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NEWSLETTER

on Developments in Banking and Insurance Law

This newsletter is an initiative by the Centre for Banking and Insurance Laws, National Law University Odisha, in furtherance of its aim to advance education, research and analysis in Banking and Insurance Laws.

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REGULATORY REFORM IN INDIA: THE BANKING LAWS (AMENDMENT) BILL, 2024

Pooja Reddy & Samriddhi

INTRODUCTION

India's banking sector is regulated by regulatory legislation for financial stability, transparency, and accountability. The recent bill that proposes to amend the Reserve Bank of India Act 1934 ('RBI Act') and the Banking Regulation Act 1949 ('BRA') has brought key changes to the upgradation of certain features of regulatory compliance, especially on cash reserves, tenure of directors, common directorship in co-operative banks, and definition of substantial interest of a company. This article draws some in-depth comparisons of the situation before and after such amendments.

TENURE OF DIRECTORS OF CO-OPERATIVE BANKS

Initially, a director of a cooperative bank other than the chairman or the whole-time director was not allowed to hold office for more than eight consecutive years, according to the BRA. If this bill is implemented, it will increase this maximum tenure of ten successive years for the directors of co-operative banks. This increased term may lead to more continuity and stability in the governance of the cooperative banks. The concern, however, is about the overstay in leadership positions that choke new ideas or initiatives.

PROHIBITION OF COMMON DIRECTORS FOR CO-OPERATIVE BANKS

It was earlier prohibited for a director of the board of a bank from holding the office of a director on the board of another bank, except on the RBI's appointment of directors. However, this Bill expands the exception of common directorship by allowing common directorship between directors of central co-operative banks if they could serve as directors on the board of the state co-operative bank, wherein he happens to be a member.

Moreover, it has been enacted to strengthen cooperation in the co-operative banks for the directors to oversee more than one institute within the co-operative structure. Critics may opine that it would lead to conflict of interest and is not an efficient form of supervision.

FORTNIGHT DEFINITION FOR CASH RESERVES

The RBI Act directed scheduled banks to maintain a minimum average daily balance with the RBI as cash reserves.

Interestingly, such an average was essentially computed based on daily balances maintained by banks at the end of business hours each day during a fortnight, referring to the period between Saturdays to the second following Friday including both days.

However, the bill changes the connotation of a fortnight in terms of cash reserve requirements. A fortnight will now mean "From the 1st day to the 15th day of each month" or "from the 16th day to the last day of each month." The amendment extends to the banks that are not scheduled under the BRA, in which the said non-scheduled banks will have to obey the same notion of a fortnight. This aligns the cycle of fortnight to the calendar and makes it easier for banks to keep their compliance in check. All-in-all, it standardizes the reporting period, which could be beneficial for the accuracy of reserve reporting as well as cuts administrative confusion.

SUBSTANTIAL INTEREST IN A COMPANY

Under the BRA, a person who had an interest in a company was held to have a substantial interest therein, if he, his spouse, or his minor child jointly held with any other person or persons, shares exceeding either twenty-five lakh rupees or ten percent of the paid-up capital whichever is less. However, the bill strengthens the acceptance level for the substantial interest up to two crore rupees allowing more direct and indirect financial interaction without triggering regulatory restrictions.

Furthermore, this amount is also empowered to be changed by the central government by a notification only. The threshold has been increased to the level that it is more typical for the contemporary economic scenario with the altered percentages of businesses and inflation. It enables investors to possess greater stakes and does not raise the eyes of the authorities, thus encouraging large investments by individuals in companies.

NOMINATION BY ACCOUNT HOLDERS

The bill proposes to allow up to 4 nominees for deposits, items left in a bank custody, or a locker hired from a bank. In cases of the death of a nominator, the nominee can access the deposit, articles, or locker in the bank.

The manner of nomination envisaged for deposits is either successive or simultaneous. For any other purpose, they can be appointed successively. In cases where nomination is simultaneous, the effect will follow the proportions which are declared. For successive nominations, a preference list order shall receive priority.

As per section 45ZA of the BRA, as of now, account holders can only nominate one legal heir. Hence, this move is expected to offer greater flexibility, and

convenience to all stakeholders, i.e., the depositors and their legal heirs.

It would result in the simplification of the tiresome procedural and legal process currently laid down for the transfer of ownership by the legal heirs of a deceased. In addition, estate planning and succession can then be planned out in advance and in an efficient manner thereby mitigating potential disputes. Overall, this move seems to be welcomed as it caters to the modern banking needs and ensures a more equitable asset distribution process.

SETTLEMENT OF UNCLAIMED AMOUNTS

Following Finance Minister Hon'ble Ms. Nirmala Sitaraman's ('FM') statements, amendments to the State Bank of India Act, 1955 and the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980 will be introduced.

They seek to address unpaid or unclaimed dividends for more than seven years, and facilitate their transfer to the Investor Education and Protection Fund ('IEPF') as per the provisions of sections 124 and 125 of the Companies Act, 2013.

Also, it expands the scope of the current framework to include shares for which dividend has not been paid or claimed for seven consecutive years, and any interest or redemption amount for bonds which is unpaid or unclaimed for seven years. Most importantly, it envisages allowing individuals to claim transfers or refunds from the IEPF. Previously, unclaimed dividends, shares, and bonds redemption amounts remained with banks and no structured process was put in place for managing such assets.

