



## NEWSLETTER

Legal, Compliance and ESG

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July 1<sup>st</sup>, 2019

**Dear Readers,**

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

- A) Legal and Regulatory Updates:
  - I. Highlights of Reserve Bank of India (Prudential Framework for Resolution of Stressed Assets) Directions, 2019;
  - II. Amendment to Housing Finance Companies (NHB) Direction, 2010;
  - III. Key decisions taken by SEBI in the board meeting dated June 27, 2019.
- B) Concept Note on Mortgage; and
- C) Article on implementation of ESG practices.

### **A) LEGAL AND REGULATORY UPDATES:**

#### **I. Highlights of Reserve Bank of India (Prudential Framework for Resolution of Stressed Assets) Directions, 2019<sup>i</sup>**

The Reserve Bank of India (“**RBI**”) has issued the Reserve Bank of India (Prudential Framework for Resolution of Stressed Assets) Directions, 2019 (“**New RBI Circular**”) on June 07, 2019 in which the RBI has continued the core principles of its circular dated February 12, 2018 (“**February 12 Circular**”) which was struck down by the Supreme Court

The New Circular creates an enabling framework for restructuring and resolutions outside the Insolvency and Bankruptcy Code, 2016 (“**IBC**”) as well as encourages use of IBC as a restructuring tool. It applies to banks, financial institutions as well as systematically important non-banking financing companies (“**NBFCs**”) (the February 12 Circular did not apply to NBFCs). Though it is not applicable for us as of now, it is important that we are aware of key features of the New RBI Circular.

Key Features:

#### **1. Default:**

The definition of default is the same as under the February 12 Circular, i.e. default is on day one. However, the RBI has introduced a 30-day review period for the lenders to decide on the resolution strategy.

#### **2. Timeline:**

The timeline of 180 days after the review period (i.e. 30 days) is provided for implementation of the resolution plan. There is no long stop date by which the resolution plan should be implemented. However, additional provisioning norms will apply after 180 days. Interestingly, while the New RBI Circular applies to NBFCs, the 'review period' is not triggered with a default to NBFCs.

**3. Inter-creditor Agreement:**

The lenders are expected to sign an inter-creditor agreement which will provide for the ground rules for finalisation and implementation of the resolution plan. The decision taken by 75% of the lenders by value and 60% of the lenders by number binds all lenders. The inter-creditor agreement is also expected to provide for protection for the dissenting creditors and creditors with differential security. The resolution plan must provide for liquidation value due to dissenting lenders (a concept which has been dispensed with in the IBC).

**4. Resolution Plan:**

Lenders have been given flexibility on the type of resolution plan that they may propose. The resolution strategy can include regularisation of the accounts, sale of debt, change in ownership and restructuring. Credit rating requirements continue to apply for resolution plans. Any change in ownership under the New Circular will have to comply with Section 29A of IBC. Additionally, it has also been stipulated that the new promoter should not be a person/ entity from the existing promoter group (including as defined under the SEBI regulations).

**5. Reporting requirements:**

The New RBI Circular requires the lenders to report defaulted loans of Rs. 50 million and above to the Central Repository of Information on Large Credits on monthly basis as opposed to quarterly basis earlier and also requires lenders to weekly report to the RBI instances of defaults by borrowers.

**6. Provisioning norms:**

Another important change under the New RBI Circular is to the provisioning regime. While the extant provisioning regime generally continues, delayed implementation of resolution plan attracts 20% additional provisioning after the 180 days-time period and another 15% after 365 days, which is applicable to all lenders of the borrower. The lenders are permitted to reverse the additional provisioning once the resolution fructifies. As a big push for the lenders to use the IBC as a resolution tool, the lenders are permitted to reverse their additional provisioning by half upon filing of the insolvency application under the IBC and the other half upon admission of such application. In addition, for IBC cases, the provisioning requirement freezes once a resolution plan has been filed for approval by the National Company Law Tribunal

("NCLT") for a period of 6 months from the filing of the plan with NCLT or 90 days from the approval of the plan by the NCLT, whichever is earlier.

