COUNTRY UPDATE-India: Securities & Banking

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The securities market in India is a vital component of the country's financial system, facilitating the buying and selling of various financial instruments, primarily securities, which include stocks, bonds, derivatives, and other investment products. The Indian securities market is regulated by the Securities and Exchange Board of India (SEBI) and is known for its vibrancy, depth, and diversity.

SEBI plays a crucial role in regulating and overseeing the IPO process. SEBI ensures that the IPO is conducted fairly and transparently, safeguarding the interests of investors.

The establishment of the Securities and Exchange Board of India in 1992 led to considerable growth in the capital markets and securities sector. SEBI serves as the autonomous statutory regulator of financial markets in India and has as its twin objectives the protection of investors' interests and the development and regulation of the Indian securities markets. SEBI has powers to investigate and examine companies, to visit their premises, to inspect records and personnel and to impose penalties that are commensurate with any misconduct.

SEBI regulates the markets through its rulemaking powers and has issued a number of regulations and guidelines relevant to the securities market and specifically related to corporate governance norms for listed companies. SEBI regulations today cover all intermediaries in the securities market, all of whom must be registered with and regulated by SEBI. The regulations also prescribe a code of conduct for each intermediary as well as for their employees and set out standards that stipulate who may be considered a fit and proper person.

The present capital market scenario features an advanced regulatory environment, steadily increasing market capitalisation, better allocation and mobilisation of resources, a rapidly developing derivatives market, an effective mutual fund industry and increased issuer transparency. SEBI has effectively brought in a strict investor protection regime and various market reforms.

Capital adequacy and other norms have been specified and a system for monitoring and inspecting their operation has been instituted to enforce compliance. Disciplinary action is taken against rule breaches. All intermediaries in the market are obliged to have a compliance officer, who reports any observed non-compliance directly and independently to SEBI. Modified regulations that SEBI introduced have enabled Indian companies to raise finances both domestically and internationally.

Structure of the Indian securities market:

I. Primary market: This is where new securities are issued to the public for the first time, often through initial public offerings (IPOs) or bond issuances. Companies raise capital by selling securities directly to investors. The primary market promotes capital formation.

II. Secondary market: The secondary market is where previously issued securities are bought and sold among investors. It provides liquidity to existing investors, allowing them to trade securities like stocks and bonds. The two primary stock exchanges in India are the National Stock Exchange (NSE) and the Bombay Stock Exchange (BSE).

As of 2020, India was ranked number one[1] in terms of number of listed companies, has a securities market which is remarkable for the sheer number of market participants, the number of listed securities and the volume of transactions. The National Stock Exchange of India is the third largest exchange in the world in terms of the number of equity transactions, after the New York Stock Exchange and NASDAQ.

Increased foreign investment in India's public sector will release large-scale resources and sizeably increase the capital available for the country's economic growth.

The Indian securities market plays a crucial role in the economy by facilitating capital formation, providing investment opportunities, and promoting financial inclusion. It remains an attractive destination for both domestic and foreign investors.

If wider index inclusion increases foreign participation in India’s government bond market to 10% from the current 0.9% (source: Institute of International Finance), it is forecasted that funds available for corporate debt issuers in India could almost triple relative to nominal GDP by 2030.

With the global economy picking up in recent times, key players in the Indian capital markets are innovating with new financial instruments and investment strategies. In recent years, Indian companies have listed themselves overseas on the AIM, the Singapore Exchange and the London Stock Exchange, and have used American Depository Receipts, Global Depository Receipts, convertible

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alternative reference securities, Foreign Currency Convertible Bonds and qualified institutional placements to raise funds in adverse market conditions.

Deeper capital market to boost India's overall economic and financing capacity

As of 2022 end, commercial banks owned 38.0% of state and government debt securities, while insurance companies held a further 25%, Reserve Bank of India data shows. This implies combined aggregate holdings of 60 trillion Indian rupees. India's central government funding is heavily skewed toward domestic issuance, with just 11% of central government debt externally funded. Investing in government securities is a core business activity for banks, with 27% of assets estimated as held in government securities.

The corporate sector has relied on a variety of non-bank funding sources such as capital markets, external commercial borrowings and internal generation of funds. In 2010, India ranked third only to Japan and China in equity capital market issuances among countries in Asia Pacific. Based on the data released by the Reserve Bank of India, the gross cumulative inflows by way of external commercial borrowings in the months from April 2010 to November 2010 totalled $11.48 billion, higher than the level of the same in the corresponding period in 2009-10.

Domestic public offerings

The India stock markets have soared this year. So far in 2023, the Sensex has gained 8.5% matching the Nifty, which scaled a near peak of 20,000 points early in September 2023 for the first time.

During the first half of fiscal year 2023-24, the number of IPOs in India stood at 31, which is the highest since the same comparative period in fiscal 2007-08. Companies have raised #26,281 crore, with September alone contributing a share of as much as 55%.

During the first half of fiscal 2023-2024, the pharmaceuticals and drugs sector accounted for the majority fund proceeds accounting for 23% along with the travel-related companies and cable and white markers at 17% and 8%, respectively.