To address this issue, the FM had then asked banking institutions to ensure that their customers nominate legal heirs to reduce unclaimed money left lying in the accounts. In response, the RBI later launched the "UDGAM" portal and the "100 Days 100 Pays" initiative to help address the same.

This change is anticipated to reinforce integrity, and strengthen transparency in the banking sector by safeguarding the interests of both depositors and investors. It would help ensure that such assets are managed responsibly, accessible to rightful claimants and banks are free from the burden of having high volumes of unclaimed assets in their accounts.

REMUNERATION OF AUDITORS

To provide banks with greater autonomy and flexibility, the bill aims to allow them to determine the compensation for statutory auditors according to the industry standards and the unique requirements of each bank. The idea behind this change is to enhance the independence and effectiveness of audits and improving overall governance. It envisions putting banks in a position where they can negotiate remuneration that reflects the complexity and scope of the audit services provided as the current

position may not always reflect market conditions or the specific needs of individual banks.

At present, the remuneration to be paid is fixed by the RBI in consultation with the central government and in accordance with section 41 of the State Bank of India Act, 1955.

This move is expected to attract more auditors and ensure that compensation structures are competitive and fair. The overall governance within the banking sector would improve significantly and would attract higher quality auditing services, thereby improving the notion of transparency and trust in the financial system.

CONCLUSION

The bill marks a significant evolution in India's banking regulatory landscape, addressing key aspects of governance, compliance, and consumer protection. The amendments are poised to enhance stability, streamline compliance, and aide banks manage their obligations more effectively.

Furthermore, by reducing regulatory hurdles it is expected that the bill would help foster a more dynamic economic environment. The provisions introduced demonstrate the government's committed to maintaining transparency and accountability, thereby reinforcing the integrity of the banking sector.

Collectively, these changes are designed not only aim to modernize banking practices but also to safeguard the interests of depositors and investors, ultimately contributing to a more robust financial system. As the sector adapts to these changes, ongoing evaluation will be crucial to ensure that the intended benefits are realized without compromising oversight and governance standards.

SEBI'S UPI BLOCK MECHANISM: SIGNIFICANT IMPACT ON SECONDARY MARKET'S TRADING EFFICIENCY

Suhani Sharma

INTRODUCTION

The Securities and Exchange Board of India (**'SEBI'**) has come out with a consultation paper which proposes that all Qualified Stock Brokers (**'QSBs'**) under the Securities Contracts Regulation Act should offer a trading facility for the secondary market. This is going to be analogous to the one which is followed in the primary market through the Application Supported by Blocked Amount (**'ASBA'**) system. The new facility would be on the lines of the User Payment Interface (**'UPI'**) block mechanism. This would be similar to the system that has been followed for the applications of retail investors in public issues since January 2019. It is also proposing an alternative option under which QSBs are allowed to provide a '3-in-1' trading account facility instead of making it mandatory to have an ASBA-like system.

The major difference between the nature of a primary and secondary market is that while the primary market includes the new securities issued and sold for the first time in the market, the secondary market involves the buying and selling of already issued securities by the investors.

The already existing feature of such primary market is ASBA. Within this system, Investors are permitted to restrict the funds in their bank account instead of transferring the funds on the upfront. This way, money remains in the account of the investor till the allotment takes place. This not only protects the funds owned by the clients but also the securities held by them. This particular money movement happens only after fulfilling the relevant conditions, and provides greater security to the transactions.

On the same lines, this facility would be similar to an ASBA within the proposed framework for the secondary market. The investor can block their funds in the bank account for trading without having to pay any advance money to the Trading Member **('TM')**. This step would safeguard the collateral funds of the investor other than allowing them to earn interest on the remaining balances. This would in turn assure that the funds move only when required, and thus, the chances of misappropriation or misuse of clients' assets reduces. According to SEBI, such a system in the secondary market would lead to a major enhancement of transaction safety and efficiency, not only for the retail investors but also for the market participants.

FEATURES OF THE SEBI'S PROPOSED TRADING FACILITY

One of the significant aspects which are presently under discussion are the proposed commercial arrangement by the National Payments Corporation of India **('NPCI').** They basically act as the Sponsor banks and the Customer banks in the market. Moreover, the secondary market will benefit the investors, in contrast to the primary market where the issuers are rewarded by offering the ASBA facility. For instance, these investors would earn interest on their blocked funds that remain in their bank accounts and not in brokers' accounts.

SEBI has determined that implementing the UPI block mechanism will not impose any additional strain on NPCI's current UPI transaction processing capacity. It would keep the funds available within the investor's account but block them specifically or trading purposes. The significant relief in this system would be that the funds will remain safe, earn interest even while they are blocked, and, thus, provide protection to the investor at a level which is different from the mechanisms where the funds are merely shunted to the brokers. In addition to the UPI block mechanism, the 3-in-1 trading account facility is to be considered by SEBI as a primary alternative mechanism. This facility is already available with some of the trading members whereby funds in respect of both cash and derivatives trading are kept in the clients' bank accounts.