**7. Upgrading of accounts:**

The New RBI Circular allows upgradation of accounts if, during the monitoring period, there is no default. The monitoring period is set with reference to the date by which at least 10% of the principal debt and the interest capitalised is repaid. This is a concession from the previous provision which allowed an upgrade only if 20% of the outstanding principal was repaid. In addition, a new requirement of credit rating has been introduced for upgradation of accounts where exposure is more than Rs. 1 billion. If the account is not performing satisfactorily during the monitoring period, an additional provision of 15% has been stipulated.

**8. Fresh Resolution Plan:**

If during the period upto which 20% of the outstanding principal and interest capitalised is repaid the borrower is in default with any of the lenders, a fresh resolution plan will be required in addition to the additional provision of 15% at the end of review period. This is an additional requirement in the new framework.

As can be seen above, implementation and compliance of the resolution plan is important as otherwise the provisioning norms will apply resulting in additional provisioning.

**9. Interaction with IBC:**

In line with the reasoning in the Supreme Court judgement which struck down the February 12 Circular, there is no mandatory reference to IBC if no resolution plan has been agreed or implemented within the timeline. However, the RBI has reserved its right to give specific direction in respect of companies.

Further, the New RBI Circular permits interim finance to be treated as standard debt. Also, similar to the February 12 Circular, additional finance to be provided under the resolution plan is also to be treated as standard debt.

II. **Amendment to Housing Finance Companies (NHB) Direction, 2010<sup>ii</sup>**

NHB have amended "**Paragraph 30**" of the Housing Financial Companies (NHB) direction 2010 on June 17<sup>th</sup>, 2019 related to requirement of minimum capital ratio:

The highlights of revised amendment are as follows:

The minimum capital ratio is changed from 12% to 13%, which is to be maintained on or before March 31, 2020. The minimum capital ratio is to be maintained at 14% on or before March 31, 2021 and 15% on or before March 31, 2022.

The Tier-I capital, at any point of time, shall not be less than 10%.

*“Tier-I capital” is defined as owned fund as reduced by investment in shares of other housing finance companies and in shares, debenture, bonds, outstanding loans and advances including hire purchase and lease finance made to and deposits with subsidiaries and companies in the same group exceeding, in aggregate, ten percent of the owned fund.*

### III. **Key decisions taken by SEBI in the board meeting dated June 27, 2019**<sup>iii</sup>

Securities and Exchange Board of India (“SEBI”) in its board meeting on June 27, 2019 had undertaken certain key decisions and has issued a press release (“Press Release”) in this regard. Some of the key decisions taken by SEBI in the board meeting:

#### 1. **Framework for Issuance of Differential Voting Rights (DVR) Shares**

SEBI has approved a framework for issuance of Differential Voting Rights (“DVR”) shares (“DVR Framework”) along with amendments to the relevant SEBI Regulations to give effect to the framework. Some of the key features of the DVR Framework are:

- **Eligibility:** A company having superior voting rights shares (“SR Shares”) would be permitted to do an initial public offering (IPO) of only ordinary shares to be listed on the Main Board, subject to fulfilment of eligibility requirements of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 and the following conditions:
  - The issuer company is a tech company (as per the definition in Innovators Growth Platform) i.e. intensive in the use of technology, information technology, intellectual property, data analytics, bio-technology or nano-technology to provide products, services or business platforms with substantial value addition.
  - The SR shareholder should be a part of the promoter group whose collective net worth does not exceed Rs 500 Crores. While determining the collective net worth, the investment of SR shareholders in the shares of the issuer company shall not be considered.
  - The SR shares have been issued only to the promoters/ founders who hold an executive position in the company.
  - The issue of these SR shares has been authorized by a special resolution passed at a general meeting of the shareholders.
  - SR shares have been held for a period of at least 6 months prior to the filing of Red Herring Prospectus (RHP).
  - SR shares have voting rights in the ratio of minimum 2:1 to maximum 10:1 compared to ordinary shares.