India's major equity benchmarks have hit record levels, as earnings and the economy grow despite the highest interest rates since 2018. The SME IPO index is outperforming, surging 26% this year compared to a 9% gain in the benchmark Nifty 50.

The Life Insurance Corporation IPO was not only one of the largest IPOs in India but was also a highly anticipated one which generated significant interest among the general public. Despite being the only IPO to surpass #21,000 crore in India, the offering received decent subscription at nearly three times over six days, with full subscription in all five categories.

Statutory regulations for securities and capital markets

In India, the regulation of securities and the capital markets is governed by a combination of laws and regulatory bodies to ensure the fairness, transparency, and integrity of the financial system. The primary regulatory laws and authorities related to securities in India are as follows:

Securities and Exchange Board of India (SEBI): SEBI is the primary regulatory authority overseeing the securities market in India. It was established by the SEBI Act, 1992. SEBI's role includes regulating securities markets, protecting the interests of investors, and promoting fair and transparent trading practices.

Securities Contracts (Regulation) Act, 1956 (SCRA): SCRA provides the legal framework for regulating stock exchanges and derivatives trading in India. It empowers the government to recognize stock exchanges, and it governs the contracts traded on these exchanges. For any further information, please refer Securities Contracts (Regulation) Act, 1956

Companies Act, 2013: The Companies Act, 2013, contains provisions related to public offerings, governance, and disclosure requirements for companies issuing securities. It also establishes civil and criminal liability for misstatements in offer documents. For any further information, please refer Companies Act, 2013

SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018: These regulations govern the process and requirements for issuing securities in the primary market, including IPOs and rights issues. For any further information, please refer SEBI ICDR Regulations.

SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015: These regulations lay down the obligations of listed companies regarding disclosure, governance, and compliance with stock exchange listing requirements. For any further information, please refer SEBI Listing Regulations.

SEBI (Prohibition of Insider Trading) Regulations, 2015: These regulations prohibit insider trading and provide a framework for identifying insiders and governing their trading activities. For any further information, please refer SEBI PIT Regulations.

SEBI (Buy-back of Securities) Regulations, 2018: These regulations govern the buyback of securities by companies and set out the conditions and procedures for such activities. For any further information, please refer SEBI Buy-Back Regulations.

SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011: These regulations regulate the acquisition of shares and takeovers of listed companies, ensuring that investors are informed and protected during such transactions. For any further information, please refer SEBI Substantial Acquisition of Shares and Takeover Regulations.

Foreign Exchange Management Act, 1999 (FEMA): FEMA governs foreign exchange transactions and regulates foreign investments, including foreign portfolio investments in Indian securities. For any further information, please refer FEMA, 1999.

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Prevention of Money Laundering Act, 2002 (PMLA): PMLA establishes provisions for combating money laundering and terrorist financing, which can be associated with securities trading activities. For any further information, please refer PMLA, 2002.

These laws and regulations are subject to periodic amendments and updates to adapt to changing market conditions and evolving global standards. Complying with these regulatory laws is essential for companies, intermediaries, and investors participating in India's securities market to maintain its integrity and safeguard investor interests.

Types of capital market transactions in India

Initial public offering

An Initial Public Offering (IPO) in India is a significant milestone in a company's journey towards becoming publicly traded. It is a process through which a private company offers its shares to the public for the first time, allowing individuals and institutional investors to buy ownership stakes in the company. Before going public, a company needs to determine its valuation. This involves assessing its assets, liabilities, and potential for growth. The company's valuation directly impacts the IPO price and the number of shares to be offered. The pricing of IPO shares can be done through a book-building process, where the price is determined based on demand from institutional investors. Retail investors typically pay the final price determined through this process. Successful IPOs can boost a company's capital, enabling them to expand, invest in research and development, or pay off debts. IPOs also contribute to the growth and dynamism of the Indian stock market.

I. Fresh Issue

This is the most common type of IPO. In a mainstream IPO, a privately-held company goes public by issuing new shares to the public, allowing investors to become shareholders in the company for the first time. The funds raised through this IPO are generally used for the company's expansion, debt reduction, or other corporate purposes. In-depth structure for a fresh issue IPO is detailed as below:

Post-IPO share cap	Minimum fresh issue size	Time period for MPS^
less than #1,600 crores	25%*	NA
#1,600 crores up to #4,000 crores	Share value of at least INR 400 crores	Within 3 years post IPO
more than #4,000 crores up to #1 lac crores	10%*	Within 3 years post IPO
more than #1 lac crores	Share value of at least #5,000 crores and more than 5%*	10% & 25% within 2 & 5 years, respectively, post IPO

**Of post-IPO share cap*

^Minimum 25% public holding

II. Offer for Sale

In an offer for sale, existing shareholders of the company, typically promoters or large investors, sell their shares to the public through an initial public offer. The company does not receive any funds/proceeds from such sale / offer of shares and instead, provides a liquidity exit for existing shareholders.