Though the block mechanism of the 3-in-1 facility appears easier to get implemented and become more widely applicable, it is still not as effective as the block mechanism of UPI because the latter ensures that the funds get blocked within the investor's own bank account.

BENEFITS OF THE PROPOSED UPI BLOCK MECHANISM

1. Enhanced Collateral Management: The UPI block mechanism improves accuracy in collateral reporting by reducing errors from TM and clearing members **('CM')**, as funds remain blocked in client accounts. This ensures proper allocation and use of funds for Clearing Corporation **('CC')** purposes.

2. Prevention of Misuse: This system also prevents the misuse of funds or unauthorized withdrawals by restricting TMs and CMs from accessing or mishandling the collateral. Funds can be used only for their intended purpose; thus, the risk of such abuse is minimized.

3. Security and Default Protection: Funds of clients can be recovered smoothly in cases where defaults occur within TM. The system ensures that no complication emerges during payout; it can also ensure the smooth transfer of trades to some other TM if there is any default.

4. Interest Generation: Unlike other systems, UPI block mechanism allows funds in the accounts of clients to continue earning interest while being blocked, thereby offering investors various financial benefits in addition to enhanced security.

5. Investor-Friendly Benefits: The UPI lock-in creates increased investor protection and convenience depending on co-operation from the sponsor banks and customer banks along with NPCI. Investors directly benefit from keeping their funds in their accounts, as they earn interest and experience enhanced security even in the secondary market.

CONCLUSION

The proposed UPI block mechanism provides an ingenious solution to the problems of ensuring an enhanced transaction security and proper fund management even in the secondary market. This is because the system allows an investor to block funds in his or her account; thus, minimising the risk of abuse. This would also lead to an accurate way of reporting of collateralized securities, while even in case of default, the payout would be comfortable.

Furthermore, interest from blocked funds would be payable to clients, providing both financial and security benefits.

Conclusively, this mechanism supports investor protection, greater convenience, and efficiency through the benevolent contribution of NPCI, other sponsor banks, and customer banks. This eventually sets itself out to be a more effective alternative to the existing trading account systems.

SAFEGUARDING INVESTORS: SEBI'S STRATEGIC MEASURES TO MITIGATE RISKS IN FUTURES AND OPTIONS MARKETS

Ishita Ayala

INTRODUCTION

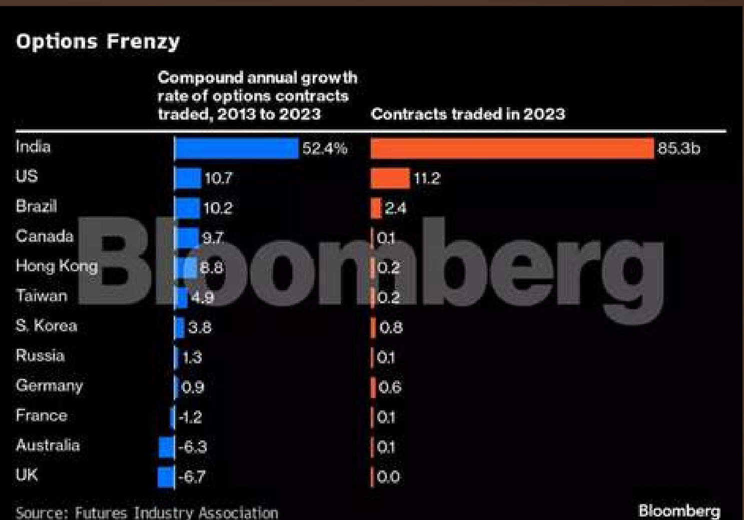
Futures and Options ('F&O') are derivative instruments that allow investors to hedge against the price movement of the underlying securities. In a futures contract, the buyer is compelled to buy or sell the asset. An options contract gives the buyer the right to buy or sell the underlying asset, but there is not obligation to do the same. F&O trading allows the buyer to buy or sell the asset at a pre-determined price. If the price rises, the trader makes a profit, or else the losses he/she may have to bear spikes in the costs in case the market movement is against the position taken by the trader.

MECHANICS OF F&O TRADING

F&O trading can be complex in nature, however, the fundamentals of this form of derivative trading has been discussed below:

- F&O trading involves leverage, allowing you to control a larger position with a smaller amount of capital.
- If the market moves against your position, the value of your investment can decline rapidly.
- When the value of your position falls below a certain level, your broker will issue a margin call, requiring you to additional funds.
- Failure to meet the margin call can lead to the forced liquidation of your position, often at a loss.
- A margin call can force you to sell your position at an unfavourable price, regardless of your investment strategy.
- Leverage can magnify both profits and losses, increasing the risk of significant financial setbacks.
- Sudden price movements can trigger margin calls, leaving investors with little time to react.

This graph depicts the rapid rise in the volume of F&O trading, with India surpassing the US in the number of derivatives traded. Jay Thakker says that introduction of weekly expiry by other indices which provides opportunities to retail participants, the reduction of the weekly premium as opposed to the monthly premium and subsequently, the



drastic reduction of the margin requirement, leading to an increase in the bet size are some of the reasons for the same.