- **Listing and Lock-in:** SR shares shall also be listed on Stock Exchanges after the issuer company makes a public issue. However, SR shares shall be under lock-in after the IPO until their conversion to ordinary shares. Transfer of SR shares among promoters shall not be permitted. No pledge/lien shall be allowed on SR shares.
- **Rights of SR shares:** SR shares shall be treated at par with the ordinary equity shares in every respect, including dividends, except in the case of voting on resolutions. The total voting rights of SR shareholders (including ordinary shares), post listing, shall not exceed 74%.
- **Enhanced corporate governance:** Companies having SR shareholders shall be subject to enhanced corporate governance standards as specified in the Press Release.
- **Coat-tail Provisions:** Post-IPO, the SR Equity Shares shall be treated as ordinary equity shares in terms of voting rights (i.e. one SR share shall have only one vote) in certain circumstances which inter alia are including appointment or removal of independent directors and/or auditor; related party transactions in terms of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 involving SR shareholder, substantial value transaction based on materiality threshold as prescribed under LODR, Changes in the company's Article of Association or Memorandum - except any changes affecting the SR instrument, initiated of voluntary resolution under the IBC.
- **Sunset Clauses:** SR shares shall be converted into ordinary shares in following circumstances/ events:
  - Time Based: The SR shares shall be converted to Ordinary Shares on the 5th anniversary of listing. The validity can be extended once by 5 years through a resolution. SR shareholder would not be permitted to vote on such resolutions.
  - Event Based: SR shares shall compulsorily get converted into ordinary shares on occurrence of certain events such as demise, resignation of SR shareholders, merger or acquisition where the control would be no longer with SR shareholder, etc.
- **Fractional Rights Shares:** Henceforth, issue of fractional rights shares by existing listed companies shall not be allowed.

## **2. Amendments under SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 regarding payment relating to royalty and brand usage**

SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 had prescribed that payments made to related parties towards brand usage or royalty are to be considered material if the transaction(s) exceed 2% of the annual consolidated turnover of the listed entity during a financial year. SEBI on account of representations received by it, decided to increase this present limit of 2% to 5% of annual consolidated turnover of the listed entity in relation to brand usage and royalty payments in order to considered as material related party transaction.

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### **3. Disclosure of Encumbrances**

In the context of recent concerns with respect to promoter/ companies raising funds from Mutual Funds/ NBFCs through structured obligations, pledge of shares, non-disposal undertakings, corporate/ promoter guarantees and various other complex structures, SEBI has decided that, going forward, promoters shall be required to disclose separately detailed reasons for 'encumbrance' whenever the combined encumbrance by the promoters and persons acting in concert (PACs) crosses 20% of the total share capital in the company or 50% of their shareholding in the company. The stock exchanges will maintain the details of such encumbrance along with purpose of encumbrance, on their websites.

The expression 'encumbrance' under SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 would be defined to include:

- "i) any restriction on the free and marketable title to shares, by whatever name called, whether executed directly or indirectly;
- ii) pledge, lien, negative lien, non-disposal undertaking;
- iii) any covenant, transaction, condition or arrangement in the nature of encumbrance, by whatever name called, whether executed directly or indirectly."

### **4. Amendments to SEBI (Prohibition of Insider Trading) Regulations, 2015**

SEBI approved amendments clarifying that trading window closure for listed companies shall be applicable from end of every quarter till 48 hours after declaration of financial results. The amendments clarify that such closure shall not be applicable in respect of transactions such as off-market inter-se transfer between insiders, transaction through block deal window mechanism between insiders, transaction due to statutory or regulatory obligations, exercising of stock options, pledging of shares for bona fide transaction such as raising of funds and transactions for acquiring shares under further public issue, right issue and preferential issue, exercising conversion of warrants / debentures, tendering shares under buy-back, open offer and delisting etc. under respective regulations, subject to conditions specified. The Board also approved amendments clarifying material financial relationships.

