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RBI | Alternative to ARCs on anvil as RBI issues discussion paper on Securitization of Stressed Assets Framework

On January 25, 2023, the RBI released a discussion paper on securitization of stressed assets framework leading to creation of one more alternative for lenders for resolving loans. Securitization refers to a process that includes the pooling of loans and then selling them to a Special Purpose Entity (**SPE**) which then issues securities backed by the loan pool and RBI seeks views that these SPEs and resolution managers should be under regulatory purview.

Pursuant to 'market feedback, stakeholder consultations and the recommendations of the Task Force on Development of Secondary Market for Corporate Loans (RBI, 2019)', the RBI had, in September 2022, announced its intent to look beyond the ARCs for securitization of NPAs. Presently, the SARFAESI Act, 2002 provides for securitization of stressed assets/NPAs through securitization by ARCs.

In the case of securitization of stressed assets, the originator of non-performing assets (**NPAs**) sells them to an SPE, which in turn appoints an entity to manage the stressed assets. Investors who buy securitization notes are paid based on recovery from the underlying assets. Securitization of Stressed Assets Framework (**SSAF**) is a relatively new concept globally as well, with European Union and UK having introduced some regulations around it.

Key aspects

- The discussion paper said the main difference between the securitization of stressed assets and the standard assets is related to the lower degree of certainty of cash flows from the underlying pool in the case of stressed assets
- The role of SPEs and the resolution managers is of paramount importance because of their involvement with resolution/recovery exercise of the underlying exposures and reporting requirements to financial regulators
- Investors are exposed to the risk that the resolution exercise may not generate sufficient recoveries to cover the net value of the transferred underlying assets
- A set of questions has been raised including whether the framework should apply only for loans recognized NPAs or it should include loans that are in categories like special mention accounts or tagged as standard assets. Responses to the question may draw upon pertinent implications regarding regulatory arbitrage and impact on resolution strategy and effectiveness. Such an approach would balance out the desirability of the resolution manager to have 'skin-in-the-game' as well without putting the onus solely on the Resolution Manager to finance expenses from own funds solely.
- The market is keen to choose retail stressed assets such as mortgages, unsecured personal loans and loans taken by MSMEs. In these categories of loans, where the borrower base is diversified, the cash flows are relatively predictable even where the assets are stressed, and borrowers often continue to make regular payments.

While the RBI had in September 2021 issued a revised framework for securitization of standard assets, at present there is no corresponding mechanism for securitization of NPAs through the SPE route. Based on market feedback, the RBI decided to enable such a process.

The discussion paper can be accessed here: https://www.rbi.org.in/Scripts/PublicationsView.aspx?id=21728

RBI | Diversification of control and ownership of Banking Companies

The RBI with the objective of ensuring that the ultimate ownership and control of banking companies are diversified, and the major shareholders of such companies are 'fit and proper', has recently issued the Master Direction – RBI (Acquisition and Holding of Shares or Voting Rights in Banking Companies) Directions, 2023[1] (**Directions**).

Key aspects

- The Directions shall be applicable to all banking companies as defined under Section 5 of the Banking Regulation Act, 1949 (**Act**) including to Local Area Banks (**LABs**), Small Finance Banks (**SFBs**) and Payments Banks (**PBs**) operating in India (**Banking Companies**).
- The Directions are to be read along with the Guidelines on acquisition and holding of shares or voting rights in Banking Companies (**Guidelines**). As per the said Guidelines, limits have been set on the shareholding of promoters and non-promoters of a Banking Company, wherein:
  - Promoters are permitted to hold 26% of the paid-up share capital or voting rights of the Banking Company (after the completion of 15 years from commencement of business). Prior to the above, the promoters may be allowed to hold a higher percentage of shareholding as part of the licensing conditions.
  - Non-promoters are permitted to hold 10% of the paid-up share capital or voting rights in case of natural persons, non-financial institutions, etc. and 15% in case of financial institutions, PSUs and central/state government.
- The Directions require any person proposing to acquire shares in a banking company, which acquisition would result in such person holding 5% or more of the paid-up capital of the banking company, to seek prior approval by making an application to the RBI.
- In respect of a person who is permitted to have a shareholding of 10% or above but not more than 40% of the paid-up equity share capital of the Banking Company, the shares so acquired shall remain under lock-in for the first 5

[1] RBI Directions: https://rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=12439#1

years from the date of completion of acquisition. However, in case any person is permitted by the RBI to have a shareholding of 40% or more, then only 40% shares shall remain under lock-in for the first 5 years from acquisition.

