



## NEWSLETTER

### Legal, Compliance and ESG

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04 July 2020

Dear Readers,

We bring to your reading and attention following topics:

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

##### **I. Loans Sourced by Banks and NBFCs over Digital Lending Platforms: Adherence to Fair Practices Code and Outsourcing Guidelines<sup>1</sup>**

RBI vide its circular dated June 24, 2020 reiterated that banks and NBFCs, irrespective of whether they lend through their own digital lending platform or through an outsourced lending platform, must adhere to the Fair Practices Code guidelines in letter and spirit.

They must also meticulously follow regulatory instructions on outsourcing of financial services and IT services.

It must be noted that outsourcing of any activity by banks/ NBFCs does not diminish their obligations, as the onus of compliance with regulatory instructions rests solely with them. Wherever banks and NBFCs engage digital lending platforms as their agents to source borrowers and/ or to recover dues, they must follow the following instructions:

- a) Names of digital lending platforms engaged as agents shall be disclosed on the website of banks/NBFCs.
- b) Digital lending platforms engaged as agents shall be directed to disclose upfront to the customer,

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<sup>1</sup>

<https://rbidocs.rbi.org.in/rdocs/notification/PDFs/>

[CCN112LNBCF387F4EE693D74EA6A70E6938C7CDCE47.PDF](https://rbidocs.rbi.org.in/rdocs/notification/PDFs/CCN112LNBCF387F4EE693D74EA6A70E6938C7CDCE47.PDF)

the name of the bank/ NBFC on whose behalf they are interacting with him.

- c) Immediately after sanction but before execution of the loan agreement, the sanction letter shall be issued to the borrower on the letter head of the bank/ NBFC concerned.
- d) A copy of the loan agreement along with a copy each of all enclosures quoted in the loan agreement shall be furnished to all borrowers at the time of sanction/ disbursement of loans.
- e) Effective oversight and monitoring shall be ensured over the digital lending platforms engaged by the banks/ NBFCs.
- f) Adequate efforts shall be made towards creation of awareness about the grievance redressal mechanism.

Any violation in this regard by banks and NBFCs (including NBFCs registered to operate on 'digital-only' or on digital and brick-mortar channels of delivery of credit) will be viewed seriously.

## II. Section 10(A) and Section 66(3) are inserted in the Insolvency and Bankruptcy Code, 2016 which resulted in suspension of Section 7, 9 and 12 of IBC Code, 2016<sup>2</sup>

The Hon'ble President of India exercising its power under Article 123 of Constitution of India, has promulgated the Insolvency and Bankruptcy Code (Amendment) Ordinance, 2020 on June 05, 2020.

Through the IBC (Amendment) Ordinance, 2020 Section 10(A) and Section 66(3) are inserted in The Insolvency and Bankruptcy Code, 2016 which resulted in suspension of Initiation of corporate insolvency resolution process by financial creditor under Section 7, Application for initiation of corporate insolvency resolution process by operational creditor under section 9 and Time-limit for completion of insolvency resolution process under section 12 of The Insolvency and Bankruptcy Code, 2016 to safeguard corporate Debtors from insolvency Resolution for the Default arising on or after

March 25, 2020 for a period of six months or such further period not exceeding one year, as may be notified in this behalf.

## III. Scheme for relaxation of time for filing forms related to creation or modification of charges under the Companies Act, 2013.<sup>3</sup>

MCA vide its general circular dated June 17, 2020 has announced a scheme for relaxation of time for filing forms relating to creation or modification of charges under the Companies Act, 2013 for the purpose of condoning the delay in filing certain forms related to creation/ modification of charges.