### **5. Review of Risk Management Framework of Liquid Funds, Investment Norms and Valuation of Money Market and Debt Securities by Mutual Fund**

SEBI after deliberations, approved certain proposals pertaining to risk management framework of liquid funds, investment norms and valuation of money market and debt securities by mutual funds.

## **6. Risk Management Framework of Liquid Funds and prudential norms governing investments in debt and money market instruments**

- i. Liquid Schemes shall be mandated to hold at least 20% in liquid assets such as Cash, Government Securities, T-bills and Repo on Government Securities.
- ii. The cap on sectoral limit of 25% shall be reduced to 20%.
- iii. The additional exposure of 15% to HFCs shall be restructured to 10% in HFCs and 5% exposure in securitized debt based on retail housing loan and affordable housing loan portfolios.
- iv. The valuation of debt and money market instruments based on amortization shall be dispensed with completely and shall be based on mark to market.
- v. Liquid and overnight schemes shall not be permitted to invest in Short Term Deposits, debt and money market instruments having structured obligations or credit enhancements.
- vi. A graded exit load shall be levied on investors of liquid schemes who exit the scheme up to a period of 7 days.
- vii. Mutual Fund schemes shall be mandated to invest only in listed NCDs and the same would be implemented in a phased manner. All fresh investments in Commercial Papers (CPs) shall be made only in listed CPs pursuant to issuance of guidelines by SEBI in this regard.
- viii. All fresh investments in equity shares by Mutual Fund schemes shall only be made in listed or to be listed equity shares.
- ix. Prudential limits on total investment by a Mutual Fund scheme in debt and money market instruments having credit enhancements and on investment by Mutual Fund scheme in such debt securities of a particular group, as percentage of debt portfolio of the respective scheme have been prescribed at 10% and 5% respectively.
- x. There should be adequate security cover of at least 4 times for investment by Mutual Fund schemes in debt securities having credit enhancements backed by equities directly or indirectly.

## **B) CONCEPT NOTE ON MORTGAGE**

Mortgage as we all know, is a debt instrument, secured by the collateral of specified immovable property, that the borrower is obliged to pay back with a predetermined set of payments.

Section 58 a of Transfer of Property Act, 1882 ("**TPA**") states that "A mortgage is the transfer of an interest in the specific immovable property for the purpose of securing the payment of money advanced or to be advanced by way of loan, an existing or future debt, or the performance of an engagement which may give rise to a pecuniary liability."

Mortgage can be affected only on immovable property, the immovable property includes land, benefits that arise out of things attached to the earth like trees, buildings, and machinery. But a machine which is not permanently fixed to the earth and which can be shifted from one place to another is not considered to be immovable property.

### **Essentials of mortgage:**

1. A mortgage is the transfer of an interest in the specific immovable property and differs from sale wherein the ownership of the property is transferred.
2. The object of transfer of an interest in the property must be to secure a loan or performance of a contract which results in monetary obligation.

There are essentially six types of mortgages envisaged in TPA. We are going to discuss about two types in this article which are commonly used in the banking sector in India:

1. Simple Mortgage (also commonly known as Registered Mortgage); and
2. Mortgage by deposit of title deeds (also commonly known as Equitable Mortgage).

### **1. Simple mortgage**

Simple mortgage is executed where without any property being delivered to the Lender, the mortgagor makes himself liable to repay the debt. It is implied by him in an express or implied manner that in the event of non-repayment of loan, the mortgaged property can be used to make good of the loan by the Lender.

Mortgage Instrument: Mortgage Deed

Usage: to be used where

- i. the original title chain documents are not available; OR
- ii. the party has already created a mortgage and a second mortgage has to be created in favour of the Lender. Usually in balance transfer cases.

