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NEWSLETTER

on Developments in Banking and Insurance Law

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

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The Adani-Hindenburg Enigma

Pooja Reddy

The recent Adani-Hindenburg episode has captured the attention of global financial markets, sparking a heated debate over the allegations and the resulting market volatility. However, this focus has left the broader implications for regulators and the legal world less explored. Beyond the surface-level debate, it is imperative to consider the wider ramifications for India's financial ecosystem and market stability. This article aims to delve into the legal framework surrounding such actions and entities, offering a comprehensive analysis of the challenges and consequences that could potentially reshape the financial landscape.

Hindenburg Research – Legal Liability of the RA

Hindenburg Research is a research analyst (**'RA'**) which specialises in forensic financial research. They inquire into, examine, find, or revise facts, principles, and theories related to the securities of a company either for internal use or for external client use.

However, Hindenburg Research and its associate investors are often observed to use their reports for engaging in short selling in the targeted companies' stocks. To determine liability for such actions under Indian law, accuracy of the claims and methods involved is crucial. Pursuantly, the Securities and Exchange Board of India (**'SEBI'**) has established several regulations that govern an RA's market conduct. The SEBI (Research Analysts) Regulations, 2014, (**'RA Regulations'**) and the SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations, 2003 (**'PFUTP Regulations'**) were tailored to ensure that reports published are credible and reliable. They mandate reports to be formed on the basis of thorough research to avoid any kind of conflict of interest that may bring their integrity into question. Further, they also play an important role by prohibiting market manipulation, and false or misleading advents regarding the trading of securities.

The recent RA Regulation amendments introduced in August 2024 further intensified the requirements for an increase in transparency and accountability. Now, an RA must disclose any kind of conflict of interest and shall not undertake the activity that can be perceived as manipulative or misleading.

The SEBI (Prohibition of Fraudulent and Unfair Trade Practices Amendment) Regulations, 2024, also have expanded the scope of what constitutes fraudulent and unfair trade practices, which has resulted in an increased exposure of RAs to regulatory oversight. For instance, Regulation 4 (2) (r) now explicitly prohibits the dissemination of misleading research reports and condemns the failure to disclose conflicts of interest as fraudulent activities.

Additionally, the law provides protection to those whistleblowers and investigative journalists whose claims are corroborated with facts and solid

evidence. Therefore, a conclusion can only be reached regarding Hindenburg's liability once the veracity of the allegations has been examined.

Short Selling and Its Legal Framework in India

Previously stated, one overlooked aspect was understanding the very concept of short selling and its legality in India. Short selling is a trading strategy employed by investors to profit from an anticipated decline in a stock's price. It is often used by those investors who believe that a particular stock is overvalued or that the company's fundamentals are weak. But there are many instances, such as the current, where short selling companies have been accused of releasing misleading or exaggerated negative reports about a target company order to benefit from the decline in stock prices.

The process encompasses three detailed steps. First, shares of stocks are borrowed from a broker and sold at the current market price. Second, the short seller then repurchases the shares at a lower price in the future and returns them to the lender. And last, the difference between the selling price and the repurchase price, minus any fees or interest paid for the borrowing is pocketed as the profit.

While it is a legitimate trading strategy, it involves high risks and has several pit-falls. Unlike a traditional long position, where the maximum loss is restricted to the initial investment, a short seller can lose significantly more if the stock price rises instead of falls. This is because there is no upper limit to how high a stock price can go.

Market volatility, margin calls, and regulatory scrutiny compound the risk. SEBI's mandate to protect investor's rights goes directly against the fundamental idea that this market approach follows. These potential risks and the dichotomy result in necessitating stringent analysis and risk management.

SEBI's Framework for Short Selling and Related Issues

Short selling in India is currently regulated by the 'Framework for Short Selling'. It was introduced by SEBI to ensure that short selling is conducted transparently and does not cause destabilization in the market.

This move was motivated by an order from the Supreme Court (**'SC'**) which mandated the SEBI and Central Government to consider the recommendations of an expert committee. The order, however, was issued in the context of the previous Adani-Hindenburg fiasco, where another report was published in January 2023 accusing the Adani Group of unabashed stock manipulation and accounting fraud.

Prior to this, short-selling transactions have been governed by the 2007 circular titled 'Short selling and securities lending and borrowing' (**'SLB Circular'**). The current circular is built upon this framework which introduced only a few additional provisions related to the disclosure requirements of short selling.

In October 2023, SEBI released a 'Master Circular for Stock Exchanges and Clearing Corporations' (**'Master Circular'**) which consolidated and superseded previous circulars and regulations. It imposed a ban on naked short selling, where the seller does not borrow shares before selling them,

and established a set of guidelines to regulate short selling in India.

The 2024 circular brought a large number of measures into play, such as mandatory reporting of short positions and restrictions on naked short selling. It basically mandated brokers to collect and report details of scrip-wise short-sell positions with stock exchanges, and then the consolidated information is to be publicly disclosed on a weekly basis.