These figures hide the stories of retail investors who have gotten addicted to F&O trading and have lost their savings and are financially precarious, having gotten influenced by seeing successful traders on social media platforms. SEBI's analysis of the situation, as highlighted in their latest research paper states that 93% of over 1 crore individual F&O traders incurred average losses of around Rs 2 lakh per trader (inclusive of transaction costs) during the three years from FY22 to FY24, with 1.13 crore traders losing a collective sum of Rs 1.81 lakh crores.

SEBI'S STEPS TO CURB F&O TRADING

Securities and Exchange Board of India ('SEBI') released a consultation paper on Measures to strengthen index derivatives framework for increased Investor protection and Market stability provides seven proposals to curb rampant F&O trading by retail investors which have been discussed below. The paper is presently open for comments.

·**Rationalisation of Strike Prices:** Reducing the number of options strikes at contract launch and standardizing strike intervals. Contract launch refers to the introduction of a new options contract by the exchange. It provides traders the ·opportunity to speculate about the future prices and hedge accordingly.

·**Upfront Collection of Premiums:** Mandating upfront collection of premiums from options buyers, in addition to the existing margin requirements for futures positions.

·**Removal of Calendar Spread Benefit:** Eliminating the margin reduction for positions with different expiries on the same day.

·**Intraday Monitoring:** Introducing intraday monitoring of position limits for index derivatives.

·**Minimum Contract Size Increase:** Phasing in a higher minimum contract size, starting at ₹15-20 lakh.

·**Rationalisation of Weekly Expiries:** Limiting weekly expiry to one benchmark index per exchange.

·**Increased Margins Near Expiry:** Requiring additional margin on the last two trading days before contract expiry.

CONCLUSION

In totality, this proposal has been met with mixed reviews with some analysts calling it useful to curb the exuberance in the markets, however, some analysts have argued that if all the proposals were to be implemented simultaneously, the vibrancy of the market would be heavily affected, just like South Korea. There is no doubt that F&O trading can lead to immense loss for retail traders and the proposals drafted by SEBI are a step in the right

direction, however, more clarity will be provided after the period for offering comments is closed and SEBI's consideration of the same.

SEBI'S UPDATED GUIDELINES FOR BUSINESS CONTINUITY AND DISASTER RECOVERY IN MARKET INFRASTRUCTURE INSTITUTIONS

Subhashmin Moharana

Market Infrastructure Institutions (**'MIIs'**) provide essential services that facilitate trading, clearing, and settlement of securities. Business Continuity Plan (**'BCP'**) are a set of protocols that MIIs put in place to ensure their uninterrupted operation during adverse events such as natural disasters, cyberattacks, or system failures. Disaster Recovery (**'DR'**) are mechanisms to restore critical systems and data even after a disruptive event. Any disruptions in market infrastructure institutions will inevitably cause subsequential effects on the entire financial ecosystem. For instance, whenever a trading site goes offline even for a minute, it would affect trading, settlement and investor confidence at the same time.

EXISTING GUIDELINES

Recently, Securities and Exchange Board of India (**'SEBI'**) released a circular to notify the modification of existing guidelines on BCP and DR of MIIs. SEBI has prescribed a framework for BCP and DR for stock exchanges, depositories, and clearing corporations. Some of its key points includes the following:

1.**Primary Data Centre ('PDC') and Disaster Recovery Site ('DRS'):** Stock exchanges and clearing corporations must have both a DRS and a Near Site (**'NS'**) to ensure zero data loss. The DRS should ideally be in a different seismic zone, and if not feasible, a minimum distance of 500 kilometres between PDC and DRS is required.

2.**Incident and Response Team ('IRT'):** Each institution must establish an IRT or Crisis Management Team responsible for declaring disasters, invoking BCP, and shifting operations to the DRS.

3.**Training and Awareness:** Regular training programs enhance preparedness among employees and outsourced staff.

4.**Quarterly Review:** The Technology Committee of these institutions reviews BCP-DR policy implementation.

RECENT MODIFICATIONS

The following key modifications are notified by SEBI for enhancing the safety net and resilience of MIIs.

Near zero data loss: The guidelines enforce that stock exchanges must implement systems that ensure near-zero data loss. Clearing Corporations and Depositories are expected to achieve a zero data loss. MIIs are advised to collaborate in developing a standardized definition of "near zero data loss" and

submit the same to SEBI after taking approval from their respective Standing Committee on Technology ('SCOT').

Independent DRS Operations: MIIs must ensure that their DRS is capable of running operations independently. Trained staff should be ready to manage operations at short notice. This means that even if the primary data centre faces issues, the DRS can seamlessly take over without relying on staff from the primary site. This would immediately come into effect as per the circular while others shall be implemented within next two months.

Recovery Point Objective ('RPO'): MIIs are now required to maintain a Near Site **('NS')** alongside their existing DRS. MIIs shall have a documented methodology for data reconciliation when resuming operations from DRS or any other site as applicable. In addition to that, the maximum tolerable period for which data might be lost due to a major incident shall be near-zero.

NEXUS WITH BANKING LAWS

While MIIs are not banks, their stability and resilience are crucial for overall financial stability. MIIs and banks operate in different spheres, yet their interconnectedness underscores the need for effective risk management across the financial ecosystem to maintain a stable economy.