- As per the Directions, any person, whether a natural or a legal person, intending to make an acquisition which is likely to result in major shareholding in a Banking Company is required to seek a prior approval of the RBI by submitting an application in this regard.
- The RBI would undertake due diligence to assess the 'fit and proper' status (as provided in Annex II of the Directions) of the applicant, pursuant to which it may: (a) accord or deny permission, or (b) accord permission for acquisition of a lower quantum of aggregate holding than that has been applied for. Any decision by the RBI in this respect shall be binding on both the applicant and the concerned Banking Company.
- Subsequent to such acquisition, if at any point in time the aggregate holding of the person falls below 5%, as per Section 12B (1) of the Act, then in such a case the person will be required to again obtain prior approval from RBI to raise the aggregate holding to 5 % or more.
- In addition to the above, under the Directions, following monitoring arrangements are required to be adhered by Banking Companies:
  - **Due Diligence:** Under the latest Master Direction, banking companies are now required to have their own 'fit and proper' criteria, too, for such major shareholders (for this, the Master Direction also lays down certain illustrative minimum criteria which ought to be followed/referred to). Hence, for any such acquisition to go through, the banking company is required to assess the relevant person on the yardstick of its own said criteria, conduct due diligence, and then pass a board resolution and forward its comments (in a prescribed form) to the RBI. The RBI thereafter undertakes its own due diligence on the said applicant to assess if it is 'fit and proper', before deciding on the application. Henceforth, no person from FATF non-compliant countries may acquire any shares of a banking company which would make it a major shareholder (i.e., with >5% shareholding/voting rights). Even after the acquisition, the banking company is required to monitor the 'fit and proper' status of major shareholders on a continuous basis
  - **Monitoring mechanism for SBO:** Banking Companies shall put in place a mechanism to obtain information on any change in Significant Beneficial Owner (SBO) or acquisition by a person to the extent of 10 % or more of paid-up equity share capital of the major shareholder.
  - **Regular reporting:** Banking Companies shall submit periodical reports on the continuous monitoring arrangements to its board.
  - **Diversification of shareholding:** Banking Companies (excluding Payments Banks) in which a person has an aggregate holding which is not in conformance with the Guidelines, as on the date of issue of the Directions, shall within 6 months from the date of issue of the Directions submit a shareholding dilution plan.

RBI | Operationalization of Central Bank Digital Currency – Retail (e₹-R) pilot

On November 29, 2022, the RBI launched the first pilot for Retail Digital Rupee, which commenced from December 1, 2022. Earlier, the RBI had launched the first pilot in the Digital Rupee - Wholesale segment (e₹-W) which was initiated from November 1, 2022. The e-Rupee is a Central Bank Digital Currency (**CBDC**), which is defined by the RBI as the legal tender issued by a Central Bank in a digital form. It is the same as a sovereign currency and is exchangeable one-to-one at par (1:1) with the fiat currency[2]. Not long ago, the Reserve Bank of India Act, 1934 was also amended to include digital currency in the definition of bank notes[3].

As per the Concept Note on CBDC released by the RBI on October 7, 2022, the Retail Digital Rupee is primarily devised for consumption of common public with features akin to physical cash viz. anonymous, unique serial numbers, etc. It is a token-based system where a type of digital token issued by and representing a claim on the central bank. The digital token would effectively function as the digital equivalent of a banknote that could be transferred electronically from one holder to another.

A token CBDC is a 'bearer-instrument' like banknotes, meaning that whoever 'holds' the tokens at a given point in time would be presumed to own them. Under a token-based Retail Digital Rupee regime, users would be able to withdraw digital tokens from banks in the same way they can withdraw physical cash. They would maintain their digital tokens in a wallet and could spend them online or in person or transfer them via an app.

The pilot aims to cover select locations in Closed User Group (**CUG**) comprising participating customers and merchants[4]. Around 50,000 individuals and merchants have been selected for the pilot along with four banks - State Bank of India (**SBI**), ICICI Bank, Yes Bank and IDFC First Bank. The pilot initially covers four cities, viz., Mumbai, New Delhi, Bengaluru and Bhubaneswar and will later extend to Ahmedabad, Gangtok, Guwahati, Hyderabad, Indore, Kochi, Lucknow, Patna and Shimla[5]. Users will be able to transact with Retail Digital Rupee

[2] https://www.rbi.org.in/Scripts/BS_SpeechesView.aspx?Id=1111

[3] Section 2 (aiv) of the Reserve Bank of India Act, 1934

[4] https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=54773

[5] https://www.hindustantimes.com/india-news/lowvalue-payment-in-digital-rupee-may-bemadeanonymous-101673200173755.html

through a digital wallet offered by the participating banks and stored on mobile phones/devices. Transactions can be both Person to Person (**P2P**) and Person to Merchant (**P2M**). Payments to merchants can be made using QR codes displayed at merchant locations[6]. As of February 1, 2023, Infibeam Avenues Limited flagship brand - CCAvenue, has become India's first payment gateway player to process CBDC or e₹ transactions for online retail merchants[7].