These guidelines emphasise the importance of market transparency and the preservation of market integrity. Despite certain concerns having been brought up, the framework for short selling is a giant leap toward building a fair and tightly regulated market. With continued attention to its implementation, it can lead to an effective balance between market dynamics and investor protection.

SEBI's Authority and Internal Mechanisms

SEBI has various mechanisms to investigate and examine into allegations levelled against its own leadership. It has a dedicated set of guidelines where they are empowered to conduct internal audits, and set up oversight committees. They have the 'General Guidelines for Dealing with Conflicts of Interest framework' to identify and manage conflicts among various stakeholders. In particular, this framework provides them power to initiate investigations into potential misconduct.

But the allegations levelled against SEBI's chairperson recently have given rise to questions about the regulator's ability to take action against its own leadership. Effectiveness of the framework designed to manage conflicts of interest and ensure accountability within itself are being scrutinised.

In response to the concerns raised, SEBI has emphasized its commitment to maintain integrity and address any potential conflicts within its ranks. It has stated that it will conduct a thorough investigation into the allegations and take any appropriate action if misconduct is found. By addressing these allegations transparently and taking firm action where needed, SEBI aims to uphold its reputation as a reliable regulator in India's financial markets.

Conclusion

As the situation has now unfolded, multiple complexities and challenges involved in regulating financial markets have been brought to the fore yet again. It is vital for regulatory bodies to maintain investor confidence by ensuring transparency and accountability. It has been stated by multiple experts in the industry that the ongoing investigation and regulatory response will be significant in shaping India's financial market stability.

Analyzing the New Insurance Accounting Standards and Their Global Implications

Samriddhi

INTRODUCTION

On August 12, 2024, the Ministry of Corporate Affairs introduced the new accounting standards Ind AS 117 for insurance contracts by aligning the Indian standards to the global standards. This transition paves the way for a significant revamp in the accounting practices of India that are adopted in the insurance sector. Effective from April 1, 2024, these standards would intersect with the IFRS 17 ('International Financial Reporting Rules'), which has already been adopted by almost 140 countries on January 1, 2023. The IFRS 17 is made to capture the unique features of investment and insurance contracts.

This change intends to bring a major transformation in the process in which the insurance companies in India report and manage their finance reserves. Further, this move would bring Indian accounting practices closer to the globally accepted accounting standards. This marks a significant moment in the evolution of India's insurance sector. It shows a major shift towards globalizing and modernizing the regulatory framework that governs the insurance contracts in India.

The Indian insurance sector is governed by certain standards but they lag behind the global framework. The absence of uniformity in the Indian insurance sector with international standards has caused voids and difficulties in the financial reporting and compliance processes of the companies that are situated within and outside India. These standards are introduced-to decrease these complexities while also ensuring that the Indian insurance industry remains competitive globally.

BENEFITS AND CHALLENGES OF THE NEW ACCOUNTING PRACTICES

The new accounting standards showcase a significant step toward international financial reporting consistency that makes Indian insurance practices similar to IFRS 17. This alignment might draw Foreign Direct Investment and promote cross-border commercial possibilities by making Indian insurers more identical to their overseas counterparts. The application of standardized reporting guidelines promotes increased confidence among the stakeholders, particularly the investors, regulators, and policyholders through enhanced transparency.

One of the major benefits of these new standards is the demand for a more detailed disclosure of the insurance contract liabilities. This will make it achievable for insurers to do more reliable risk assessments and effectively manage their financial reserves which would ensure the solvency of the companies. Further, if these revenue rules are made transparent, the financial misunderstandings can be decreased, thereby strengthening the financial forecasting.

The enhanced transparency may decrease the perception of investors regarding the risk associated with making investments in the Indian insurance businesses, thereby lowering their capital costs. The guidelines also support putting long-term stability ahead of short-term profits, thereby encouraging environmentally conscious company operations and a robust insurance sector in the face of economic ups and downs.

The new standards guarantee positive impacts on the insurance industry. However, there are several challenges while making the shift to these new standards. The entire procedure can be difficult and drawn out, prompting insurers to completely restructure their accounting systems. This might be expensive and may demand a large number of staff training and transition time. Furthermore, neither the Insurance Regulatory and Development Authority ('IRDAI') nor the RBI has yet mandated the Ind AS adoption for the regulated entities under them. It would be desirable if IRDAI mandates the implementation of Ind AS among various insurance companies.

During the initial stages, share prices and confidence may be negatively impacted for a temporary period of time due to market uncertainty. The equity adequacy ratios and lower reported capital may cause increased liability valuations. The consistency target may be decreased due to the inconsistent application of the new standards throughout such companies. Moreover, the disruptions in will operations occur due to the larger focus on the company rather the commercial tasks.

