



NEWSLETTER

Legal, Compliance and ESG

June 4, 2019

Dear Readers,

We bring to your attention and reading following topics for this month:

- A) Legal and Regulatory Updates:
 - I. Liquidity Risk Management Framework for Non-Banking Financial companies and Core Investment Companies – Draft Guidelines for public comments
 - II. Amendment to Master Direction (MD) on KYC
- B) Importance of IT Clearance under section 281 of Income-Tax Act, 1961 (“**IT Act**”) for security creation in lending transactions;
- C) Importance of Stamping of Legal Documents; and
- D) ESG at APAC Group.

A) Legal and Regulatory Updates:

- I. Liquidity Risk Management Framework for Non-Banking Financial companies and Core Investment Companies – Draft Guidelines for public comments

RBI has issued draft guidelines to revise the extant guidelines on liquidity risk management to strengthen and raise the standard of Asset Liability Management (ALM) framework applicable to NBFC and invited comments on or before June 14, 2019. Key highlights of the same are as below:

- all non-deposit taking NBFCs with asset size of 1 billion and above, systemically important Core Investment Companies and all deposit taking NBFCs irrespective of their asset size, shall adhere to the set of liquidity risk management guidelines proposed in the draft Circular.
- it will be the responsibility of the Board of each NBFC to ensure that the guidelines are adhered to. The internal controls required to be put in place by NBFCs as per these guidelines shall be subject to supervisory review.
- the draft guidelines cover the application of generic Asset Liability Management (ALM) principles, granular maturity buckets in the liquidity statements and tolerance limits, liquidity risk monitoring tool and adoption of the “stock” approach to liquidity;
- the board of NBFCs shall have to frame a liquidity risk management framework which ensures sufficient liquidity is maintained and to have the overall responsibility for the management of liquidity risk.

- NBFCs should formulate a contingency funding plan (CFP) for responding to severe disruptions, publicly disclose information on a regular basis that enables market participants to make an informed judgment, make public disclosure on liquidity risk to be made on quarterly basis, disclosure on top 20 large deposits, top 10 borrowings and funding concentration must be regularly disclosed to investors.
- NBFCs will have to maintain minimum high-quality liquid assets of 100% of total net cash outflows over the following 30 calendar days.
- the draft suggested setting up of a risk management committee, an asset-liability management committee and an asset-liability management support group in NBFCs.
- a granular maturity bucket system has been proposed to keep a check on mismatches across tenures. Under new norms, the 1-30 days bucket would be bifurcated into 1-7 days, 8-14 days, and 15-30 days buckets. Also, NBFCs will need to monitor their cumulative mismatches (running total) across all other time buckets up to 1 year by establishing internal prudential limits with the approval of their boards.
- The draft circular requires the NBFCs to actively manage their collateral positions, differentiating between encumbered and unencumbered assets;
- NBFCs should have sufficient collateral to meet expected and unexpected borrowing needs and potential increases in margin requirements over different time frames. The NBFCs have to formulate a contingency funding plan for responding to severe disruptions, which might affect their ability to fund some or all of their activities in a timely manner and at a reasonable cost.
- The NBFCs, however, are expected to monitor their cumulative mismatches (running total) across all other time buckets up to one year by establishing internal prudential limits with the Board's approval.
- The NBFCs are required to adopt liquidity risk monitoring tools/metrics in order to capture strains in liquidity position, if any. Such monitoring tools should cover concentration of funding by counterparty/instrument/currency, availability of unencumbered assets that can be used as collateral for raising funds, and certain early warning market-based indicators such as price-to-book ratio, coupon on debts raised, breaches, and regulatory penalties.
- In addition to the measurement of structural and dynamic liquidity, NBFCs have also been mandated to monitor liquidity risk based on a "stock" approach to liquidity. The monitoring will be by way of predefined internal limits as decided by the Board for various critical ratios pertaining to liquidity risk.
- LCR
 - a. All non-deposit taking NBFCs with asset size of ₹5,000 and above, and all deposit taking NBFCs irrespective of their asset size, need to maintain a liquidity buffer in terms of a Liquidity Coverage Ratio (LCR).

- b. This will promote the resilience of NBFCs to potential liquidity disruptions by ensuring that they have sufficient High-Quality Liquid Asset (HQLA) to survive any acute liquidity stress scenario lasting for 30 days.
- c. The stock of HQLA to be maintained by the NBFCs will be minimum of 100 per cent of total net cash outflows over the next 30 calendar days. The LCR requirement will be binding on NBFCs from April 1, 2020 with the minimum HQLAs to be held being 60 per cent of the LCR, progressively increasing reaching up to 100 per cent by April 1, 2024.

