for NEFT payments and increase the same to settle such transactions faster.

iii. The RBI shall explore the possibility of giving Urban Co-operative Banks and Regional Rural Banks access to Central Payments Fraud Information Registry. It also plans to publish reports on trends in payment frauds.

Inclusion

i. The RBI shall publish a discussion paper on the need for proportionate regulation for FinTechs and BigTechs that are in the payments space with respect to domestic incorporation, reporting, data usage, etc.

ii. Since there is no uniformity in user onboarding processes and transparency in operations of intermediaries, the RBI shall consider directly regulating all significant payment intermediaries, including offline payment aggregators.

Innovation

i. Currently, only a bank account and debit card can be linked to the United Payments Interface ("**UPI**") Virtual Payment Address. The RBI will explore linking credit cards and credit components of banking products to UPI Virtual Payment Address to offer more avenues and ease of access to users.

ii. Payment system operators across the globe are currently in the process of implementing ISO 20022, which is a global standard for electronic data interchange between financial institutions. The RBI wants to increase interoperability with systems of other jurisdictions and shall take steps to migrate all the RBI operated payment messaging systems to ISO 20022.

Institutionalisation

i. Payment Systems in India are currently regulated under the Payment and Settlement Systems Act, 2007. Since the payments landscape has changed significantly since 2007 the RBI shall comprehensively review the Payment and Settlement Systems Act, 2007 and the relevant regulations.

ii. Any payments made at point of sale ("**PoS**") machines are currently only processed through the concerned card network while all ATM transactions are processed through either National Financial Switch ("**NFS**") or the relevant ATM networks. The RBI shall explore the possibility of implementing a National Card Switch to process such transactions.

Internationalisation

i. RTGS currently settles domestic fund transfer transactions on a gross basis. The RBI aims to streamline RTGS with the globally accepted standard of cross-border payments. It shall also explore the possibility of expanding RTGS to settle payments in major global currencies such as the euro, US dollar, yen, pound, etc., through bi-lateral or multi-lateral arrangements.

ii. Domestic payments are secured due to additional factor authentication ("**AFA**") implementation. The RBI, with a view to increase safety of international transactions done through cards issued in India, will explore implementing AFA for cross border transactions.

iii. Continuous Linked Settlement ("**CLS**") is a global initiative with payment vs. payment mode to mitigate the settlement risks associated with foreign exchange trades. CLS currently provides cross-currency settlement in 18 currencies. Global acceptance of INR would increase greatly if it were included as a currency in CLS. The RBI aims to initiate a dialogue to get the INR included as a currency in CLS as India already has an excellent financial market infrastructure.

Conclusion

The RBI under Payments Vision 2025 plans to implement specific directions under the above anchor goalposts to make India a global powerhouse in digital payments.

The RBI's Draft Master Direction on Outsourcing IT services

Background

The Reserve Bank of India (“**RBI**”) has in the past issued guidelines/ framework outlining the norms for outsourcing activities undertaken by Regulated Entities (“**RE**”) i.e. commercial banks, co-operative banks, non-banking financial companies and payment system operators (“**Existing Guidelines**”). These guidelines enable the REs to retain control over the outsourcing the activities, enlists the obligations to be captured under the outsourcing agreement and protects the confidentiality of customer the data. However, the existing outsourcing framework fails to include IT specific services outsourced by RE.

The RBI observed that REs have lately been extensively leveraging Information Technology (“**IT**”) and IT enabled Services (“**ITeS**”) to support their business models and products and services offered to their customers and substantial portion of their IT activities/ ITeS are outsourced to third party service providers.

In view of the potential significant risks that might arise due to this, the RBI on June 23, 2022, issued a Draft Master Direction on Outsourcing of IT Services (“**IT Outsourcing Guidelines**”), proposing norms to ring-fence REs from financial, operational, and reputational risks. The IT Outsourcing Guideline is broadly akin to the Existing Guidelines.

Implications

The IT Outsourcing Guideline is a proposed framework applicable to most banks, Non-Banking Financial Companies (“**NBFCs**”), Credit Information Companies, and all India Financial Institutions. The new framework states that REs desirous of outsourcing IT and IT enabled services shall not require prior approval from the RBI. The RE is required to take effective steps to ensure that the service provider renders and employs the same high standard of care in performing the services as would have been employed by the RE if the same activity was not outsourced.