CONCLUSION

The introduction of the new accounting standards in India aligned with the IFRS 17 marks an important advancement in the insurance sector. It promises enhanced transparency, global competitiveness, and investor confidence. At the same time, it also presents challenges and complexities that include the need for restructuring and potential short-term market volatility. It is important for the regulatory bodies like IRDAI to mandate their adoption as soon as possible to achieve the intended impact of these new standards. Although the Initial implementation may be difficult, the long-term benefits would ultimately strengthen the insurance industry of India and its position on the global stage.

ITAT Upholds Reopening but Deletes Addition: Sales Already Taxed Cannot be Treated as Unexplained Cash Credits

Kushagra Keshav

Introduction

The case of *L.K.S. Bullion (Import and Export) Pvt.Ltd. v. The Income Tax Officer*, **(Bullion Case)**, brings forth the issues where the Assessing Officer (**'AO'**) treated a certain amount as an unexplained cash credit under the Income Tax Act (**'The Act'**) and added it to the assessee's taxable income. Meanwhile, the assessee claimed that the amount in contention reflected sales transactions that had already been documented, included in their books of accounts and taxed accordingly. This conundrum arose when the AO characterised the amount in question as unexplained cash credit and added it to the assessee's income for taxation purposes. However, at the end of this fiasco, the Income Tax Appellate Tribunal (**'ITAT'**) ruled in favour of the assessee based on certain issues of law which the article delves into and solidified the established principle that income that has already been taxed cannot be re-characterised and taxed under a different income tax provision.

This article delves into the specifics of Section 68 of The Act which concerns unexplained cash credits and explores the judicial approach towards this contentious issue.

Overview of Section 68

The intent of the provisions concerning cash credits under section 68 of the Act is to curb the spread of black money. If an assessee discovers a sum credited in his books and fails to explain the nature and source of the money, or if the assessee's explanation is deemed unsatisfactory by the AO, the AO may tax the amount equal to the taxpayer's income for that year. The basic text of Section 68 of the Act revealed three important ingredients: (i) the existence of books of account, (ii) credit entry, and (iii) the assessee's failure to provide a reasonable explanation.

Analysis

The ITAT ruled against considering declared sales as unexplained cash credits under Section 68 of the Act, citing the Gujarat High Court's ruling in *CIT v. Vishal Export Overseas Ltd*. This decision established the notion that income already subject to taxation cannot be re-taxed as unexplained cash credit, as this would result in double taxation. In the Bullion Case, the assessee presented extensive documentation, including sales invoices, registers, and bank statements, to demonstrate that the challenged amounts were sales profits that had already been reflected in their books and tax filings. The ITAT observed that the AO had not rejected the books of accounts or questioned the quantitative details of stock, implying implicit acceptance of the assessee's records. This approach is consistent with the recognized notion that, unless specifically denied, books of account should be given due weightage in tax procedures. Furthermore, the ITAT highlighted that once a prima facie justification for credits is presented, it is the tax department's responsibility to disprove it

with solid proof. The AO's failure to offer conclusive evidence against the assessee's explanations was a major reason for the ITAT's decision to reverse the addition of INR. 1,92,29,000 made under Section 68 of the Act.

On the issue of reopening of assessments under Section 148 of the Act, the ITAT sided with the AO's decision. The ITAT specified that the "reason to believe" criteria for reopening does not obviate conclusive proof, but rather a reasonable cause to assume income has escaped assessment. This approach was clarified in *Pushpak Bullion (P.) Ltd. v. Dy. CIT*, in which reopening based on specific information from investigative authorities was found lawful. The ITAT contrasted this matter with *Amar Jewellers Ltd. v. Dy. CIT*, in which the reopening was reversed due to the AO's failure to conduct independent verification. In the instance of the Bullion Case, the AO received specific information from the investigation and conducted preliminary inquiries, including examining bank statements for transactions between the assessee and M/s. Vishnu Trading Co. This approach brings forth that, while borrowed gratification alone is insufficient, reopening based on tangible, specific facts and some level of verification is acceptable.

WAY FORWARD

In order to curb this menace and balance the interests of the tax authorities and taxpayers amending section 148 of the Act to provide clearer guidelines on what constitutes "reason to believe" for reopening assessments could be a viable option. Addition of a criteria wherein the AO needs to be satisfied with a "tangible material" before deciding upon the matter of reopening of the assessment. If the said proceedings are initiated based on information received, then adjacently suitable thresholds for the quality and relevance of the information must be outlined clearly so that the misuse of discretion by the AO is minimized.

Additionally, mandating a preliminary inquiry process before initiation of reassessment proceedings would protect both the parties from unwanted litigation as it would provide the AO enough time to gather some tangible evidence warranting reassessment. For example, the amended section could state that "An assessing officer may issue a notice under this section when, based on specific and credible information from a reliable source, verified through preliminary inquiry, there is reasonable ground to believe that income exceeding [X amount] or [Y% of declared income] has escaped assessment."