This is a welcome step taken by the RBI, as a proposed full roll out of a CBDC in the entire country would reduce time and costs in transactions, reduce operational costs involved in managing physical cash in the country, enable real-time tracking and ledger maintenance all due to its blockchain technology. In addition, India will be at par with countries such as the Bahamas (Sand Dollar), Jamaica (JAM-DEX), Nigeria (e-Naira) and 8 countries in the Eastern Caribbean Union (DCash) having a digital currency backed by a Central Bank[8].

Although the Government has deferred the introduction of a bill in parliament to regulate cryptocurrency, it plans to introduce Standard Operating Procedures (**SOPs**) for global regulation of cryptocurrencies during India's G20 presidency, from Dec. 1, 2022, to Nov. 30, 2023[9]. A side event for the 1st International Financial Architecture Working Group Meeting of the G20 Finance Track, titled 'Central Bank Digital Currencies (CBDCs): Opportunities and Challenges' was held in Chandigarh recently indicating that further developments can expected for CBDCs as well[10].

SEBI | Latest developments in Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements), 2023

By way of notification dated January 17, 2023, the Securities Exchange Board of India (**SEBI**) amended Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 (LODR). Some of the key changes introduced by the amendment are set forth below, which are applicable from January 17, 2023.

- The definition of 'senior management' has been broadened, which now includes 'Functional Heads' of the listed entities along with all the members of the management one level below CEO or Managing Director or Whole Time Director or Manager, and the Company Secretary and the Chief Financial Officer.
- The compliances of SEBI LODR Regulations applicable on 'senior management' shall also be applicable on the Functional Heads of the organizations as well.
- The word re-appointment has been inserted under Regulation 17, as per which the approval of shareholders is required within 3 months in case of both appointment and re-appointment of a director/manager. Earlier, the clause stated that 'the approval of shareholders would be required within 3 months from the date of appointment or a general meeting, whichever is earlier'. Therefore, it has been amended with effect from April 01, 2023.
- A proviso has been inserted in Regulation 17 (1C) as per which listed public sector companies can now obtain shareholders' approval at the next general meeting. They are exempted from seeking shareholders' approval for the appointment/re-appointment of director/manager within 3 months from the date of appointment.
- Definition of listed public sector company has been clarified i.e. it shall mean a company in which 51% or more of the subscribed and paid-up equity is owned and controlled by the Central or State Government or both.
- The details of material subsidiaries of all the listed entities such as, the date and place of incorporation, the name and date of appointment of the statutory auditors, should be disclosed in the annual report with effect from FY 22-23 & onwards.

SEBI | Asset Management Companies with active ELSS allowed to launch passively managed ELSS

SEBI vide its letter dated January 10, 2023 to the Association of Mutual Funds in India (**AMFI**) has allowed mutual funds or Asset Management Companies (**AMCs**), which are engaged in 'actively managed' Equity Linked Savings Schemes (**ELSS**), to also launch passive ELSS.

Earlier, as per SEBI's circular on the Development of Passive Funds dated May 23, 2022 (**Circular**), the AMCs were restricted to either launch an active ELSS or passive ELSS, but not both. Now, AMCs are allowed to launch passively managed ELSS schemes but only after they stop accepting fresh money/inflows in their existing active ELSS plans. The AMCs are also required to ensure the closure of the existing actively managed ELSS fund before introducing a new passively managed ELSS.

The ELSS which is an open-ended scheme category for undertaking investment into equity or equity-related instruments is regulated under the ELSS, 2005. The ELSS schemes offer tax exemption to a unit holder/investor under Section 80C of the Income Tax Act and while there is no maximum tenure of investment, there is a minimum lock-in period of 3 years.

With reference to actively managed ELSS, the fund managers are the decision-makers and select stocks as per their discretion/judgment, which leads to a higher expense ratio. In comparison, the passive ELSS category, which was introduced in

[6] Supra
[7] https://www.livemint.com/industry/banking/infibeam-avenues-says-ccavenue-becomes-india-s-first-payment-gateway-player-to-process-digital-rupee-11675058399175.html
[8] https://www.atlanticcouncil.org/cbdctracker/
[9] https://www.financialexpress.com/blockchain/india-aims-to-develop-crypto-sops-during-g20-presidency-fm-sitharaman/2713550/
[10] https://timesofindia.indiatimes.com/city/chandigarh/india-working-on-agreement-on-how-to-ensure-global-economic-and-financial-stability/articleshow/97509624.cms

2022 vide the above said Circular, are benchmarked to a particular index in the passive mode without the involvement of a fund manager, such as Nifty 50, Nifty 100 or Nifty 200. Since there are no fund managers required, therefore the passively managed ELSS has a lower expense ratio.