The purpose of an offer for sale (OFS) is to allow early investors to monetize their investments. The company will have to send an invitation to all its shareholders to sell all/any of their shares in the initial public offer. The eligibility criteria to participate in the offer for sale is as below:

- Minimum holding period of equity shares*^ of 1 year prior to the filing of the draft red herring prospectus, including dematerialization of offered shares.
- Withdrawal – Investors have right to withdraw. If change in offer for sale size of more than 50% from draft red herring prospectus size, then the draft red herring prospectus would have to be refiled.

In case of a Regulation 6 (2) of the SEBI ICDR Regulations offer, the offer for sale size may have to be tailored.

**In case of convertibles (CCDs/CCPS), it should be converted at updated DRHP stage but its calculated equity size to be disclosed in DRHP as OFS*

^Bonus component on securities with 1 year ownership at DRHP are eligible for OFS provided: a) securities are issued basis free reserves and share premium during the latest FY at DRHP and b) equity shares are not stemming from revaluation reserves / unrealized profits of the issuer.

Regulatory requirements and procedural norms for a public issue - the Companies Act, 2013

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The Companies Act, 2013 (Act), in India contains provisions related to IPO or public issues of securities by companies. These provisions are primarily focused on the disclosure, accountability, and protection of investors in the IPO process. Below are some of the key provisions of the Companies Act, 2013, pertaining to IPOs:

Prospectus Requirements (Chapter III, Section 26): The Act defines the term "prospectus" and mandates that companies making an IPO must issue a prospectus or offer document. The prospectus should contain all material information about the company, including its financials, objectives, management, and details about the issue of securities.

Civil and Criminal Liability for Misstatements (Chapter III, Section 34): This section of the Act establishes civil and criminal liability for misstatements in the prospectus. Investors who subscribe for securities and suffer losses due to misstatements or misrepresentations can file civil lawsuits against the company and its officers. Additionally, those responsible for fraudulent misstatements can face criminal prosecution, including fines and imprisonment.

Allotment and Return of Allotment (Chapter IV, Section 39): The Act specifies the requirements for the allotment of securities offered in a public issue and the filing of a return of allotment with the Registrar of Companies (ROC).

Payment of Commission (Chapter IV, Section 40): Companies are prohibited from paying any commission to any person in connection with the subscription or procurement of securities in the IPO.

Promoters' Contribution and Lock-in (Chapter IV, Section 42): Promoters are required to contribute a minimum specified percentage of the total capital of the company and ensure that such contributions remain locked in for a specified period.

Refund of Application Money (Chapter IV, Section 73): If a company fails to receive the minimum subscription for the IPO, it must refund the application money to applicants within a specified time frame.

Report on Utilization of IPO Proceeds (Chapter IV, Section 73(2)): The company is required to submit a report to the ROC regarding the utilization of the IPO proceeds within a specified time frame.

Initial public offering through pre-filing of draft offer document

SEBI vide its notification dated November 21, 2022 came up with the SEBI (Issue of Capital and Disclosure Requirements) (Fourth Amendment) Regulations, 2022 under Chapter IIA, effective immediately, making changes in the existing SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 in relation to the initial public offer.

The said amendment introduced an alternate method for filing the DRHP. Pursuant to this alternate method, the issuer company shall have the option to keep the information rich DRHP confidential from the public at large until the issuer company is sure to proceed with its IPO, majorly after receiving observation(s) from SEBI on the draft RHP filed. Until such time, the issuer can interact with the QIBs only to gauge the market for interested investors.

Any kind of marketing of IPO apart from interacting with the QIBs is prohibited during this period. It adds an additional layer in terms of listing timelines. Tata Play and Oyo are some of the established entities who have explored this route. For any further information, please refer SEBI ICDR Regulations, 2018.

Further public offer (FPO)

SEBI, under Chapter IV of Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations 2018 provides for the provisions for an already listed company to make a further public offer. Under FPO the listed entity issues new shares to investors or existing shareholders, typically the promoters. FPOs are used by companies to diversify their equity base and raise capital for their business. FPO typically occur after the company has completed an initial public offering to make its shares available to the public. FPO allows a company to raise additional funds through the issuance of new shares.

This capital can be used for a variety of purposes such as general corporate expenses, working capital, expansion, and debt reduction. It also provides an opportunity for existing shareholders to increase their stake in the company. Additionally, FPOs also provide an opportunity for new investors to buy shares in the company. Overall, FPO is a way for companies to raise further capital and increase their equity base, while also providing investment opportunities for both existing and new shareholders.

In terms of investors, FPO benefits them because it allows fresh and new investors to participate with a low minimum investment requirement. For any further information, please refer: SEBI ICDR Regulations, 2018.

Rights issue

The regulatory directives under Chapter III of Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations 2018 provides for rights issue, which is an offering of rights to the existing shareholders of a company that gives them an opportunity to buy additional shares directly from the company at a discounted price rather than buying them in the secondary market. The number of additional shares that can be bought depends on the existing holdings of the shareowners.

Companies undertake a rights issue when they need cash for various objectives. The process may allow the company to raise money without necessarily incurring underwriting fees, although some rights issuances may be underwritten if the company wants to ensure the amount of capital raised.