Moving forward, this ruling inter alia may catalyse administrative and legislative reforms in the Indian taxation framework. An approach which balances the necessity of scrutiny and the rights of taxpayers must be factored into ~~in~~ this evolving landscape ensuring fairness, transparency and efficiency.

Impact of Revised Deposit Norms by RBI on Housing Finance Companies

Suhani Sharma

Introduction

The Reserve Bank of India **('RBI')** established new rules on Non-Banking Financial Companies **('NBFC')** and Housing Finance Companies **('HFC')** on August 12, 2024. These include such changes in the public deposit coverage ratio, the threshold in liquid asset percentage, and contingencies allowances among others. Implementation of this would be in phases with the first phase beginning from January 1, 2025. Currently, RBI has aimed at tightening the control on HFCs and segregating NBFCs from them. These changes have been made after the HFC regulation shifted from the National Housing Bank to the RBI on August 9, 2019, to cover the HFCs within the NBFC regulations.

Three major amendments in the revised norms

HFC norms are tightened by introducing three major revised norms. Firstly, this amendment is intended to gradually raise the minimum requirement of liquid assets held by HFCs as collateral for public deposits. This will be increased to 14 per cent by January 1, 2025, and to 15 per cent by July 1, 2025. Secondly, the maximum number of public deposits that HFCs are allowed to make has been reduced from three times to 1.5 times their net owned funds by the RBI. Lastly, the maximum duration for the public deposits by HFCs has been curtailed to 5 years.

This step is part of a broader effort to standardize regulatory practices across these two categories of financial institutions. Moreover, RBI has decided that instructions related to the operation of branches and the appointment of agents to collect deposits will now apply to deposit-taking HFCs as well. HFCs are required to notify the NHB of their compliance with these instructions. These revised norms are to be implemented with immediate effect except for the public deposits which are executed in a phased manner.

Impact on HFCs

The revised norms permit HFCs to participate in derivatives related to interest rates, credit risks, and the use of currencies. These norms ensure a dual advantage including overall improvement in the long-term financial health of HFCs in the country and mitigate potential liquidity risks to allow them to meet their obligations more effectively. These norms tend to harmonise the regulations on NBFCs and HFCs in the country. The significance of implementing especially the deposit norms in a phased manner is to avoid disruption and ensure a smooth shift to these new norms.

These norms also intend to improve the opening and closing of public deposits held by HFCs. It includes the restriction on deposit mobilisation based on credit rating and restriction on the branch opening. In response, HFCs are expected to have a significant impact on the sector by ensuring financial stability and greater harmonisation with

NBFCs. The RBI's step to reduce the threshold for public deposits held by HFCs to 1.5 times signifies tightening regulatory oversight. This revision in the ceiling limit allows the HFCs to form a capital structure and bolster investor confidence in them.

Furthermore, these revised norms grant HFCs an additional time of six months to properly comply with the revised ceiling on public deposits. This is designed to ensure a phased approach allowing these HFCs adequate time to change their strategies and organise their functioning accordingly without disrupting their regular operations.

As per Mr. Sabyasachi Saggar, a leading financial analyst at the Indian Council of Research Association, the newly revised norms would not substantially change the operations of deposit-accepting HFCs. This is because most of these HFCs already have sufficient liquidity assets as well as they are operating within the prescribed deposit limits. However, it must be noted that tighter regulations may lead to a higher cost of compliance especially in the short term. These changes, while introducing a higher cost of compliance in some cases, are likely to enhance the resilience of the sector and provide greater protection for depositors.

Furthermore, the public deposits account for a small part of HFC funding, with only 12 out of the 94 HFCs holding a deposit-taking license. As of March 2012, HFCs' deposits outstanding aggregated a sum of Rs 25,000 crore, which is 5 per cent of their total borrowings, although three HFCs rely on public deposits for more than 10 per cent of their funding.

According to Ms. Subha Sri Narayanan, Director at CRISIL Ratings, most deposit-taking HFCs already adhere to the new RBI norms, requiring a 15 per cent liquid asset ratio. Although it may reduce a bit of flexibility in exposure to very long-tenure assets, the overall impact will be insignificant, considering that long-term deposits are a small part of HFCs' funding. "The amendments are expected to benefit the financial resilience of the HFCs in the long-term," she said.

CONCLUSION

The new directions set by the RBI regarding changes to the norms for Housing Finance Companies make a clear contribution to the improvement of the stability and business performance of the sector. Thus, the central bank strives to develop a clearer, stronger set of HFC regulations all aligned most closely with those governing NBFCs. Although some HFCs may experience short-term changes in the liquidity management and compliance of the organization and increased cost of compliance, the following benefits are likely to be realized. Altogether, these amendments are going to help to create a more protective and effective system of housing finance in India.