In banking law, systemic risk is a major concern. MIIs constitute the backbone of the capital markets. Any disruption can have a major impact on the financial system and its market liquidity as well as price discovery for their operations both are very much dependent on MIIs.

As per provisions of the Banking Regulation Act, 1949 and directives from the Reserve Bank of India, it is obligatory upon banks to have business continuity as well as disaster recovery management strategies in place, to protect their respective business from various disruptions. These guidelines emphasize operational readiness and the goal to prevent the occurrence of systemic shocks that may endanger banks, making financial market infrastructure more insecure.

Financial institutions especially banks widely rely on MIIs. The guidelines proposed by SEBI stress on the MIIs on having sound backup procedures, disaster recovery solutions, and fail-safe solutions, thus, safeguarding the banks and other financial organizations from possible failures, which could affect the complete market chain.

The banking laws have gradually begun to focus on cybersecurity because of the existing cyber threat. Modifications to the BCP and DR guidelines of SEBI echo the same principles where MIIs need to be able to bounce back after a cyber-attack. This also corresponds with banking regulations being directed to protect customer details and financial identity

identity especially in the advent of online banking.

BEST PRACTICES AROUND THE GLOBE

The International Financial Services Centre Authority **('IFSCA')** has its own guidelines for BCP and DR in the International Financial Services Centre ('IFSC'). We can draw some general best practices followed by other countries. Identifying potential risks that could disrupt MII operations and understanding the impact of disruptions on critical functions, stakeholders, and the overall market is necessary. Then, the development of detailed plans for various scenarios, including communication protocols, alternative sites, and resource allocation, BCP and DR must be tested regularly to ensure their effectiveness. There should also be clear defining roles and responsibilities within the organization for BCP and DR. Most of the Indian BCP and DR regulations align with these global standards.

To summarize, SEBI's updated BCP and DR guidelines emphasize near-zero data loss, independent DR operations, and regular testing, align with global best practices and address contemporary challenges. This ensures the continuous and reliable functioning of our financial market infrastructure. These measures foster investor confidence and market integrity. With increasing technological dependencies and cybersecurity threats, SEBI's proactive approach sets a strong foundation for a robust, secure, and globally competitive financial market infrastructure in India.

INTEREST EQUALIZATION SCHEME (IES) ON PRE AND POST SHIPMENT RUPEE EXPORT CREDIT

Rahul Agarwal

The Interest Equalisation Scheme (**'IES'**) is a government initiative aimed for the purpose of providing subsidized interest rates to the exporters. This scheme would make the credit systems affordable for the Indian exporters by allowing interest rate subsidies. Hence, the overall cost of the loan would decrease, making Indian goods more competitive in the global market. IES is one of the most important export promotion strategies implemented in the country currently.

The coverage would include both pre and post shipment of the exports. The initial pre-shipment credit is provided to the exporters for the procurement, manufacturing and the processing of the goods which are meant for export. The post-shipment credit would help the exporters bridge the financial gap till the payment is acquired from the buyers. This would be highly beneficial for the sellers, especially the Micro, Small & Medium Enterprises (**'MSME'**) manufactures to recover the working capital for the production of their new set of exports.

The subvention ranges from 3-5%, depending upon the size and sector of the exporter. Loans would be issued by the banks at the subsidized rates. The subvention would include rate of interest equalization as 2% for Manufacturers and Merchant Exporters and 3% for the MSME manufacturers. The government would reimburse the banks for the subvention ensuring that the exporters get the subsidised rates. This mechanism would ensure that the exporters have access to cheaper credit system, helping their financial burden.

This scheme is a strategy to promote exports of the country. This move mainly aims at the MSMEs which are a strong part of India's export economy, however, they are subject to limited access to low-cost credit. The key sectors include agriculture, textiles, leather, gems and jewellery and other labour-intensive industries. Exporters from other large corporations could also be included which are critical for the economy, yet are facing various challenges in the global markets. IES does not include multinational corporations as they have the means to find other sources for the purpose of cheaper financing.

OUTCOMES

One of the direct and foreseeable outcomes is the boost in export performance. Due to the subvention by the government, there has been an

increase in supply of Indian products in the global markets. The exporters themselves are taking an additional risk and diversifying their products for entering into these new markets without the fear of high credit costs. The increase in the number of exports also contribute to a stronger foreign exchange reserve and maintaining a healthy balance of payments account. Several other positive outcomes such as growth in job creation and a better economical stance for the country is inevitable as a result of the same.

The IES supports the government's "Make in India" initiative by encouraging the small-time exporters. This would also indirectly boost the domestic production of the country. Moreover, niche sectors such as pharmaceuticals and auto components would gain a major boost. This scheme also encourages various banks and financial institutions to extend credit facilities to the exporters. Here, not only is the cost of borrowing being reduced but this scheme also helps to strengthen the fiscal power of the exporter itself.

CHALLENGES AND CRITICISMS

As per the latest notification by the Reserve Bank of India (RBI), the IES scheme is extended only till the end of August, 2024. The month-long extension would not cover non-MSME exporters. This would hamper the ongoing exports of the traders and would increase their financial burden. The scheme does not cater much to the larger exporters which contribute significantly to the economy of the country. Lack of awareness and navigating through the complexities of the scheme could itself discourage the small-time exporters to avail the benefits of the tool.