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These rights are normally distributed in the form of a dividend and the number of additional shares that can be purchased by the shareholders is usually in proportion to their existing shareholding. Rights may be fully or partially exercised by the holder.

A rights issue gives preferential treatment to existing shareholders, where they are given the right (not obligation) to purchase shares at a lower price on or before a specified date.

Existing shareholders also enjoy the right to trade with other interested market participants until the date at which the new shares can be purchased. The rights are traded in a similar way as normal equity shares.

Existing shareholders can also choose to ignore the rights; however, if they do not purchase additional shares, then their existing shareholding will be diluted post issue of additional shares. For any further information, please refer: SEBI ICDR Regulations, 2018.

Qualified institutions placement (QIP)

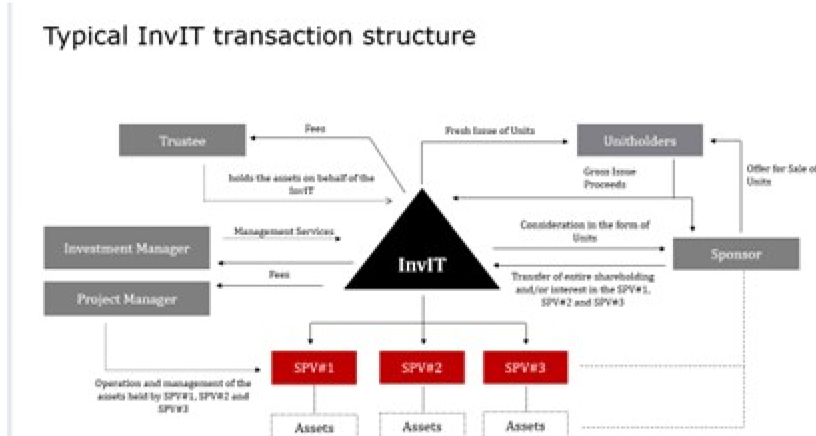
A qualified institutional placement under Chapter VI of Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations 2018 is, at its core, a way for listed companies to raise capital without having to submit legal paperwork to market regulator, SEBI. For raising capital through a QIP, the entity must be listed on a stock exchange along with the minimum shareholding requirements as specified in their listing agreement. Also, the entity must issue at least 10% of its issued securities to mutual funds or allottees.

Regulations also exist for the number of allottees on a QIP, depending on the specific factors within an issue. Additionally, no single allottee is allowed to own more than 50% of the total debt issue. Furthermore, allottees must not be related in any way to promoters of the issue. Several more regulations dictate who may or may not receive QIP securities issues.

The only parties eligible to purchase QIPs are qualified institutional buyers (QIBs), which are accredited investors, as defined by whatever securities and exchange governing body preside over it. This limitation is due to the perception that QIBs are institutions with expertise and financial power that allows them to evaluate and participate in capital markets, at that level, without the legal assurances of a follow-on public offer (FPO). For any further information, please refer: SEBI ICDR Regulations, 2018.

Investment in infrastructure with the introduction of infrastructure investment trusts (InvITs)

In a significant move to boost investment in India's infrastructure sector, the country has embraced Infrastructure Investment Trusts (InvITs) as a financial instrument to attract both domestic and foreign investments into critical infrastructure projects. InvITs have been gaining momentum as a promising investment avenue, offering an innovative and structured way for investors to participate in the growth of the infrastructure sector.



Parties to an InvIT:

Sponsor	Investment manager	Project manager	Trustee
Sets-up the InvIT Financial wherewithal and project experience/track record Transfers its entire shareholding and/or interest in project assets to InvIT (pursuant to formation transactions)	Meets financial and technical eligibility criteria Experienced key personnel Overall management of investments of the InvIT Compliance and governance Periodic reporting	Sectoral expert responsible for development/ operations and management of InvIT's assets Reports to the Trustee and Investment manager	SEBI-registered debenture trustee Independent of Sponsor and Investment Manager Holds InvIT's assets for the benefit of Unitholders. Predominantly, oversight function

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Minimum unitholding post-initial offer Typically, provides the InvIT with access to its future portfolio to ensure replenishment of InvIT's assets			

From the perspective of the source of funds, InvITs can be of 2 types:

Particulars	Privately-placed InvIT	Publicly-offered InvIT
Minimum Investors	5	20
Maximum Investors	1,000	Not Applicable
Minimum Investment per Investor	#1 crores Or #25 crores if the InvIT proposes to invest not less than 80% of the value of the InvIT Assets in completed and revenue generating assets	#10,000 – #15,000
Minimum Asset Size	#500 crores	#500 crores
Minimum Initial Offer Size	#250 crores	#250 crores

For any further information in relation to InvITs, please refer: Master Circular for Infrastructure Investment Trusts (InvITs) and Securities and Exchange Board of India (Infrastructure Investment Trusts) Regulations 2014

Corporate governance measures for listed entities and entities proposing to go public

Corporate governance for listed entities in India is governed by a set of regulations and guidelines put forth primarily by SEBI under the SEBI (Listing Obligation and Disclosure Requirements) Regulations, 2015. The objective of these regulations is to ensure transparency, fairness, accountability, and the protection of the interests of shareholders and stakeholders in publicly traded companies. Corporate governance is essential for maintaining the trust of investors, promoting economic stability, and ensuring long-term business sustainability.