KARNATAKA GOVERNMENT HALTS ORDER TO SUSPEND ALL TRANSACTIONS WITH SBI AND PNB

Shreya Mathur

INTRODUCTION

The Karnataka government on August 16, 2024 has halted the order against State Bank of India **('SBI')** and Punjab National Bank **('PNB')**, passed on August 12, 2024. The order directed all state government departments, public sector units, boards, corporations, local bodies, universities and other institutions to close their accounts at SBI and PNB by September 20, 2024.

BACKGROUND

The state government initiated the circular against SBI and PNB in light of uncovering two fraudulent transactions having occurred at these banks.

- SBI:
  Karnataka State Pollution Control Board (KSPCB) had a fixed deposit in the erstwhile State bank of Mysore, which later in 2017 merged with SBI, for Rs. 10 crores. This is alleged to have been mishandled and appropriated by the bank to adjust against the loans taken by a private company.
- PNB:
  Karnataka Industrial Area Development Board (KIADB) had started a fixed deposit of Rs. 25 crores in the bank's Rajajinagar branch. Upon maturity of the same, the bank allegedly only returned Rs. 13 crores to the board.

In response to the allegations in the circular, SBI and PNB sought a 15-day period to look into and resolve the matter, also furnishing the fact that the matters were currently sub judice. In the light of this, the Karnataka government has decided to pause the order passed, accepting their request.

LAWS RELATED TO THE ALLEGATIONS LEVELLED:

As we peruse judgements throughout the years, we find that money has been categorised as moveable property. S. 2(21) of Bhartiya Nyaya Sanhita **(BNS)** defines moveable property as, *"includes property of every description, except land and things attached to the earth or permanently fastened to anything which is attached to the earth."*

Misappropriation:

Accordingly, such instances where there has been a charge for misuse of funds deposited against a financial institution, we find the attraction of these sections of the BNS:

1. S.314: Dishonest misappropriation of property
2. S. 316: Criminal breach of trust

These sections deal with the dishonest misappropriation of the property and dishonest misappropriation of property entrusted to him respectively. In this case, further, S. 316 (5) is attracted. The same deals with cases where one of the cases of the breach of trust has been at the hands of a banker. These crimes are categorized as white-collar crimes.

When a financial institution has allegations of the same levelled against them or their employees, it leads to lessening of trust of the public in them.

PUBLIC SECTOR BANKS:

Public Sector Banks **('PSBs')** are those banks which have a majority share owned by the government. They are appointed to provided banking services to the government in addition to catering to individuals, businesses etc.

In India, PSBs are divided into two categories, Nationalised Banks and State Bank of India and its associates. They are governed under State Bank of India Act, 1955 and Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970/Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980.

CONCLUSION:

The order and allegations of criminal charges against SBI and PNB by the Karnataka government in future shall lay doubts in the amount of trust that can be placed in public sectors banks as well as raise questions about their accountability.

IMPLICATIONS OF RBI TIGHTENING NORMS OF NBFC P2P TRANSACTIONS

Subhashmin Moharana

INTRODUCTION:

The Reserve Bank of India (RBI) has recently introduced stringent regulations for 'NBFC-P2P' lending platforms. RBI on August 16, 2024 has released a master directory amending the regulation. The primary reason why this was done was to caution the NBFC-P2P platforms that have been flouting the 2017 Master Directions on NBFC-P2P and such violations result in being remediated by RBI.

Non-Banking Financial Companies (**'NBFCs'**) have been a cornerstone in India's financial ecosystem since the 1960s when it was first mentioned in the RBI Act, 1934 (**'RBI Act'**), which was amended on December 01, 1964 by Reserve Bank Amendment Act, 1963 where, 'Chapter III-B' was introduced to Regulate 'Deposit Accepting' NBFCs. This was done to reach the places where regulated banks could-not reach, for small-scale and retail sectors.

Peer-to-Peer('P2P') NBFCs acts as an intermediary platform, where individuals can lend money directly to borrowers online. These platforms help in matching borrowers with lenders. Thus, managing the loan process and conducting due diligence. P2P lending platforms are regulated by RBI subjected to specific guidelines in order to ensure transparency, protect investors, and maintain the stability of the financial system.

KEY CHANGES:

The following key changes have been made by the Review of Master Direction NBFC-P2P (Reserve Bank) Directions, 2017

1. Credit Enhancement and Credit Guarantee

NBFC-P2Ps are now explicitly prohibited from assuming any credit risk, directly or indirectly. This means that lenders will be responsible in case the entire loss of interest with adequate disclosures. This will make the lenders more aware about the risks involved and cause more cautious lending practices. This reinforces that NBFC-P2Ps are not guarantors, and risk bearers, but rather mere facilitators.

2. Cross-Selling Restrictions

The reviewed directions clarified that NBFC-P2Ps cannot cross-sell any insurance product that have the nature of credit enhancement or credit guarantee. This means that NBFC-P2Ps concentrate on their primary function of facilitating loans and the consumers by not selling them products that are not in their best interests. It also mandates that NBFC-P2Ps shall not utilize the funds of a lender for replacement of any other lender(s).