Though, most of the IT Outsourcing Guidelines provisions overlapped with the Existing Guidelines, there are certain provisions that are absent under the IT Outsourcing Guidelines, but are present in the Existing Guidelines and vice versa.

For instance, we see that key risks (i.e. operational risks, exit strategy risk, etc.) (for Existing Guidelines), self-assessment of the outsourcing agreement (for commercial banks), reporting of transactions to FIU or other competent authorities in respect of NBFCs’ customer related activities carried out by the service providers and inclusion of outsourcing activities by the participants of payment systems operated by the PSOs, but supervised by the RBI are left out from IT Outsourcing Guidelines.

However, the IT Outsourcing Guidelines provides a robust risk management framework, more comprehensive clauses for outsourcing agreement, exit strategies and also provides for the storage of data to be done only in India.

Several other important provisions in the IT Outsourcing Guidelines are outlined below:

i. **Grievance redressal mechanism**: The guidelines provide guidance on management of concentration risk and put in place a robust grievance redressal mechanism. Any grievance of customers related to outsourced IT services shall be the responsibility of the RE.

ii. **Additional requirement for cross-border outsourcing**: The framework provides for additional requirements for cross-border outsourcing, which requires REs to closely monitor the service provider’s country’s government policies and accordingly establish robust procedures and mitigating country risks.

iii. **Risk Management**: The draft framework also mandates a robust risk management framework, dealing with

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identification, measurement, mitigation / management and reporting of risks associated with outsourcing of IT services arrangements, subject to internal/ external quality assurance on a periodic basis. The RBI clarifies that public confidence and customer trust in REs is a prerequisite for their stability and reputation. Hence, it shall be the responsibility of the RE to ensure the preservation and protection of the security and confidentiality of customer information in the custody or possession of the service provider.

iv. **Confidentiality and Security**: Access to the RE's data/ location center by the service provider shall be on a need-to know basis where the RE shall exercise appropriate control to avoid security breaches and data misuse. It shall be the responsibility of the RE to ensure the preservation and protection of the security and confidentiality of customer information in the custody or possession of the service provider. REs shall execute a Non-Disclosure Agreement even after the outsourcing contract expires or is terminated.

v. **Business Continuity Plan and Disaster Recovery Plan**: The draft framework mandates REs to ensure that their service providers develop and establish a robust framework for Business Continuity Plan and Disaster Recovery Plan and ensure to retain an appropriate level of control over the outsourced IT services arrangement, along with a right to intervene and takeover the business operations, in case of unexpected termination of service providers.

vi. **Cloud services**: The RBI has also provided the requirements for storage, computing and movement of data in cloud environment since these models come with business benefits and risk profiles. Inclusion of outsourcing of cloud services by the RBI proves to be a welcome step towards the liberalisation of the often-witnessed anti-cloud approach but the management and security considerations laid down in the guidelines may prove difficult to implement.

vii. **Security Operations Center**: The RBI has also covered the outsourcing of Security Operations Center ("**SOC**"), which entails the risk of data being stored and processed at an external location, which is managed by a third party wherein the REs have lesser visibility.

The CERT-In directions dated April 28, 2022, provides for aggressive compliances for ensuring cyber security including, inter alia, reporting of any cyber incidents within 6 (six) hours of noticing such incident or becoming aware brought to the notice of such incident and also whenever required by way of an order/direction the service provider/intermediary/data center/body corporate shall be required to furnish the information/assistance to the CERT-In to contribute towards cyber security mitigation actions and enhanced cyber security situational awareness. The REs shall have to ensure that the outsourced SOC comply with the CERT-In directives, which shall be effective from September 25, 2022, to avoid any punitive action for non-compliance.

Conclusion

The IT Outsourcing Guideline has adopted a uniform framework by expanding the scope of applicability to a larger group. The RBI has managed to integrate every aspect of outsourcing IT service, the risks involved and the adequate safeguards to put in place to mitigate the risks.