These regulations provide a framework to encourage responsible corporate behaviour and protect the interests of shareholders and stakeholders in publicly traded companies. It's important for listed entities to stay updated on evolving regulations and best practices in corporate governance. For any further information, please refer: SEBI LODR Regulations, 2015.

Here are some key aspects of corporate governance for listed entities in India:

Constitution of board of directors

In case of a material subsidiary, at least one ID of the issuer should be a director of the material subsidiary

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Constitution of committees

Audit Committee	Nomination and Remuneration Committee	Stakeholders' Relationship Committee	Corporate Social Responsibility Committee	Risk Management Committee (top 1000 listed cos)
• At least three directors as members, two-third of which shall be independent directors • The chairman should be an independent director • All members are required to be financially literate • At lease one member should have accounting or related financial management	• At least three directors, all of which are required to be non-executive directors • At least 50% should be independent directors • The chairperson should be an independent director • However, the chairperson of the Company whether executive or non-executive may be appointed as a member of such committee but should not chair such committee	The chairman should be a non-executive director	• At least three directors as members • One of which must be an independent director	• At least three members with majority being directors • One of which must be an independent director

Recent regulatory updates with regards to issuance of capital and listing obligations on entities

Increase in key performance indicators disclosures: Period for key performance indicators and restated financial statements to be aligned, b) key performance indicators disclosed (to pre-IPO investors) in last 3 years should be continued for IPO and subsequently post listing or end-use of IPO proceeds, whichever is later and c) key performance indicators to be approved by issuer's audit committee and validated by auditor/Independent Chartered Accountant.

Pre-IPO / Promoter and Promoter Group Trades: SEBI via the AIBI platform, disseminates instructions to BRLMs, one of which relates to disclosing to the stock exchanges within 24 hours of primary or secondary trade by Promoter/Promoter Group of more than 1% of share cap (including Pre-IPO) and in relation to trades mentioned above, the public announcement needs to be released within 48 hours of disclosing the date/price/ # of shares/name of the selling shareholder/allottee/acquirer in the announcement/price band advertisement and c) Declaration/Details if the allotee/acquirer is connected with the Issuer/Promoters/Directors/Key Managerial Personnels/Subsidiaries/Group Companies and their directors and Key Managerial Personnels.

Approach for WACA disclosures: a) Committee of independent directors to recommend that the price band is justified based on quantitative factors / Key Performance Indicators vis – a – vis the Weighted Average Cost of Acquisition of primary / secondary transactions and b) Issuer to disclose share pricing details based on past transactions and fund raising from investors prior to IPO: by disclosing price for primary/secondary trade in last 18 months (if any) or last five primary/secondary trades in last 3 years.

Minimum price band: Minimum price band has to be at least 105% of the floor price (in current regulations only has limit of 120% of floor price has been specified).

Identification of SMPs: Senior management personnels including all members of management one level below CEO/Whole Time Director, all functional heads, the Company Secretary and the CFO to be identified and disclosures akin to Key Managerial Personnels to be included.

Revised allocation formula for NII: a) Allocation to Non-Institutional Investors shall be revised as follows: i) 1/3rd of the Non-Institutional Investors portion shall be reserved for application above #200,000 and up to #1,000,000 lakhs; and ii) 2/3rd of the Non-Institutional Investors portion shall be reserved for application above #1,000,000 lakhs. b) Allotment in case of Non-Institutional Investors category shall be on 'draw of lots', as is currently applicable for retail individual investors.

T+3 Listing: SEBI via June 2023 BM adopted T+3 listing timelines from the existing T+6 framework. SEBI ICDR amendments (including updated Master Circular for ICDR which has been recently introduced) are awaited and its voluntary/mandatory for IPOs opening post September 1, 2023 / December 1, 2023.

Monitoring Agency: a) Credit Rating Agencies to act as Monitoring Agency instead of scheduled commercial banks and Public Financial Institutions; b) Monitoring of fresh issue proceeds until 100% utilization (increased from 95% earlier) including for general corporate purposes; and c) Monitoring Agency Report to be placed before audit committee for consideration on "on a quarterly basis" instead of "on an annual basis".

Acquisition Objects: Unidentified Acquisitions capped at 25% of issue size and the general corporate purpose along with unidentified acquisition object to be capped at 35% of issue size.

Revised Anchor Lock-In & Underwriting Decision: a) 50% to be locked-in for 1 month and balance holding for 3 months for Anchor Investors, vis-à-vis earlier framework of 30 days lock-in for entire holding; and b) Underwriting Agreement can also be executed at red herring prospectus stage unlike earlier situation of only at Prospectus stage. Helpful if the hard-underwriting obligation on the book running lead managers is ascertainable at red herring prospectus stage, failing which it will continue with Prospectus stage execution.