3. Aggregate Exposure Cap

There has been a 'minor change in the language of the act' to focus on ensuring that the amount lent by the lender is consistent with their net worth. This helps in spreading risks and prevents over-

concentrations in investments in P2P lending. This also ensures that lenders have the required capacity to bear potential losses, thus promoting responsible lending practices.

4. Matching/Mapping Policy

The amendment of the term "matching" to "matching/mapping" requires compliance with a Board-approved policy. RBI directs the matching or mapping of participants to happen within a closed user group through an affiliate service provider, thereby ensuring that the process of matching lenders with borrowers is fair and non-discriminatory. This strengthens their adherence to internal policies, promoting consistency and fairness in operations.

5. Fund Transfer Mechanism

It had provided a more detailed process for fund transfers, introducing a T+1 day limit for funds to remain in escrow accounts and it enhances the efficiency of fund transfers, reducing the time funds remain in escrow accounts. It also provides an operational clarity for the movement of funds, ensuring compliance a reduction in such operational risks.

6. Disclosure Requirements

The reviewed directions require that borrower details must be disclosed with the borrower's consent and also requires the inclusion of all losses borne by lenders in public disclosures. This enhances transparency by disclosing relevant information to borrowers as well as lenders and the public, helping all stakeholders make informed decisions through comprehensive performance data.

7. Promotion of Lending

The reviewed directions also prevent P2P platforms from promoting lending as an investment product with assured returns or liquidity options. Before, the P2P-NBFC platforms promoted it through tenure-linked assured minimum returns and liquidity options which are false. This prevents misleading promotions, ensuring that the stakeholders are not misled about the nature of NBFC P2Ps investment lending practices.

8. Outsourcing Restrictions

The reviewed directions expand the list of non-outsourceable core functions to include pricing of services/fees. This ensures that critical functions remain within the control of the NBFC-P2P, maintaining operational integrity and promoting compliance with internal policies and regulatory requirements.

IMPLICATIONS

LenDenClub, Liquiloans, Lendbox, Faircent, and Finzy are some of the prominent P2P lending platforms that will need to adapt to these changes by focusing more on core lending functions. The new changes are expected to cause subdued growth along with declined new investments due to tighter norms. There has also been restrictions on algorithm-based borrower matching (by the new matching policy) which is speculated to increase operational costs and manual processes which will inevitably to a certain degree discourage P2P lending in India. Nonetheless, there is also positive response from these platforms too, as Mr. Bhavin Patel, founder and CEO of LenDen club, said he

welcomes this move of RBI since it's in the best interest of both lenders and borrowers.

Conclusion

The new changes are expected to ensure a more informed lending practice as well as the practice of borrowing. These changes encourage responsible lending practices, focus on core services, and promote a more informed and cautious investor base. Although these regulations might be difficult to comply with and adjust to, they ultimately aim to create a safer and more transparent lending environment. The ultimate goal of this is to protect all the stakeholders involved in the process and promote a transparent culture of lending and borrowing.

Global Financial Shifts: The Impact of Bank of Japan's Interest Rate Hike on Indian Markets and Legal Frameworks

Shriyansh Singhal

Introduction

The Bank of Japan (**'BoJ'**) has recently raised its interest rates for the first time in 17 years. The decision by the BoJ have notable effects on global markets, including India. In March 2024, the BoJ subdued its negative interest rate policy and raised its short-term interest rates from minus 0.1% to a range of 0% to 0.1%. In the July meeting, the BoJ raised its benchmark rate to 0.25% from the before 0 to 0.1% range.

Background and Effects

The BoJ came forth with a negative interest rate policy to combat deflation and stimulate economic growth but its recent shift away from this policy has marked significant change in global financial dynamics. This decision not only impacts the finance world but also affects the legal and regulatory challenges for markets like India, which are closely related to foreign capital flows.

The Indian equity markets reacted to this policy change by witnessing significant drops in the indices such as BSE Sensex and Nifty. The increased volatility was propelled by the destressing of the popular yen carry trade strategy where traders borrow in yen at low interest rates and invest in higher- yielding assets globally, to enjoy lucrative profits. The BoJ's actions indicate on a robust legal and regulatory framework such as the Foreign Exchange Management Act ('FEMA') 1999 & the Banking Regulation Act 1956 to manage the intertwined global finance horizon and mitigating economic risks.

Understanding the Changes

At present, Indian Regulatory Authorities such as the Securities Exchange Board of India (**'SEBI'**) and the Reserve Bank of India (**'RBI'**) are in the position of determining the stability of the financial system during the world's turmoil. There emerges the need to reform the cross border financial regulations with the increased market fluctuations for instance in currency exchange and capital transfer for protection of the markets against manipulations and speculations.
For instance, if the rupee is fluctuating and the RBI wants to change this, it may consider participating in the foreign currency market, and this may require a change in the laws on the exchange control system. Further, SEBI may have to enhance its FPI surveillance mechanisms to ensure that any such outflows do not lead to volatility in the markets.