Moreover, certain changes to existing market practices may be required wherein a large ecosystem of credit underwriting being undertaken by REs is extended in partnership with Fintech companies. Since these Fintech companies provide loan origination services to the REs through their IT/ ITeS platforms, the borrowers have to provide data to the Fintech. Now, Fintech must segregate data collected from consumers into two broad pools of data. Firstly, where the data sits, on a transient basis, till that particular customer is provided the required credit facilities through a partner RE. Upon such credit facility being provided by the RE, the customers data must be shifted to the second pool, which would only contain data of the customers of that specific lending RE and accordingly such data can only be accessed by the relevant RE.

Although the IT Outsourcing Guidelines have attempted to resolve the risks attached to outsourcing of IT services, there are a few rough areas that may need to be ironed out, for instance, including the payment system operator under the ambit of this guideline and simplifying the cloud service management and security procedures.

RBI Regulatory Updates

1. Tokenisation: Restriction on Storage of actual data [i.e. Card-on-File (“CoF”)]

Card-on-File data, or stored credentials is information a merchant, or its agent stores about a cardholder to process future transactions and it includes account number, expiry date, payment token, etc.

The Reserve Bank issued its Guidelines for Regulation of Payment Aggregators and Payment Gateways and Card-on-File Tokenisation (“**CoFT**”) Services (period). No entities in the card transaction/ payment chain, other than the card issuers and/ or card networks, can store CoF data, and any such data stored previously had to be purged.

Some storing of information is permitted for guest checkout transactions, but this data shall be used only for settlement of such transactions and must be purged thereafter.

The RBI decided to extend the timeline for storing CoF data by three months, i.e., till September 30, 2022, after which such data shall be purged.

CAM Thought: Multiple extensions have been provided by the RBI because of widespread industry discussion regarding this rule. With the above extension circular, the RBI has not provided a blanket extension on storing card data and has instead carved out exceptions for merchants/ PAs for settlement/ post-transaction activities. Industry readiness for compliance may still be an issue.

Extension of timeline for implementation of certain provisions of Credit Card and Debit.

2. Introduction of ‘On-Device wallet’ - UPI Lite for Small Value Transactions

To ease the processing of large-scale small value digital payments, NPCI has designed the ‘UPI Lite - On-Device wallet’ (“**UPI Lite**”) functionality for UPI users. In phase 1, UPI Lite will process transactions in near offline mode i.e. debit offline and credit online, and at a later point, UPI Lite will process transactions in complete offline mode i.e. debit and credit both offline.

The user can allocate funds from her/ his bank account to UPI Lite. Such funds shall reside with the user’s bank in an escrow/ pool/ designated account and such balance shall reside on-device on the common library of the user’s UPI App.

At present, only debit from UPI Lite balance shall be permitted and all credits to UPI Lite will be processed online in the user’s bank account, maintained in the bank’s core banking system. The upper limit of an UPI Lite payment transaction shall be INR 200/ and balance for “On-device wallet” shall be INR 2,000 at any point of time.

Final implementation timeline for ‘ODR- Enhancing Compliant handling and Compliance timeline for international acceptance using UPI (UPI Global).

NPCI has introduced international merchant payments acceptance through UPI vide circular dated September 4, 2020 and mandated its implementation by December 31, 2021. NPCI has extended the timeline for the compliance of the same till September 30, 2022.

Ecosystem participants shall note that once enabled for one country by the issuer bank/ PSP and TRAP, there shall not be additional certification or change for any incremental country by all participants in the transaction flow. The incremental work for additional any country shall be done by the NPCI.

Miscellaneous Updates

3. Extension of Time Window for Payment Aggregator Licence Application

The RBI has decided to allow another window to all payment aggregators existing as on March 17, 2020, to apply to the RBI for PA licence. They can now apply by September 30, 2022 but they are required to have a net worth of ₹ 15 crore as on March 31, 2022.

They can continue their operations till they receive communication from the RBI regarding their application.

CAM Thought: RBI's move will help in going through the data collected through geo-tagging. This will enable the RBI to bring about suitable policy interventions wherever required. This move proves to be a breakthrough for the advancements of RegTech looking at the bouquet of payment systems in India.