CONCLUSION

The IES could prove as a critical step in boosting the current exports of the country. MSMEs would be provided with a step to start or increase their exporting capabilities. Furthermore, if extended to more sectors and for a greater span of time, the IES could also help several larger exporters in a similar fashion. The exhaustive nature of the scheme poses a definitive disadvantage to the exporters. Though it is a step in the development of the export sector, which has been overlooked for too long now. The export sector continues to strengthen itself with the increase in demand of domestic products in the international markets. The inclusion and availability of such schemes provide the exporters a strong financial safety net to mitigate the risks. Several other schemes like the IES, if implemented would strengthen the economy of the nation immensely.

RBI FINES HDFC BANK FOR REGULATORY NON-COMPLIANCE

Snigdha Dash

On March 31, 2022, a statutory inspection was carried out as part of a supervisory examination of HDFC Bank Limited's **('HDFC')** financial status. Based on this, HDFC Bank was sent with a show cause notice, asking it to explain why it shouldn't be penalized.

Recently, the Reserve Bank of India ("RBI") fined HDFC Rs. 1 crore by order dated September 3, 2024 for failing to comply with the RBI's directives on the "interest rate on deposits," "recovery agents engaged by banks," and "customer service in banks," as well as the guidelines on risk management and the Banking Codes and Standard Board of India **('BCSBI')** Code.

IMPLICATIONS OF THE PENALTIES

Regulatory Compliance Culture: The penalties help to reinforce compliance with regulatory requirements for ease of doing business. This step by the RBI is evidently seen through the activities of the central financial institution to enforce the provision of high standards by the banks in order to protect consumers as well as the country as a whole.

Reputational Risks: These violations may ead to reputational risks because of the types of businesses the bank transact in. lDetails on fines can lower clients' confidence in their regulators that affects customer retention and acquisition. Its existence also points at the requirement of the compliance with the laws in the banks as one of the principles of corporate governance.

Financial Consequences: Although these penalties may appear small in comparison with the total asset and profits of the concerned banks, such penalties show that non-compliance to the rules entails worse consequences, particularly where overall problems are recurrent. Other stimuli may push more attention to the relevant authority or the penalties might increase.

REGULATORY CONTEXT

The RBI's actions are in line with the general trend observed in the regulation of banking activities in the global economy. The RBI has made it clear that these penalties are not a commentary on some of the various transactions or agreements that the banks have had with their customers, but simply a result of non-compliance with set statutes. As much as it is possible that compliance issues can be salvaged by providing a workable solution which does not

necessarily compromise the legal procedures in the conduct of banking activities, it is wise to make such a difference.

CONCLUSION

Punishments in terms of fines that two of the big banks in India – Axis Bank and HDFC Bank – have been incurring, are in a way appropriate to a range of regulation and compliance fields that require upgradation. It is stated in those actions that these operations pose a threat to those banks that are involved and also to the banking institutions, the proper rules and regulations have to be observed if the particular operation is to be allowed. Further, in the discussion, it would be argued that both the banks will have to strengthen their compliance systems to ensure that no such misconducts take place in the future and they keep a check and balance system at place in an increasingly globalised as well as packaged sphere of economics.

SCHEME FOR TRADING AND SETTLEMENT OF SOVEREIGN GREEN BONDS IN THE INTERNATIONAL FINANCIAL SERVICES CENTRE IN INDIA

Shreya Mathur

INTRODUCTION

A new scheme for the issuance of Sovereign Green Bonds **('SGrBs')** has been recently announced by the Reserve Bank of India **('RBI')** pursuant to their bi-monthly policy statement. The SGrBs herewith shall be issued as an instrument for investment and trading which can be purchased or sold by eligible foreign investors in the International Financial Services Centre **('IFSC')** in India.

SOVEREIGN GREEN BONDS

Green bonds are debt securities that are issued to raise money for initiatives pertaining to the environment and the climate.

The Indian government in the Union budget for the fiscal year 2022-23, first introduced sovereign green bonds. The aim for the same is to help the government tap the requisite investment from potential investors for its use in public sector projects.

Through this scheme, the government is looking to increase the participation of the non-resident investors.

ELIGIBILITY

Persons eligible to invest in the scheme are persons who are not residents of India under S. 2(w) of the Foreign Exchange Management Act, 1999 or Foreign Exchange Management (International Financial Services Centre) Regulations, 2015. They should be eligible to invest in IFSC. In addition, they must not be incorporated in High-Risk jurisdictions subject to a Call of Action as identified by Financial Action Task Force ('FATF'). IFSC Banking Units ('IBU') of a foreign bank are also eligible to be the investors in the scheme.

DETAILS OF THE SCHEME

The SGrBs shall be available for investors in two phases.

1. The **first phase** shall consist of the primary auctions where bids from the interested parties shall be invited.
2. The **second phase** shall be the transaction occurring in market of securities in the IFSC. This shall be undertaken as per the rules laid down in the scheme, during the trading hours specified by the RBI.