The global shift in interest rates, which is more likely to be triggered by the BoJ's action is most likely going to exert pressure on the Indian debt markets. This might require changes to the laws that exist on the issuance of bonds in India particularly with regard to regulatory approvals, disclosure standards and investor safeguards. This is especially important to maintain competitiveness of corporate bond rules and protect investors' rights, which may require SEBI

to reconsider its rules in this regard. To make Indian bonds closer to the reach of international investors, legal requirements related to pricing and distribution of debt securities may also be looked into and aligned with international standards.

In India, compliance officers and legal advisors would require the client to go through their risk management strategy with more focus on the risks arising from change in interest rates and exchange rate. This could involve reconsidering existing contracts once more to ensure that they are adequately protected against fluctuations in the economy which may not have been foreseen when the contracts were being drafted, particularly with partners in foreign countries. In order to provide more protection in the present environment of increased risk, some of the critical provisions of the contract such as force majeure or Material Adverse Change (**'MAC'**) clauses may require reconsideration and possibly modification. Furthermore, due to the increased focus on the cross-border financial flows, companies may have to enhance their compliance with the international financial regulations, especially the Know-Your-Customer (**'KYC'**) and Anti-Money Laundering (**'AML'**) requirements.

The Way Forward

The rate increases by the BoJ can have severe contractual implications for the Indian companies engaged in the international business or having foreign currency debt. Foreign debt may be repaid at a higher cost because of the changes in the exchange rates that are occasioned by the change in the global interest rates and this may lead to a covenant or default on the loan agreement. To avert such defaults, there may be a need for firms to change the loan agreements, probably by seeking waivers or changes in the terms. The exchange rate risks may also make multinational businesses to reconsider their hedging policies to ensure that they are in a position to mitigate against any adverse exchange rate fluctuations. It may also lead to increased demand of legal services in relation to dispute and contract alteration.

Conclusion

The recent increase in the interest rates set by the BoJ is a clear indication that the national markets including the Indian market, are entwined with global policies. This development has implication and issues for the Indian enterprises and policy makers. It is for this reason that there is a need to have strong legal and regulatory frameworks that can effectively respond to the challenges that are occasioned by changes in the international financial landscape. Some of these problems can be solved by India adopting some of the following strategies that can help to maintain the stability of its financial markets regardless of the global economic cycles.

India and Russia Eye Vostro Account Mechanism to Beat Dollar Hurdles

Rahul Agarwal

India and Russia are considering to implement a dynamic Vostro account mechanism to overcome the difficulties in trade. The dynamic Rupee-Rouble exchange would allow the two countries to trade in their domestic currencies. Similarly, the rate of exchange itself would vary depending upon the market conditions, ensuring smoother transactions. Vostro accounts are special accounts that are held by a domestic bank on behalf of a foreign bank in the domestic bank's currency.

This mechanism is being implemented to mitigate the various sanctions imposed by the United States of America (**'USA'**) on Russia in February 2022 pursuant to the Russia-Ukraine conflict. This system would help the two nations in avoiding potential disruptions that can be caused due to the interference of other nations. This financial arrangement would also help enhance trade and economic ties between the two states. The Vostro account mechanism would allow simplified cross border payments by way of direct settlements in their respective domestic currencies.

For India, it offers a way to maintain healthy trade relations with Russia. It aligns with the broader goals of BRICS which consists of nations such as Brazil, Russia, India, China, South Africa, in order to promote intra-BRICS trade in local currencies. The process of payment would be expedited with the implementation of the Vostro Account mechanism. With the removal of the dollar as an intermediary currency, the trade volumes in sectors of oil, gas, defence might see a considerable hike.

By mitigating exposure to the volatility of dollar, the two nations will be able to better manage their foreign reserves. And due to the trade in their own domestic currencies, they would be unperturbed by the inflationary pressures due to a rise in prices of oil and gas. These changes could enhance their economic sovereignty and reduce their vulnerability to external political pressures. This financial system could be a foundation for further agreements in future trade between the two nations, that would make bilateral relations more diversified and resilient.