## **2. Mortgage by deposit of title deeds**

Mortgage by deposit of title deed is also known as Equitable Mortgage. Where a person delivers documents of title to immovable property to a Lender or their agent, with the intention to create a mortgage thereon, the transaction is called a mortgage by deposit of title deeds.

A Mortgage is said to be Mortgage by deposit of title deeds if it has following essentials:

- i. debt;
- ii. deposit of title deeds;
- iii. intention to create mortgage thereon;

Such mortgage can only be created in notified cities. The mortgaged property need not be situated in any of the specified towns. It is necessary that the deposit of title deeds must be in specified towns.

**Mortgage Instrument:** Declaration and undertaking along with Memorandum of deposit of title deeds

**Usage:** to be used where title documents for the entire chain is available, attracts lesser stamp duty.

## C) ESG AT APAC GROUP

### Implementation of ESG practices

~Fatema Kanchwala  
(Legal Intern)

*ESG – Environmental, Social and Corporate Governance: A self-explanatory word, to be honest.*

One wonders, how to implement ESG in our daily work life. Well, there are many ways actually, so let us talk about some basic things we can implement in our daily lives.

Yes, the printer, use it wisely and reuse the paper properly, paper printed on the one side can be flipped and get the print on the other side. And if the unofficial papers are half inked, cut the soiled paper and use it on our desk to jot down notes or reminders.

Let's solve your Emergency problems, wash your hand, use soap, but be careful towards the amount of water you use.

Post washing your hands, comes the issue of wet hands. Fun Fact: Use of hand dyers is much better than wasting paper towels; Plus it's a lot fun too (provided we limit the fun to the extent required). Be careful with the electricity, turn off when it is not in use, not only lights and air-condition but even the charger of your laptop which you use.

What about your work desk, do we have a picture frame of your family sitting on your desk? Good for you. Why not put a small plant beside that. The beauty of the organization increases by placing flower-pot on each desk; Not only it helps to purify the air, but also gives positive vibes, plus it might help reduce your work stress - no more Monday blues!

Do we have a messy desk, good! Think about what among those can be recycled.

Did you know your commute affects your happiness. Don't waste fuel, share your car. Driving alone hurts your wallet and your health. Enjoy some carpooling and make new friends on your way. Carpooling can save our Earth.

How is your social life? Probably better than hundreds of thousands of people with far less resources than we possess. A financial service company can service others in a lot more ways: by donating the blood by tying up with blood banks and organising blood donation camps; by giving food to hungry people by arranging the food donation camps; or by organizing a cloth donation camps. You get the idea, don't you?

Keeping a fast, or just thinking of skipping your lunch (Health conscious much!), give the same to those poor guys just around the corner of the office.

We do provide educational loans, let's do it enthusiastically, and invest a minimum of Re. 1 per day in sponsoring educational expenses of a child.

July 31st is approaching. Do you know what day it is? The last day to file your IT returns. Why not a good citizen, inform the taxpayers about the same. Wouldn't that be a sign of good social governance?

The human resources are the biggest asset of any organization; and as the saying goes, “Health is Wealth”. Arranging a health check-up twice a year will make them healthier.

The small step by the employees and management will impact whole organization, lets implement the principles of ESG in our daily lives. DO IT!

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<sup>i</sup> <https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11580&Mode=0>

<sup>ii</sup> [https://nhb.org.in/wp-content/uploads/2016/10/NHB.HFC\\_\\_DIR\\_\\_22-MDCEO-2019.pdf](https://nhb.org.in/wp-content/uploads/2016/10/NHB.HFC__DIR__22-MDCEO-2019.pdf)

<sup>iii</sup> [https://www.sebi.gov.in/media/press-releases/jun-2019/sebi-board-meeting\\_43417.html](https://www.sebi.gov.in/media/press-releases/jun-2019/sebi-board-meeting_43417.html)