II. Amendment to Master Direction (MD) on KYC

- Banks have been allowed to carry out Aadhaar authentication/ offline-verification of an individual who voluntarily uses his Aadhaar number for identification purpose. (*Section 16 of the amended MD on KYC*).
- ‘Proof of possession of Aadhaar number’ has been added to the list of Officially Valid Documents (OVD) with a proviso that where the customer submits ‘Proof of possession of Aadhaar number’ as OVD, he may submit it in such form as are issued by the Unique Identification Authority of India (UIDAI). (*Section 3 of the amended MD*).
- For customer identification of “individuals”:
 - For individual desirous of receiving any benefit or subsidy under any scheme notified under section 7 of the Aadhaar (Targeted Delivery of Financial and Other subsidies, Benefits and Services) Act, 2016, the bank shall obtain the customers Aadhaar and may carry out its e-KYC authentication based on his declaration that he is desirous of receiving benefit/subsidy under the Aadhaar Act, 2016. (*Section 16 of the amended MD*)
 - For non-DBT beneficiary customers, the Regulated Entities (REs) shall obtain a certified copy of any OVD containing details of his identity and address along with one recent photograph. (*Section 16 of the amended MD*)
- REs shall ensure that the customers (non-DBT beneficiaries) while submitting Aadhaar for Customer Due Diligence, redact or blackout their Aadhaar number in terms of sub-rule 16 of Rule 9 of the amended PML Rules. (*Section 16 of the amended MD*)
- REs other than banks may identify a customer through offline verification under the Aadhaar Act with his/her consent. (*Section 16 of the amended MD*)
- In case OVD furnished by the client does not contain updated address, certain deemed OVDs for the limited purpose of proof of address can be submitted provided that the OVD updated with current address is submitted within 3 months. (*Section 3(a) ix of the amended MD*)
- For non-individual customers, PAN/Form No. 60 of the entity (for companies and Partnership firms – only PAN) shall be obtained apart from other entity related documents. The PAN/Form No. 60 of the authorised signatories shall also be obtained. (*Section 30-33 of the amended MD*)

- For existing bank account holders, PAN or Form No. 60 is to be submitted within such timelines as may be notified by the Government, failing which account shall be subject to temporary ceasing till PAN or Form No. 60 is submitted. However, before temporarily ceasing operations for an account RE shall give the customer an accessible notice and a reasonable opportunity to be heard. (*Section 39 of the amended MD*)
- Also, additional certifying authorities for certifying the OVDs of Non-Resident Indian (NRI) and Person of Indian Origin (PIO) customers have been specified in section 3(a)(v) of the Master Direction i.e.
 - i. authorised officials of overseas branches of Scheduled Commercial Banks registered in India,
 - ii. branches of overseas banks with whom Indian banks have relationships,
 - iii. Notary Public abroad,
 - iv. Court Magistrate,
 - v. Judge,
 - vi. Indian Embassy/Consulate General in the country where the non-resident customer resides.

CHANGES / ADDITIONS IN DEFINITIONS

Section	2016	2019
3 a (i)	“Aadhaar number”, as defined under sub-section (a) of section 2 of the Aadhaar (Targeted Delivery of Financial and Other Subsidies, Benefits and Services) Act, 2016, henceforth ‘The Aadhaar Act’, means an identification number issued to an individual by Unique Identification Authority of India (UIDAI) on receipt of the demographic information and biometric information as per the provisions of the Aadhaar (Targeted Delivery of Financial and Other Subsidies, Benefits and Services) Act, 2016.	“Aadhaar number”, as defined in the Aadhaar and Other Law (Amendment) Ordinance, 2019, means an identification number issued to an individual under sub-section (3) of section 3 of the Aadhaar (Targeted Delivery of Financial and Other Subsidies, Benefits and Services) Act, 2016 (18 of 2016), and includes any alternative virtual identity generated under sub-section (4) of that section.
3 a (iii)	“Authentication”, as defined under sub-section (c) of section 2 of the Aadhaar Act, means the process by which the Aadhaar number along with demographic information or biometric information of an individual is submitted to the Central Identities Data Repository (CIDR) for its verification and such Repository verifies the correctness, or the lack thereof, on the basis of information available with it;	“Authentication”, in the context of Aadhaar authentication, means the process as defined under sub-section (c) of section 2 of the Aadhaar (Targeted Delivery of Financial and Other Subsidies, Benefits and Services) Act, 2016.
3 a (v)	New Insertion	Certified Copy of OVD” - Obtaining a certified copy by regulated entity shall mean

		comparing the copy of officially valid document so produced by the customer with the original and recording the same on the copy by the authorised officer of the regulated entity.
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B) Importance of IT Clearance under section 281 of Income-Tax Act, 1961 (“IT Act”) for Security Creation in Lending Transactions

The IT Act provides that if any person transfers or alienates (sale, mortgage, gift etc.) any property **while any proceedings under the Income-Tax Act is pending**, such transfer/alienation is void as against demand from income-tax unless (a) the transaction is for adequate consideration and without notice of pending proceedings/demand; or (b) with previous approval of the tax officer. However, the above provision does not apply to stock in trade.