SEBI Regulatory Updates

UPI Related Update

KYC Registration Agency (KRA) related updates

1. **Guidelines in pursuance of amendment to SEBI KYC (Know Your Client) Registration Agency (KRA) Regulations, 2011**

   To effectively implement the KRA regulations, the SEBI, through a circular dated April 06, 2022, has issued additional guidelines. It declared that

   i. KRAs shall continue to act as repositories of KYC data in the securities market and shall be responsible for storing, safeguarding and retrieving the KYC documents and submitting to the SEBI or any other statutory authority;

   ii. KRAs shall independently validate records of those clients (existing as well as new) whose KYC has been completed only using Aadhaar as an Officially Valid Document (OVD).

   iii. The systems of Registered Intermediaries and the KRAs shall be integrated to facilitate seamless movement of KYC documents;

   Upon KYC validation, a unique client identifier called KRA identifier shall be assigned by KRA to the client and such may be used by the client for opening of account with any other intermediary, without repeating the KYC process, etc.

   The provisions of this circular under Clause 9 and Clause 13 were to come into effect from July 01, 2022. However, through a circular dated June 24, 2022, SEBI declared that - KYC records of all existing clients (who have used Aadhaar as an OVD) shall be validated within a period of 180 days from August 01, 2022, and the validation of all KYC records (new and existing) shall commence from August 01,2022.

   CAM Thought: SEBI has issued revised guidelines directing KRAs to act as repositories of KYC data in the securities market and additionally, made it responsible for storing, safeguarding and retrieving KYC documents. Therefore, logistically it will be convenient for the KRA's to comply with the aforementioned directions and protect the interests of investors.

Cyber Security and Cyber Resilience Framework Related Updates

It directed MIIs to communicate the status of the implementation of the provisions of the circular to SEBI within 10 days from the date of this Circular.

CAM Thought: SEBI has taken a step to create a robust cyber security and cyber resilience framework for MIIs with partial modifications vide this Circular. However, ensuring the compliance of SEBI's directions shall be challenging since the circular is silent on the contravention of these provisions.

1. **Modification of the Cyber Security and Cyber resilience framework of KYC Registration Agencies (KRAs)**

   Through a circular dated July 05, 2022, SEBI has partially modified Annexure A of the Cyber Security and Cyber resilience framework of KRAs that was prescribed vide a circular dated October 15, 2019, and May 30, 2022.

   It has nearly identical requirements as the Circular of June 30, 2022 mandating that all cyber-attacks, threats, cyber-incidents and breaches experienced by KRAs be reported.

2. **Modification of the Cyber Security and Cyber resilience framework of Qualified Registrars to an Issue and Share Transfer Agents (QRTAs)**

   Through a circular dated July 06, 2022, SEBI has partially modified Annexure A of the Cyber Security and Cyber resilience framework of QRTAs that was prescribed vide a circular dated September 08, 2017.

   It has nearly identical requirements as the Circular of June 30, 2022 mandating all cyber-attacks, threats,

cyber-incidents and breaches experienced by QRTAs be reported.

CAM Thought: The reporting requirements for Stock Brokers / Depository Participants, KRAs and QTRAs within 6 hours may prove to be challenging and result in enhanced costs requirement for such operational implementation.

Miscellaneous updates

3. Procedure for seeking prior approval for change in control of Portfolio Managers

Portfolio Managers are required to obtain prior SEBI approval in case of change in control in cases specified by SEBI as per Regulation 11(aa) of SEBI (Portfolio Managers) Regulations, 2020. SEBI has modified for obtaining SEBI approval through a circular dated June 02, 2022, which will be applicable from June 15, 2022.

Now, an application for prior approval which is valid for 6 months has to be made online through the SEBI Intermediary Portal by a Portfolio Manager in case of a change in control, applications for fresh registration pursuant to change in control will have to be made to SEBI within 6 (six) months from the date of prior approval.

The Portfolio Manager also has to inform its existing investors/ clients about the proposed change, prior to effecting the same and give an option to exit within 30 (thirty) days.