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Special Rights of Investors: a) Remove Board nomination rights at DRHP from Part A and B of the Articles of Association of a company; b) Part B to survive until the red herring prospectus instead of 'listing'; c) Existing Nominee need not resign, at max, can be re-designated as non-executive-non-independent director; and d) Other special rights to be included in Part B at DRHP. This is a moving piece and still to be crystallized with SEBI on other ongoing deals.

Securities and Exchange Board of India (Merchant Bankers) Regulations, 1992

The Securities and Exchange Board of India has been, from time to time, issuing various circulars/directions to Merchant Bankers appointed for any Capital Markets transactions under the relevant provisions of the Securities and Exchange Board of India (Merchant Bankers) Regulations, 1992 (Merchant Bankers Regulations 1992) and extant securities laws. In order to enable the stakeholders to have access to all such circulars at one place, this Master Circular in respect of Merchant Bankers has been prepared with the issuance of this Master Circular, all directions/instructions contained in the circulars listed out in the Appendix to this Master Circular shall stand rescinded to the extent they relate to the Merchant Bankers. For any further information please refer: Master Circular for Merchant Bankers.

Banking overview

The legal framework for banking regulation in India is primarily governed by the Banking Regulation Act, 1949 (Banking Regulation Act). The Banking Regulation Act envisages the legal framework for regulation and supervision of banks in India, including provisions for licensing, operations and management of banks.

The Reserve Bank of India (RBI) is the country's central bank and the primary regulatory body for banking in India. RBI was established under the Reserve Bank of India Act, 1934 (RBI Act). The RBI Act empowers RBI to issue directives, rules, regulations, instructions and guidelines to banks and financial institutions on various banking and financial sector related topics. RBI also regulates foreign exchange, current and capital account transactions, by the authority granted to it under the Foreign Exchange Management Act, 1999 (FEMA).

Regulators

RBI is the country's central bank and banking regulator. It has extensive authority to oversee the financial industry including (without limitation) the following:

- Establishing standards for setting up and licensing of banks (including international bank branches or subsidiaries in India) and financial institutions in India
- Corporate governance
- Prudential standards
- Requirements for product and service structuring

For regulating the banking sector in India, RBI issues circulars, guidelines and directives from time to time. Its main goal is to provide for a comprehensive supervision of the financial sector, which includes commercial banks, financial institutions and non-banking financing companies (NBFCs).

Other regulators

Apart from RBI, banks in India are also governed by the Ministry of Finance, which is a part of the central government. The central government has the authority to make laws relating to the banking sector and to direct RBI on public policy and other matters relating to regulating banks and financial institutions.

The central government, through its Department of Financial Services, also supervises and legislates functioning of banks and financial institutions. For implementing this, the Department of Financial Services prescribes norms for the functions and operations of public sector banks and examines the legislative measures along with judicial mechanisms for recovery of bank debts. Their role also includes monitoring banking operations as well.

Further, the Directorate of Enforcement (which is a multi-disciplinary organization under the Ministry of Finance, mandated with investigation of offence of money laundering and violations of foreign exchange laws) has responsibility for:

- Enforcing the provisions of the Prevention of Money Laundering Act, 2002 (as amended from time to time) (PMLA) by conducting investigations to trace assets derived from the proceeds of crime.
- Conducting investigations into suspected contraventions of foreign exchange laws and regulations.
- Adjudicating and imposing penalties on individuals and institutions that have contravened the laws mentioned under PMLA or foreign exchange laws and regulations.

Permission to operate

To conduct banking business in India, entities must obtain a licence from RBI under the provisions of the Banking Regulation Act.

The two primary categories of licence are:

- Universal bank licence.

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- Differentiated bank licence. This includes licences for payment banks and small finance banks, each with its own eligibility criteria and guidelines.

This power to issue licenses has been given to RBI by the Banking Regulation Act.

In addition to providing core banking services such as accepting deposits and providing loans, banks in India engage in a range of ancillary business including:

- Securitisation.
- Trade finance.
- Execution of trusts.
- Guarantee and indemnity business.

Entities proposing to deal in foreign exchange must obtain a separate authorised dealer licence from RBI under Section 10 of FEMA. Authorised dealers are responsible for overseeing and facilitating foreign exchange and cross-border transactions.

Capital reserve requirements

The capital adequacy framework for banks in India is based on the Basel III accord, which is a global regulatory framework for banks, established by the Basel Committee on Banking Supervision. A bank must comply with the capital adequacy ratio (CAR) requirements at the consolidated group level and at standalone level.

In addition to the minimum CAR requirement, banks are also subject to additional capital buffers, such as the capital conservation buffer (CCB), which requires banks to hold additional Tier 1 capital to absorb losses during times of financial stress.

RBI is the regulatory authority responsible for supervising and enforcing the capital adequacy framework for banks in India. It conducts regular stress tests to assess the resilience of banks' capital buffers and their ability to withstand adverse shocks to the financial system.

For any further information please refer: Master Circular – Basel III Capital Regulations

Global legislation applicable to the country

Other than the legislations which have been adopted and implemented by the Indian authorities (including RBI), such as the Basel Norms which have been notified by RBI under Master Circular – Basel III Capital Regulations, there are no specific global legislation applicable in India in relation to companies in the financial sector.