1. Applicability: The scheme shall be applicable in respect of filing of Form No. CHG-1 and Form No. CHG-9 by a company or a charge holder, where the date of creation / modification of charge:
  - (a) Is before 01.03.2020, but the timeline for filing such form had not expired under section 77 of the Act as on 01.03.2020, or
  - (b) Falls on any date between 01. 03.2020 to 30. 09.2020 (both dates inclusive).
2. Relaxation of Time:
  - (a) In case a form is filed in respect of a situation covered under sub-para (1)(a) above, the period beginning from 01.03.2020 and ending on 30.09.2020 shall not be reckoned for the purpose of counting the number of days under section 77 or section 78 of the Act. In case, the form is not filed within such period, the first day after 29.02.2020 shall be reckoned as 01.10.2020 for the purpose of counting the number of days within which the form is required to be filed under section 77 or section 78 of the Act.
  - (b) In case a form is filed in respect of a situation covered under sub-para (1)(b) above, the period beginning from the date of creation/ modification of charge to 30.09.2020 shall not be reckoned for the purpose of counting of days under section 77 or section 78 of the Act. In case, the form is not filed within such period, the first day after the date of creation / modification of charge shall be reckoned as

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<https://ibbi.gov.in/uploads/legalframework/741059f0d8777f311ec76332ced1e9cf.pdf>

3

[http://www.mca.gov.in/Ministry/pdf/Circular23\\_17062020.pdf](http://www.mca.gov.in/Ministry/pdf/Circular23_17062020.pdf)

01.10.2020 for the purpose of counting the number of days within which the form is required to be filed under section 77 or section 78 of the Act.

#### **IV. Implementation of Amendments in the Indian Stamp Act, 1899 and Rules made from 1st July 2020 for Rationalized Collection Mechanism of Stamp Duty across India with respect to Securities Market Instruments<sup>4</sup>**

In order to facilitate ease of doing business and to bring in uniformity of the stamp duty on securities across States and thereby build a pan-India securities market, the Central Government, after due deliberations and consultations with the States, through requisite amendments in the Indian Stamp Act, 1899 and Rules made thereunder, has created the legal and institutional mechanism to enable states to collect stamp duty on securities market instruments at one place by one agency (through Stock Exchange or Clearing Corporation authorized by it or by the Depository) on one Instrument. A mechanism for appropriately sharing the stamp duty with relevant State Governments has also been developed which is based on the state of domicile of the buyer.

The Ministry of Finance vide its press release dated June 30, 2020 stated that the implementation of relevant amendments to the 'Indian Stamp Act, 1899' and corresponding enforcement of the 'Indian Stamp (Collection of Stamp-Duty through Stock Exchanges, Clearing Corporations and Depositories) Rules, 2019' will come into effect from July 1, 2020.

For more info please refer the link: <https://pib.gov.in/PressReleaseDetailm.aspx?PRID=1635399#.XvthzMSYFrM.whatsapp>.

#### **V. The (Share Capital and Debentures) Amendment Rules, 2020<sup>5</sup>**

MCA vide its notification dated June 05, 2020 has notified the Companies (Share Capital and Debentures) Amendment Rules, 2020.

key point of the Amendments are as follows:

- (a) in Rule 8(4) of the said Rules related to "Issue of sweat equity shares" has been substituted stating that the company shall not issue sweat equity shares for more than 15% of the existing paid-up equity share capital in a year or shares of the issue value of rupees five crores, whichever is higher, provided that a start-up company may issue sweat equity shares not exceeding 50% of its paid-up capital up to 10 years from the date of its incorporation or registration.
- (b) Further, Rule 18(7)(b)(v) of Companies (Share Capital And Debentures) Rules, 2014, related to "Debentures" has been substituted, to be provided that for NBFCs registered with Reserve Bank of India under section 45- IA of the RBI Act, 1934 and for Housing Finance Companies registered with National Housing Bank or other unlisted companies, it shall on or before the 30th day of April in each year, in respect of debentures issued by such a company, invest or deposit, as the case maybe, a sum which shall not be less than 15% of the amount of its debentures maturing during the year, ending on the 31st day of March of the next year in any one or more methods of investments or deposits.

Provided that the amount remaining invested or deposited, as the case may be, shall not any time fall below 15% of the amount of the debentures maturing during the year ending on 31st day of March of that year.