CAM Thought: SEBI has introduced this Circular to streamline the process of change of control of Portfolio Managers and protect the interests of investors by providing them with the option to exit without any exit load.

4. Modification of the Operational Guidelines for Foreign Portfolio Investors, Designated Depository Participants and Eligible Foreign Investors - Bank account details to which the payment is to be done electronically

Through a circular dated June 21, 2022, SEBI has mandated change in Annexure D of the 'Operational Guidelines for Foreign Portfolio Investors, Designated Depository Participants and Eligible Foreign Investors', that were issued vide SEBI Circular dated November 05, 2019 ("**Operational Guidelines**").

The Operational Guidelines specified Bank account details for remittances of various payments of various SEBI fees in US currency.

Through this circular, SEBI has notified a change in the bank details for foreign inward remittances in order to facilitate faster confirmation of remittances.

CAM Thought: SEBI, with the introduction of fresh guidelines, is trying to facilitate faster confirmation of remittances by intermediaries. It will be applicable to Foreign Portfolio Investors and Designated Depository Participants.

Market Updates

Key Deals in the FinTech Sector

The fintech space has seen considerable M&A activity in the June to September period. Some key deals and industry movements are set out below:

1. As on July 4, 2022, HDFC Bank's proposed merger with parent HDFC is expected to be fully executed in the next 18 months. Once all approvals are in place, HDFC Bank will become a 100% publicly owned institution, with HDFC's 21% promoter holding getting extinguished.
2. US-based private equity giant Apollo Global Management is rethinking its asset reconstruction company (ARC) joint venture with ICICI Bank after it failed to take off due to intense competition in the distressed debt space. It is also exploring new avenues to invest in the space, like through an Alternative Investment Fund (AIF).
3. Axis Bank and Citibank's respective Boards of Directors approved the acquisition of Citibank's consumer businesses in India by Axis Bank. The acquisition is subject to customary closing conditions, including receipt of regulatory approvals.

Various sectors in the FinTech industry see new Unicorns and high value investments. The period between June to September , also saw Indian FinTech companies entering the unicorn, club along with huge investments in fintechs, which are enumerated below:

1. In July 2022, One Card joined the unicorn club, after it raised $100 million in a round led by Temasek. According to calculations by companies, the startup's valuation reached $1.25 billion with the latest funding round.
2. Debt marketplace CredAvenue joined the unicorn club with $137 million funding from Insight Partners, B Capital, and Dragoneer Investment Group, among others.
3. Multiples Alternate Asset Management invested $30 million in fintech platform Niyo, which offers digital savings accounts and other banking services in partnership with banks.
4. Hyperface, a credit-card infrastructure provider, started by Juspay cofounder Ramanathan RV, has raised $9 million in funding, led by 3one4 Capital. Existing investors such as Global Founders Capital, Better Capital, and new investors Flipkart Ventures, Groww, and Rebalance Angel Community participated in the funding.
5. DaoLens, a business-to-business (B2B) decentralised autonomous organisation service provider has raised an undisclosed amount in funding from 36 angel investors, including CoinDCX cofounders Neeraj Khandelwal and Sumit Gupta, and Nazara Technologies CEO Manish Agarwal, among others.

cyril amarchand mangaldas
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LIST OF CONTRIBUTORS

Anu Tiwari
Partner

Ketaki Mehta
Partner

Pallavi Rao
Partner

Jian Johnson
Partner

Shehryar Khanum
Consultant

Saurabh Sharma
Principal Associate

Utkarsh Bhatnagar
Principal Associate

Kush Wadehra
Senior Associate

Himani Doot
Associate

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Cyril Amarchand Mangaldas
Advocates & Solicitors

100 years of legacy | **1000** Lawyers | **Over 160** Partners

Peninsula Chambers, Peninsula Corporate Park, GK Marg, Lower Parel, Mumbai – 400 013, India
T +91 22 2496 4455 **F** +91 22 2496 3666 **E** cam.mumbai@cyrilshroff.com **W** www.cyrilshroff.com
Presence in Mumbai | Delhi-NCR | Bengaluru | Ahmedabad | Hyderabad | Chennai | GIFT City | Singapore