Domestic laws (including proposals before parliament)

Primarily, banking in India is governed by the Banking Regulation Act. It envisages the legal framework for regulation and supervision of banks in India. It also (among others) provides for licensing and management of banks, and regulates banks' operations.

The RBI Act empowers RBI to issue directives, rules, regulations, instructions and guidelines to banks and financial institutions on various banking and financial sector-related topics. RBI also regulates foreign exchange, current and capital account transactions by the authority granted to it under FEMA.

Certain other supplemental legislations that apply to banking are:

- Recovery of Debts Due to Banks and Financial Institutions Act, 1993.
- Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI).
- Payment and Settlement Systems Act, 2007.
- Companies Act, 2013.
- Insolvency and Bankruptcy Code, 2016.

Some of the key regulatory developments and trends in banking regulation in India are:

Development of a "green finance" ecosystem: RBI and the central government are working on measures to boost sustainable financing and to meet climate change commitments, including by way of:

- the Ministry of Finance, Government of India, has issued a Framework for Sovereign Green Bonds, aimed at reducing the carbon impact of the Indian economy.
- RBI has issued a framework for acceptance of green deposits by scheduled commercial banks, including small finance banks and all deposit-taking NBFCs.

Enhancing efficient regulatory processes: Regulated financial businesses generally require licences, authorisations and approvals from RBI under various statutes and regulations. The application and approval processes for these can now be done in on-line and off-line modes. The central government has announced the need to simplify and reduce cost of compliance by financial sector regulators within set time limits. RBI is also developing a secure web-based centralised portal for all types of applications made to RBI across all functions.

IT governance: RBI has released draft Master Directions on Information Technology Governance, Risk, Controls and Assurance Practices dated October 20, 2022, following its Statement on Developmental and Regulatory Policies released on February 10, 2022.

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Digital lending: RBI has issued guidelines to regulate digital lending activities in India and to enhance protection of customers. The aforementioned guidelines introduce various changes which include:

- prohibiting grants of credit on e-wallets;
- regulating collection of fees by lending applications;
- mandating compulsory reporting of all digital loans to the credit bureau;
- regulating collection and usage of customer data by fintech companies; and
- curbing first loss default guarantee arrangements.

Product specific legislation

Banking/Credit institutions: Mortgages

Mortgages in India are governed by the Transfer of Property Act, 1882, which contemplates six kinds of mortgages. These are simple mortgage, mortgage by conditional sale, usufructuary mortgage, English mortgage, equitable mortgage, and anomalous mortgage. SARFAESI is also one of the legislations which provides the mechanism for enforcement of mortgage by banks.

Enforcement and investigation

The power to impose penalty on a banking company rests with RBI, which it exercises upon any contravention or occurrence of a default on the part of banks. The manner of dealing with such contravention and default will be dealt with in the manner specified in the Banking Regulation Act.

Complaints and redress

RBI's Master Circular on Customer Service in Banks (dated July 1, 2015, as amended, supplemented or replaced from time to time) contains detailed guidelines on customer service, including the requirement for banks to ensure that a suitable mechanism exists for receiving and addressing complaints from its customers with a specific emphasis on resolving complaints fairly and expeditiously.

According to the above mentioned Master Circular, banks are required to ensure that their policies on grievance redressal are widely publicised by way of, inter alia, placing them on their web-sites and displaying them on notice boards in their branches. The banks are also required to apprise their customers on the services provided at the time of establishment of initial relationship and take necessary steps to keep the customers duly informed of the changes from time to time.

To further strengthen the grievance redressal mechanism in banks, RBI has advised certain banks based on their asset size, business mix, etc., to appoint an internal ombudsman to function as an independent and objective authority at the apex of their complaints resolution system. Where a customer is dissatisfied by a bank's handling of a complaint, it can file a complaint with the banking ombudsmen of RBI under the Integrated Ombudsman Scheme, 2021.

Under RBI's circular on Strengthening of Grievance Redress Mechanism in Banks dated January 27, 2021, banks in India are now required to have a comprehensive framework for:

- Enhanced disclosures on customer complaints.
- A mechanism for recovering the costs incurred by RBI from banks for maintainable complaints received against them in excess of the peer group average.

The circular also provides that RBI will formulate a remedial action plan, which banks are required to implement within a specific time frame. In case no improvement is observed in the grievance redressal mechanism of banks upon implementation of the remedial action plan, RBI may undertake corrective actions through regulatory and supervisory measures.