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<https://pib.gov.in/PressReleaseDetailm.aspx?PRID=1635399#.XvthzMSYFrM.whatsapp>

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[http://www.mca.gov.in/Ministry/pdf/Rule\\_080620\\_20.pdf](http://www.mca.gov.in/Ministry/pdf/Rule_080620_20.pdf)

**B) Ministry of MSME issues criteria of investment and turnover calculation for classification under new definition of MSME**

The Ministry of Micro, Small and Medium enterprises vide notification dated 26 June, 2020<sup>6</sup> notifies certain criteria for classifying the enterprises as micro, small and medium enterprises, manner of calculation of Investment and Turnover and specifies the form and procedure for filing the Udyam Registration with effect from the 1 day of July 2020:

**Composite criterion of investment and turnover:**

CATEGORY	OLD CAPITAL	NEW CAPITAL	OLD TURNOVER	NEW TURNOVER
Micro	25 Lakhs	1 Crore	10 Lakhs	5 Crores
Small	5 Crores	10 Crores	2 Crores	50 Crores
Medium	10 Crores	50 Crores	5 Crores	250 Crores

Further the Cabinet committee on economic affairs vide its press release<sup>7</sup> approved an upward revision of MSME definition and modalities/ road map for implementing the remaining two Packages for MSMEs

- (a) Rs 20000 crore package for Distressed MSMEs; and
- (b) Rs 50,000 crore equity infusion through Fund of Funds.

**C) RBI proposes new rules for housing finance companies**

The Reserve Bank of India (RBI) proposed to tighten the rules governing home financiers, including putting restrictions on lending to builders and doubling the minimum net owned funds criterion.

The regulator's proposal has also clearly defined home finance firms and those that are systemically important among them. RBI has also proposed that home financiers should not be simultaneously allowed to lend to a real estate developer as well as homebuyers in the developer's project.

The proposed changes in the rules have come following RBI's taking over as the regulator of mortgage lenders from National Housing Bank (NHB) in August 2019. Following the review of the rules, home financiers will now be regulated as a category of non-banking financial companies.

Under the NHB regulations, there was no formal definition of housing finance. In the draft framework released on its website, RBI said housing finance will now mean "financing, for purchase/construction/reconstruction/ renovation/ repairs of residential dwelling unit ..." and some other activities, including giving loans to corporates and government agencies for employee housing projects.

"All other loans, including those given for furnishing dwelling units, loans given against mortgage of property for any purpose other than buying/construction of a new dwelling unit/s or renovation of the existing dwelling unit/s, will be treated as non-housing loans," said RBI.

According to the draft regulations, RBI also classified housing finance companies as systemically important and non-systemically important. "Non-deposit taking HFCs with asset size of ₹500 crore and above; and all deposit taking HFCs irrespective of asset size will be treated as systemically important

<sup>6</sup> [http://s3-ap-southeast-1.amazonaws.com/eminds-clr1/uploads/2020/06/27145836/IndianGazzate\\_MSME.pdf](http://s3-ap-southeast-1.amazonaws.com/eminds-clr1/uploads/2020/06/27145836/IndianGazzate_MSME.pdf)

<sup>7</sup> <https://pib.gov.in/PressReleaseDetailm.aspx?PRID=1628344>

HFCs. HFCs with asset size below ₹500 crore will be treated as non-systemically important HFCs," according to the proposed regulations.

"RBI's announcements on draft regulatory changes for HFCs sharpen the definition of what's 'housing finance' or 'providing finance for housing' to residential dwellings. It also provides relief to residential developers as lending to builders for construction of residential dwelling units is allowed in this definition," said Srinath Sridharan, a banking sector expert. "Also, with a few other tightening of regulations, I anticipate the valuation-driven hunger for HFC licences over the past few years will ebb. Only serious players will stay in this industry."

RBI also said that to qualify as a housing finance company, 50% of net assets should be to real estate lending, of which at least 75% should be towards individual housing loans. Those HFCs that do not fulfil the qualification will be treated as NBFC–investment and credit companies (NBFC-ICCs) and will be required to approach RBI for conversion of their certificate of registration from HFCs to NBFC-ICC.

RBI has proposed to double the minimum net owned funds for HFCs to ₹20 crore and align the capital requirements of all HFCs with NBFCs over a period of two years. For HFCs, minimum capital risk-weighted assets ratio (CRAR) is currently at 12%, which will be increased to 14% by 31 March 2021 and 15% by 31 March 2022.