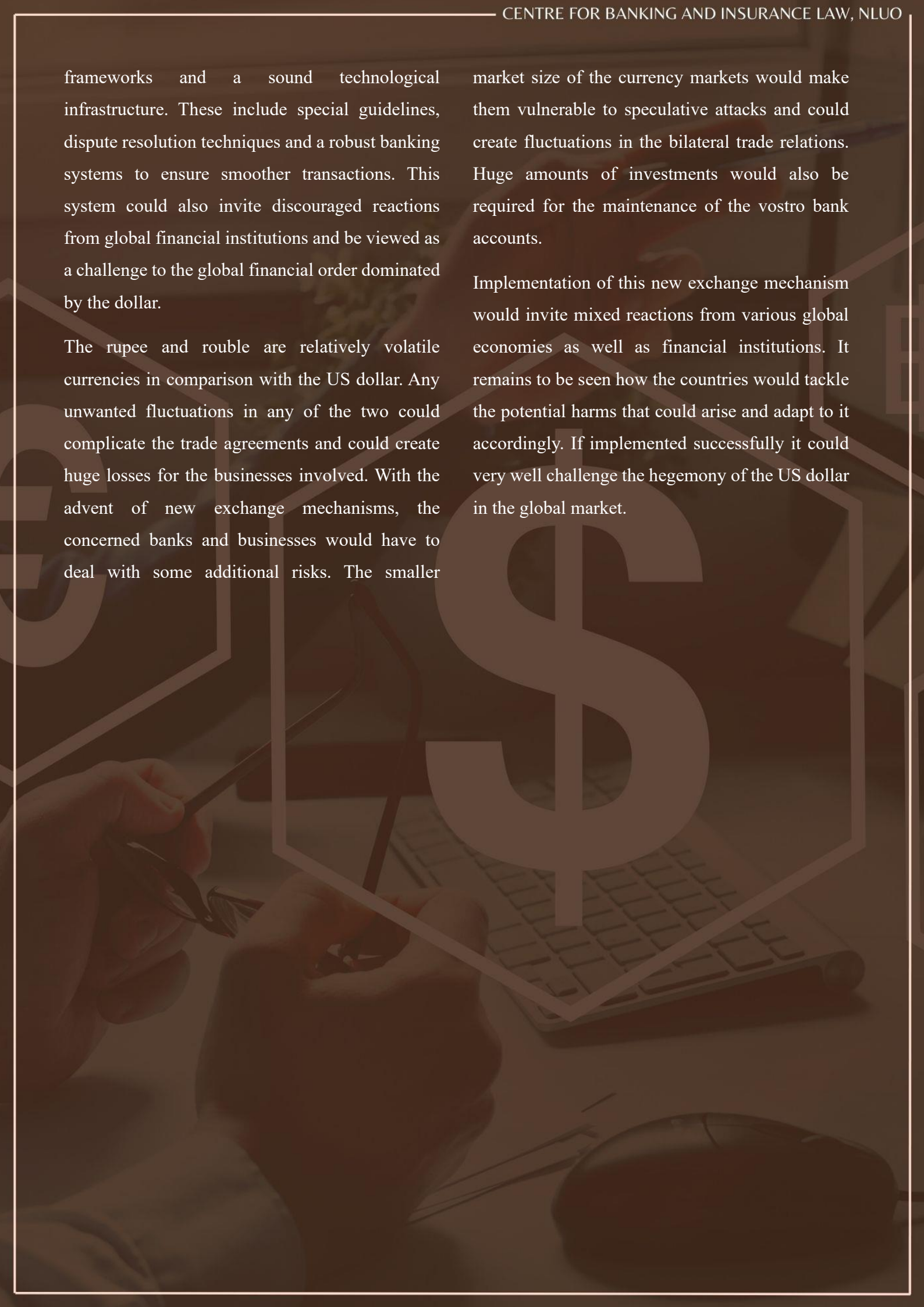
Countries facing similar sanctions or geopolitical pressure from the USA or other European countries, can establish their own domestic versions of exchange. This would enable them to mitigate the fluctuations of the dollar in special conditions. Over time, the global financial markets would evolve itself to be a more multipolar global currency system. The global financial tensions would not be dominated by the fluctuations in the dollar. This would help stabilise the markets globally. An initiative like this would help in the advancement of safer and secure methods of payments.

However, the absence of major markets for these currencies, could present the banks and various businesses with a huge challenge. Implementing this system requires debugged regulatory

frameworks and a sound technological infrastructure. These include special guidelines, dispute resolution techniques and a robust banking systems to ensure smoother transactions. This system could also invite discouraged reactions from global financial institutions and be viewed as a challenge to the global financial order dominated by the dollar.

The rupee and rouble are relatively volatile currencies in comparison with the US dollar. Any unwanted fluctuations in any of the two could complicate the trade agreements and could create huge losses for the businesses involved. With the advent of new exchange mechanisms, the concerned banks and businesses would have to deal with some additional risks. The smaller market size of the currency markets would make them vulnerable to speculative attacks and could create fluctuations in the bilateral trade relations. Huge amounts of investments would also be required for the maintenance of the vostro bank accounts.

Implementation of this new exchange mechanism would invite mixed reactions from various global economies as well as financial institutions. It remains to be seen how the countries would tackle the potential harms that could arise and adapt to it accordingly. If implemented successfully it could very well challenge the hegemony of the US dollar in the global market.



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