For any further information please refer: Master Circular on Customer Service in Banks

Creditor hierarchy

Insolvency

Insolvency of companies in India is primarily governed by the Companies Act, 2013, and Insolvency and Bankruptcy Code, 2016 (IBC). The IBC, in a corporate insolvency resolution process (CIRP), provides the following order of priority to be followed for distribution of the proceeds from sale of liquidation assets:

- the insolvency resolution process costs and the liquidation costs;
- the following debts rank equally between and among the following:
  - workmen's dues for the period of twenty-four months preceding the liquidation commencement date; and
  - debts owed to a secured creditor in the event such secured creditor has relinquished security in the CIRP;
- wages and any unpaid dues owed to employees other than workmen for the period of twelve months preceding the liquidation commencement date;
- financial debts owed to unsecured creditors;
- the following dues rank equally between and among the following:
  - any amount due to the central government and the state government in respect of the period of two years preceding the liquidation commencement date;

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- debts owed to a secured creditor for any amount unpaid following the enforcement of security interest;
- any remaining debts and dues;
- preference shareholders, if any; and
- equity shareholders or partners, as the case may be.

Banking resolution

RBI has issued a Prompt Corrective Action (PCA) Framework for Scheduled Commercial Banks (PCA Framework) for the recovery and resolution of such banks. This provides the criteria for determining steps which can be taken by RBI for restoring the financial health of a bank and an indicative list of such steps.

Under the PCA Framework, RBI:

- has the authority to intervene and initiate corrective actions for a distressed bank.
- assesses the financial health of a bank based on certain parameters and, if necessary, initiates prompt corrective action plan for its resolution.

In a resolution scenario, where the financial viability of a bank is in question, RBI has several options available to it under the PCA Framework, which includes resolution of the bank by amalgamation or reconstruction. The specific mechanisms vary based on the specific circumstances and RBI has the discretion to determine the most suitable course of action.

Broadly the discretionary actions include special supervisory actions and actions related to:

- Strategy
- Governance
- Capital
- Credit risk
- Market risk
- HR
- Profitability
- Business operations

Further, the PCA Framework applies to all banks operating in India including foreign banks operating through branches or subsidiaries. However, there is no specific mechanism for the transfer of banking business in a resolution scenario and any corrective action to be taken is at the discretion of RBI.

For any further information please refer: Prompt Corrective Action (PCA) Framework for Scheduled Commercial Banks

Data protection

The Digital Personal Data Protection Act, 2023 (pending notification) will primarily govern the data protection laws in India. The main objective behind this act is to establish a comprehensive framework for personal data processing and protection. Further, from time to time, RBI also issues relevant directions / guidelines for regulated entities in relation to consumer data protection and processing.

Corporate governance

The Companies Act, 2013 (Companies Act) and the Banking Regulation Act are the principal laws that govern corporate governance for banks in India.

The Companies Act deals with the board of directors' composition, the functioning, appointment and removal of directors, and audit / reporting requirements.

The Banking Regulation Act regulates and supervises banking companies and also sets out provisions for the appointment and removal of directors, maintenance of books and accounts and audit / reporting requirements.

Additionally for listed companies, the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 apply, which focus on investor protection through disclosures.

To ensure a robust banking system and financial soundness, RBI issues guidelines and directives from time to time to comply with best international practices and norms. Banks in India are required to comply with all RBI guidelines and directives that are applicable to them.

The guidelines cover, among others:

- Fit and proper criteria for directors of banks.
- Separation of the post of chairperson and managing director/chief executive officer (CEO).
- Directors' remuneration.
- Diversified ownership of private sector banks.
- Risk-based internal audit framework.
- Standards for outsourcing IT services. Regulated entities must:
  - conduct proper due diligence on service providers;

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- monitor and control outsourced activities; and
- establish a robust risk management framework to comprehensively deal with the identification, measurement, mitigation, management and reporting of all risks associated with the outsourcing of IT services.

RBI specifically aims to ensure corporate governance and bank soundness through transparency and disclosure standards aligned with international best practices, systems of off-line surveillance and prompt corrective action.

The Indian Banks' Association (IBA) was formed on September 26, 1946, and all banks are members of this non-statutory body. The IBA also advises banks on corporate governance.

The corporate governance of Systemically Important Financial Institutions is regulated under the provisions of the RBI Act and specific corporate governance guidelines issued by RBI.

Remuneration and bonuses

Under the Banking Regulation Act, the remuneration for the chairperson, Managing Director, any other director, manager, CEO, and any amendments to their remuneration require prior approval of RBI.

Further, no banking company is allowed to employ any person whose remuneration takes the form of commission or a share in the profits of the company, or whose remuneration is excessive in RBI's opinion.

RBI has issued guidelines for compensation of full-time directors, CEOs, material risk takers and control function staff. These guidelines are aligned with the Financial Stability Board (FSB) principles for Sound Compensation Practices and the Implementation Standards for Sound Compensation Practices and the Supplementary Guidance. The FSB principles have been endorsed by the G-20 countries and the Basel Committee on Banking Supervision.

RBI guidelines apply to private banks and foreign banks operating in India.

For any further information please refer: Guidelines on Compensation of Whole Time Directors/ Chief Executive Officers/ Material Risk Takers and Control Function staff

1 https://www.theglobaleconomy.com/rankings/listed_companies/

This country update was kindly provided by the team at JSA in Mumbai: Arka Mookerjee (lead partner), Siddhartha Desai (partner) Govind Roy, Nand Gopal Anand and Vrindesh Patel (associates)

Complaints Procedure

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