In addition, it has been laid down that the eligible IBUs shall not be permitted to take part in the initial primary auction. They shall only be permitted to subsequently invest in the SGrBs through the market of securities in accordance

with the provisions laid down therewith.

Interested investors shall further have to open a Constituents' Subsidiary General Ledger (**'CSGL'**) account and a current account with the RBI and may, on their own discretion, open an INR account with a commercial bank in India. Upon settlement of these bids, the allotted securities shall be transferred to the respective CGSL accounts of the bidders. Subsequently, trade can be undertaken between investors and IBUs but not between two IBUs.

The coupon payments and the redemption on the securities shall be credited to the current account held by the authorised depository with the RBI. They shall subsequently be disbursed by them to the other investors in the same day or only under exceptional circumstances, the next working day.

The records for the same shall be maintained by the RBI and the reports of the investments made by the investors may be published as and when required. These records shall be maintained for at least ten years from the date of transaction.

IMPLICATIONS

By way of this scheme the government can tap into global capital by garnering investments from Persons Resident Outside India (**'PROI'**). These funds shall be utilised in the development of green projects that will help reduce the carbon footprint of the economy.

This scheme allows for PROI to invest in long term Indian government bonds and projects. An added benefit posed for them is the next to no risk they face in this investment. It also provides for a higher rate of interest as opposed to Non-Resident Ordinary (**'NRO'**) deposits. SGrBs are an ethical investment, aligning with environmental and societal considerations since the funds so collected shall be used to further green initiatives.

CONCLUSION

SGrBs are a securities instrument being used by the government to gather investment that shall be utilized in projects undertaken for the benefit of the environment and the climate. Through the scheme released by the RBI, the government aims to invite PROI as well to increase investments and contribute to achieving the climate goals.

IRDAI INTRODUCES NEW PRINCIPLE-BASED FRAMEWORK FOR INSURANCE ADVERTISEMENTS

Shriyansh Singhal

The Insurance Regulatory and Development Authority of India (**'IRDAI'**) has come up with a principle-based advertising regulation for insurance adverts and those by the insurance entities' distribution networks such as agents and intermediaries. This framework supersedes the IRDAI (Insurance Advertisements and Disclosure) Regulations, 2021 and the "Master Circular on Insurance Advertisements" issued in October 2019. This is as part of a larger reform agenda to increase governance standards throughout the insurance sector.

The new guidelines are distributed across several key documents: the IRDAI (Protection of Policyholders' Interests, Operations and Allied Matters of Insurers) Regulations, 2024 (**'PPHI'** Regulations), the "Master Circular on Operations and Allied Matters of Insurers" of June 2024, and the "Master Circular on Protection of Interest of Policyholders" of September 2024. Also, certain specific norms regarding advertisement are provided under master circulars associated with the IRDAI (Insurance Products) Regulations, 2024.

KEY REFORMS IN ADVERTISING REGULATIONS

Following are the key reforms that are brought forward by these new insurance advertising regulations:

Board Approved Advertisement Policy

One of the changes is that every insurer is now mandated to have a Board-Approved Advertisement Policy **('BAAP')**. This policy outlines internal procedures such as budgeting, advertisement types and some more, that will help the company to adhere to legal requirements on advertisement placements while at the same time observing the insurance company's corporate governance principles. The BAAP also requires close monitoring of advertisements, which makes the advertising industry more responsible.

Formation of an Advertisement Committee

Historically, the compliance officer supervised the advertising operation in insurance organizations. The new framework has also provided for an Advertisement Committee which now performs this task. This committee checks all advertisements to make sure they are in compliance with the law and reflect the

product line of the company. Notably, the monitoring of advertisements released by distribution channels is also done by the compliance officer.

The Advertisement Committee should comprise two key managerial persons ('KMPs'), three other officials of the company's management, and one permanent invitee from the project management consultancy ('PMC'). This structure relates advertising more directly to product management to make advertisements compatible with product attributes and approvals.

Internal approval of advertisements

This has led to the many changes, one of the them being that the rule that had required the filing of advertisements with the IRDAI has been done away with. According to the previous regulations, insurance companies were supposed to provide the regulators with copies of the advertisements they had released within seven days. However, in the future, advertisements will be approved internally by the Advertisement Committee, and this will be much easier, though internal control will remain very tight.

Keeping Adverts Record

The former regulations for insurance advertisements called for the companies to retain advertising records for at least three years. These new rules include the advertisement record keeping provisions under the BAAP. The Advertisement Committee is also in charge of maintaining records of all advertisements so as to continue with the advertisement transparency.

Third-Party Advertisement Limited to Branding Only

Third party participation in insurance advertisement is also captured in the new framework.

The previous rules prohibited third-party advertisement, but the new framework allows third-party participation in institutional advertisements aimed at brand awareness. Although, communications which can be described as directly prompting the consumer to buy insurance is not allowed to be made by third parties, thus keeping policy-specific messages in the hands of the insurer.

Dealing with Misleading and Unfair Advertising

The new rules are introduced to protect consumers from misleading advertisements to retain high standards. The PPHI Regulations give specific examples of practices that may be misleading to consumers, for example, hiding policy terms or making exaggerated promises. Moreover, general bans on 'misleading advertisements' and

'unfair trade practices' are also strengthened in accordance with the Consumer Protection Act, 2019. These restrictions apply to all types of media, including social media.