#### **D) ESG: RBI's Discussion Paper on Bank Governance<sup>8</sup>**

RBI on 11 June 2020 published a Discussion Paper<sup>9</sup> on Governance in Commercial Banks in India. This is a significant document as it seeks to considerably enhance bank governance in India. It sets out the governance norms for banks by incorporating the international standards in the form of the Basel Committee on Banking Supervision's (BCBS) Corporate Governance Principles for Banks, and adapting it into the general governance regime in India comprising the Companies Act, 2013 and the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015. The discussion paper essentially "Indianizes" the BCBS principles in light of the experience from recent episodes. Several elements of the discussion paper seek to target the lessons the regulator has learnt so far.

The discussion paper focuses substantially on certain issues specific to banks. Here, it largely tracks the BCBS Principles. These include audit, risk management, internal controls, compliance, whistle blowing and vigilance, which all form the bulwark of the board's oversight on financial matters. There is also explicit recognition of the business culture of banks, which calls for a "tone from the top". Such measures seek to place emphasis on the manner in which banks carry on their business. While some include concrete plans for implementation through targeted governance measures, several aspects of the discussion paper are aspirational in nature. It is not clear to what extent these intangible matters such as culture are capable of translation into tangible deliverables and outcomes.

There is a strong focus on boards and committees of directors, whose duties and responsibility find specific treatment in the discussion paper. Conflicts of interests of directors and senior managers receive extensive treatment, given they have been at the core of some of the recent governance failures. Board independence takes on a crucial position, with a majority of the board to consist of independent

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<sup>8</sup> <https://indiakorplaw.in/2020/06/rbis-discussion-paper-on-bank-governance.html> [Author: By Umakanth Varottil]

<sup>9</sup> <https://rbidocs.rbi.org.in/rdocs/Publications/PDFs/DISCUSSION08CA382F39604B10B420A8A43B0DB0C1.PDF>

directors, a higher standard than that required under the Companies Act and the SEBI regulations. Moreover, the chairperson of the board must be an independent director, as must the chairpersons of some of the crucial board committees. Given the specialized nature of a bank's business, board members need to have an appropriate mix of skills and qualifications to ensure they are up to the task.

Perhaps the most debatable and controversial recommendation in the discussion paper relates to tenure caps on directors and senior managers. The total continuous tenure of non-executive directors must be no longer than eight years, after which they can be re-appointed only after a three-year cooling off period. The discussion paper caps the tenure of executive directors (EDs) and CEOs by creating a two-prong structure. If the EDs or CEOs are promoters or major shareholders of the bank, then their tenure is a maximum of 10 years. If they are not promoters or majority shareholders, they enjoy a maximum tenure of 15 years, with eligibility to reappointment only after a three year cooling off period.

There are a number of reasons supporting this stringent requirement. First, and the stated rationale in the discussion paper, the tenure requirements exist to enable promoters and majority shareholders to stabilise the operations of the bank and then transition it to a professional management. Second, familiarity and excessively long tenure would likely affect performance and governance of the bank. A change of guard would not only bring in fresh perspectives and approaches and an added enthusiasm, but excessive reliance on a long-running corporate leader will erode the robustness of the overall monitoring and governance mechanisms in the bank. While such rationales are entirely understandable, it remains open whether such a form of overarching regulation through hard tenure caps would be unduly restrictive in nature. Perhaps the regulation ought to be more targeted through a case-by-case approach rather than to tar all banks with the same brush.

Overall, the discussion paper is laudable as it considerably raises the game for bank governance in India, which has been the subject matter of discontent in recent years. The internationalisation of the governance standards by mapping it against the BCBS Principles will certainly demonstrate RBI's aims. However, the success of these efforts will lie on the extent to which the regulator effectively enforces these norms. Appropriate enforcement sends a strong signal to the market, even more so than the quality of the substantive norms. Finally, while the discussion paper encompasses both private banks as well as nationalised banks, in the latter case there is an exception for specific statutes applicable to them as also where the Government of India, as a promoter, retains the ability to issue instructions to such banks. Such an approach also creates a chasm to begin with among governance of private banks and nationalised banks, where a level playing field ought to be the order of the day.