Key aspects

Following are the steps involved for launching a passive ELSS scheme by an AMC which already has an actively managed ELSS scheme:

- AMCs to stop all fresh inflows/subscriptions, including that to Systematic Investment Plans (**SIPs**) and Systematic Transfer Plans (**STPs**), from the actively managed ELSS scheme. This is required to be done after a written communication about the proposed change, the date from which the scheme shall be stopped due to the proposed launch of a passively managed scheme, along with reasons and benefits of it, have been duly communicated to a unitholder.
- AMCs to give an advertisement about the closure of the existing actively managed scheme in a newspaper which is to be published in at least 1 English daily newspaper having a nationwide circulation.
- Unitholders to be given the option to redeem their units without exit load by the AMC, subject to lock-in requirements.
- Pursuant to completion of 3 years from the date of stopping inflows in the actively managed ELSS scheme, the said scheme shall be merged with the passively managed ELSS scheme, and the investments would be managed passively thereafter.
- As the passively managed ELSS are much cheaper with a lower expense ratio in comparison to the active ones, therefore, along with tax benefits associated with ELSS, a lower expense ratio shall lead to unitholder being able to save more money, thereby allowing the AMCs engaged in actively managed ELSS to get more inflows of funds while greater flexibility to either choose passively managed ELSS or continue with the existing actively managed scheme.

SEBI | Principles-backed approach on ESG ratings

Expected over the next few months, SEBI will adopt a principles-based approach in its first set of rules for rating a company on environment, social and governance (**ESG**) issues. This initiative would allow such scores to be assigned to more companies, making it increasingly possible for investors to assess businesses with a yardstick seen to be growing in importance.

The draft rules will follow global regulators like global regulators such as the European Securities and Market Authority (**ESMA**), the Securities Exchange Commission in the United States and the China Securities Regulatory Commission (**CSRC**).

Key aspects

- This move will steer clear of prescribing too many rules but follow a principle-based approach with more concentration on disclosures.
- The rules would focus on three aspects such as:
  - Who pays for the rating?
  - What information is considered in deciding the score?
  - The relative weights assigned to environmental, social and governance policies?
- In a shift from the most used model, in which a company issuing securities paying for the ratings, the regulator plans to allow payment by either a company or a group of investors instead wherein the risk gets minimized and the ratings are more accurate.
- The rules would permit two categories of ratings providers:
  - The first would group those that have a dialogue with the issuer and can get data from the company.
  - The second would consist of firms assigning ESG ratings solely on the basis of publicly available information.
- Ratings providers will be able to use information from the Business Responsibility and Sustainability Report (**BRSR**), a mandatory requirement for the top 1,000 listed companies by market capitalization.
- While ratings providers will have flexibility to assign different weights to environmental, social and governance policies they will have to make adequate disclosures of the factors governing ratings.

SEBI | Intermediaries need prior nod for change in control

In a modification of the existing rules by SEBI, market intermediaries must now seek prior approval for any change of control in the company structure.

Key aspects

- An intermediary is required to apply online for SEBI's prior approval and along with the application, the entity concerned has to submit various details, including the current and proposed shareholding pattern of the applicant.
- The prior approval granted by SEBI is valid for a period of six months from the date of such approval within which the applicant needs to file application for fresh registration pursuant to change in control.
- Cases involving scheme of arrangements should file the application with SEBI prior to filing the application with NCLT. An in-principal approval will be given for three months provided all other regulatory compliances are met. Within 15 days from the date of the National Company Law Tribunal's order, the intermediary should submit an online application for SEBI's final approval.
- Market Intermediaries include stockbroker/clearing member, depository participant, investment adviser, research analyst or research entity, registrar to an issue and share transfer agent and KYC (Know Your Client) Registration Agencies (**KRAs**).

Real Estate | Proposed changes to resolution mechanisms under IBC

The IBC (Second Amendment) Act, 2018 vide amendment no. 26 of 2018 dated August 17, 2018 granted homebuyers – also referred to as the 'Real Estate Allottee' – the status of 'Financial Creditor' under the purview of Section 5(8)(f) of Insolvency and Bankruptcy Code (IBC or Code) by including the terms 'any amount raised from an allottee under real estate project to be deemed to have commercial effect' (the constitutional validity of this amendment was upheld in the case of ***Pioneer Urban Land and Infrastructure Ltd. V. UOI***[11]. However, soon it was observed that the Corporate Insolvency Resolution Process (CIRP) against the entire parent entity of a real estate company for a default in one project proved counter to the objective of speedy resolution in the real estate sector.