As per Section 281(1)(ii) of IT Act, if there are any outstanding income tax assessment proceedings/pending claims on the date of creation of security in lender’s favour, then IT Department will have priority over our charges to the extent of the amount which becomes due under the relevant IT proceedings unless a prior approval for creation of security is obtained from the Assessing Officer of IT department. However, once IT Department gives its approval or if there are no outstanding IT assessment proceedings on the date of creation of security, we will have priority notwithstanding any claim from IT Department in respect of any tax dues which arise subsequent to creation of security in our favour.

To get a certificate, one needs to file an application with the assessing officer of its ward or area, stating the need for a tax-clearance certificate and the purpose for it. The officer would then review the case and accordingly honour or reject the application. Typically, it is issued in 10-15 days after payment of a nominal fee.

C) Importance of Stamping of Legal Documents:

All the legal documents chargeable with stamp duty and executed by the person in India shall be **stamped before or at the time of execution such documents**. The stamp duty payable would be as per the stamp laws of the State in which the instrument/document is executed. The stamp duty varies from State to State.

In case of a document which is required to be stamped under the applicable Stamp Act but has been under-stamped or not stamped, the document becomes inadmissible as evidence before the Court of Law. Under-stamped document can be impounded and the penalty over and above the actual stamp duty can be levied by

the stamp authorities. Further for the under-stamped document to be admitted as an evidence in the Court of Law, the document will have to be stamped with full stamp duty along with the penalty over and above the actual stamp duty (e.g. in the State of Maharashtra the penalty is @2% of the deficient portion of the stamp duty for each month or part thereof, from the date of execution of such instrument).

Further as per the stamp acts applicable to various states, any person who with the intention to evade the stamp duty executes or signs any instrument chargeable with duty without the same being duly stamped shall, on conviction, for every such offence be punished with rigorous imprisonment for a term which shall not be less than one month but which may extend six months and with a fine which may extend to rupees five thousand.

As per the new section 30A inserted in the Maharashtra Stamp Act in 2013, the liability to pay proper stamp duty on any instrument executed in favour of financial institutions such as bank, non-banking finance company or alike, is imposed on such financial institution.

D) ESG at APAC Group

APAC believes it should invest in a responsible fashion, considering environmental, social and corporate governance (ESG) and business integrity matters.

Some of the key aspects of ESG are as follows:

Every business of APAC will:

- operate in compliance with applicable local and national laws including laws covering environmental impacts, labour rights, social issues, corporate governance and those intended to prevent extortion, bribery, corruption and financial crime;
- operate in compliance with relevant international sanctions, including those of the European Union and the United Nations;
- implement management systems, appropriate to the size and nature of the business, that ensure a systematic approach to ESG risk assessment, addressing relevant risks, monitoring and reporting on progress and, to the extent possible, involving stakeholders;
- uphold high standards of business integrity and honesty;
- adopt and implement policies to prevent extortion, bribery, fraud, corruption and financial crime in accordance with local law requirements and international best practice;
- properly record, report and review financial and tax information;
- establish corporate governance practices appropriate to the size and nature of the business;
- deal with regulators in an open and co-operative manner; and
- use information received from its business partners only in the best interests of the business relationship and not for personal financial gain by any worker.

Also, APAC would not invest with or lend borrowers, who are involved in any of the following activities:

- Production of, or trade in, any product or activity deemed illegal under applicable local or national laws or regulations or subject to internationally agreed phase-outs or bans as defined in global conventions and agreements such as certain:
 - hazardous chemicals, pharmaceuticals, pesticides/herbicides and wastes;
 - polychlorinated biphenyl (PCBc)
 - ozone depleting substances;
 - endangered or protected wildlife or wildlife products; and
 - unsustainable fishing methods such as blast fishing and drift net fishing in the marine environment using nets in excess of 2.5 kilometers in length;
- Production of, or trade in, arms (i.e. weapons, munitions or nuclear products);
- Production of, use of, or trade in, unbonded asbestos fibres;
- Production of, or trade in, radioactive materials;
- Commercial logging operations for use in primary tropical moist forest.
- Production or trade in wood or other forestry products other than from sustainably managed forests;
- Production or activities involving harmful or exploitative forms of forced labor/harmful child labor; or
- Prostitution.
- Any businesses, if any of the following activities represents a substantial portion of such business:
 - gambling, gaming casinos and equivalent enterprises;
 - production or trade in alcoholic beverages (excluding beer and wine).
 - production of or trade in tobacco or tobacco related products; or
 - Pornography.

Sources:

1. <http://rbidocs.rbi.org.in/rdocs/Content/PDFs/DRAFT240520191328DA089BA641768EDAF5BEF059150.PDF>
2. <https://rbidocs.rbi.org.in/rdocs/notification/PDFs/NOTI190B865EC9E06464105A4A9318119A7455B.PDF>