Norms for Ratings, Rankings, and Awards

The new framework maintains the prohibition on the employment of ratings, rankings, or awards in an advertisement. Insurance companies are restricted from using claims of market share rankings and any rating or award used must come from an independent third party not affiliated with the insurer. However, when presenting claims paid ratios, companies are required to present figures that are derived from annual audits.

Enhanced Disclosures

These new framework adds more scrutiny to ensure that mis-selling is prevented as some of the most basic requirements like the insurance company's registered name and contact information remain mandatory, enhanced disclosure requirements make it more mistake-proof.. For example, before selling complicated products such as life insurance policies, the advertisements should include information on how the market volatility affects the investment and state that returns are not assured.

The new principle-based framework of IRDAI has brought a paradigm shift in the regulation of insurance advertisements in India. The IRDAI has recently come up with the Board Approved Advertisement Policy and the Advertisement Committee to compel insurance companies to be more involved in ensuring that they adhere to the set rules and regulations when campaigning their advertisements. The framework also covers the new media mechanisms and applies even tighter measures to prevent consumers from being given wrong information. With these new requirements in place, the insurance industry will have to shift the ways they operate in order to meet these new guidelines and avoid penalties.

ITAT MUMBAI UPHOLDS SECTION 68: ADDITION FOR DISGUISED UNSECURED LOANS

Ashwasti Shravani

INTRODUCTION

Section 68 of the Income Tax Act, 1961, serves to tackle the matter of unexplained cash credits in an assessee's books. It directs that whenever any amount is credited to an assessee's books, the assessee must provide an adequate explanation to Income Tax Authorities about the characterization of income and its source. If no reasonable explanation is given, or if the explanation is specifically considered unsatisfactory by the Assessing Officer, the credited amount can be treated as taxable income in that financial year. This allows the assessing authorities to examine and classifies the unexplained cash credits as business profits or income from other sources. Essentially, it serves as a means of detecting and taxing unexplained income to decrease tax evasion.

KEY ISSUES IN THE RULING

This provision has become increasingly important in recent years, especially in cases involving accommodation entries where such entities fabricate loans or financial entries to help persons evade taxes. In J.K Global v ITO , an assessee had made three separate appeals to an order made by National Faceless Appeal Centre ('NFAC'), concerning the assessments years 2010-11, 2011-12 and 2012-13;

- In AY 2010-11, the assessee took an unsecured loan of Rs. 25 lakhs from Ryan International.
- In AY 2011-12, a loan of Rs. 5 lakhs were taken from Casper Enterprises Pvt. Ltd.
- In AY 2012-13, Rs. 20 lakhs were borrowed from Duke Business Pvt Ltd.

The main issue in these appeals was the treatment of unsecured loans taken by the assessee as unexplained or unaccounted for under Section 68 of the Income Tax Act.

The DGIT (Mumbai) investigation revealed that Shri Praveen Kumar Jain was involved in providing accommodation entries through disguised unsecured loans and share applications via various paper companies that did not conduct any real business. Shri Praveen Kumar admitted under Sec- 132(4) of Evidence Act, that the entire business was operated by him and his associates through various paper companies under their control. The tax authorities treated these unsecured loans as unexplained and added them to the assessee's income under Section 68 of the Income Tax Act, thereby subjecting them to taxation for the relevant assessment years.

OBSERVATIONS OF THE TRIBUNAL

The ITAT, composed of Narendra Kumar Billaiya (Accountant Member) and Sunil Kumar Singh (Judicial Member), made several key observations:.

It has been established that the companies involved—Ryan International, Casper Enterprises, and Duke Business—were providing accommodation entries through unsecured loans claimed by J. K. Global. This classification was based on prior findings from a coordinate bench regarding Jain's operations. The ITAT confirmed that these loans were rightly treated as unexplained under Section 68 due to a lack of satisfactory explanation from the assessee regarding their nature and source. The counsel for J. K. Global argued that since they had already repaid the loan during the year under consideration, they should be permitted to offset it against their taxable income. The tribunal rejected this argument. It pointed out that merely repaying the loan does not alter the fact that the loans were ultimately determined to be accommodation entries. The repayment of unaccountedmoney does not change their nature. This tribunal also confirmed additional assessments related to interest paid on these unsecured loans and stated that those interest payments were unexplained and could not be verified.

The tribunal indicated that J. K. Global did not attend, or offer any evidence at hearings, and that lack of evidence to counter the alleged claims kept them doubting in their judgment.

WAY FORWARD

This ruling cautions against the practice of using false transactions as accommodation entries, as it can lead to significant tax consequences. It reinforces the legal principle that assesses must explain and substantiate any cash credits, otherwise it can be treated as income to be taxed. This ruling will serve as precedent for future matters involving similar situations, thereby maintaining consistency in tax assessments regarding unreported and unaccounted income.

As laws governing taxation change, this ruling will continue to shape the way taxpayers and tax authorities deal with compliance and enforcement of laws, and keep financial integrity as a part of normal business operations in India.

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