With a view to streamlining the insolvency resolution process, recasting the liquidation process and reforming the role of service providers under the Code pertaining to the real estate sector, a notification by the Insolvency Bankruptcy Board of India under File No. 30/38/2021 dated January 18, 2023 has been issued to invite objections to the proposed mechanisms to speed up the redressal system and provide decent opportunities to allottees. The two primary mechanisms being contemplated are:

- **Project-wise Insolvency Resolution:** This simply refers to allowing only that project to go under the CIRP which is at default or becoming insolvent, thus attempting to localize the pain point even while making it easy and advantageous for both the developer and allottee to function smoothly.
- **Reverse CIRP:** With this approach, it is possible for the corporation to continue managing the project's implementation while still preserving the existence of the project's original promoter. Under this approach, the said promoter remains outside the purview of CIRP but intends to play the role of a lender at the same time.

With the proposed amendments, particularly those relating to Project-wise Insolvency, all stakeholders stand to benefit. An adequately designed settlement can be reached depending on the real estate project's situation and the goals of the relevant stakeholders, which will largely comprise the project's allottees or financial creditors resulting in a minimal or low conflict of interest and the interests of all the home buyers will not be affected due to one single project default by a company. For instance, if all projects go under CIRP, instead of having their advances repaid with appropriate haircuts or having the liquidation process start, some allottees of other projects of the same corporation would want to have title and control of the land, apartment, or building per se leading to a deficit in needs of allottees aching. Also, the allottees of other projects will be ring fenced from the impact of the project default and that shall restrict the extent of impact numerically. Thus, it can safely be surmised that the proposed regime shall have the propensity towards a speedier resolution untrammeled by complexities of the current situation.

Miscellaneous | Centre sets green hydrogen, ammonia consumption targets

On launching its policy for Green Energy, the government has set green hydrogen and ammonia consumption targets for some industries to create demand for cleaner fuel. India approved a plan of incentives worth more than USD 2 billion last week to develop a green hydrogen production capacity of 5 million tons a year by 2030. This incentive plan will help to cut emissions making India a major exporter in the field, with the aim to achieve net-zero carbon emissions by 2070.

Green hydrogen is a zero-carbon fuel made by electrolysis, using renewable power from wind and solar to split water into hydrogen and oxygen and India wants to apply green hydrogen to replace grey hydrogen, produced using gas, as it moves to decarbonize sectors such as oil and fertilizers.

Key aspects

- All the state-run oil and gas companies that charter 40 vessels for fuel transport will also have to hire at least one ship powered by green hydrogen each year from 2027 to 2030.
- Green ammonia bunkers and refueling facilities will be established at all major ports.
- For Hydrogen-powered shipping lines, the state-run Shipping Corporation of India will retrofit at least two ships to run on green hydrogen-based fuels by 2027.
- India aims to end imports of ammonia-based fertilizer by 2034 to 2035, replacing them with locally produced green ammonia-based soil nutrients.
- The government will also invite bids to set up two domestic green hydrogen-based urea and diammonium phosphate plants.

The policy also requires new steel plants to be capable of operating on green hydrogen. India's announcement that it aims to reach net zero emissions by 2070 and to meet fifty percent of its electricity requirements from renewable energy sources by 2030 is a hugely significant moment for the global fight against climate change.

[11] (2019) 8 SCC 416: (2019) 4 SCC (Civ) 1: (2019) SCC Online SC 1005

Contributors

Amaresh Singh
Partner

Ashutosh Gupta
Partner

Jivesh Chandrayan
Partner

Monali Dutta
Partner

Ravi Jain
Partner

Soumya Kanti De Mallik
Partner

Sumit P
Partner

Prithviraj Chauhan
Senior Associate

Bhagwati Tiwari
Associate

Pradyun Chakravarty
Associate

Pranav Rattan
Associate

Rhea Lobo
Associate

Unnati Goel
Associate

Meeval Varghese
Intern

Srishti Bansal
Intern

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CONTACT US

www.hsalegal.com

mail@hsalegal.com

HSA Advocates

PAN INDIA PRESENCE

New Delhi
Email: newdelhi@hsalegal.com

Mumbai
Email: mumbai@hsalegal.com

Bengaluru
Email: bengaluru@hsalegal.com

Kolkata
Email: kolkata@hsalegal.com