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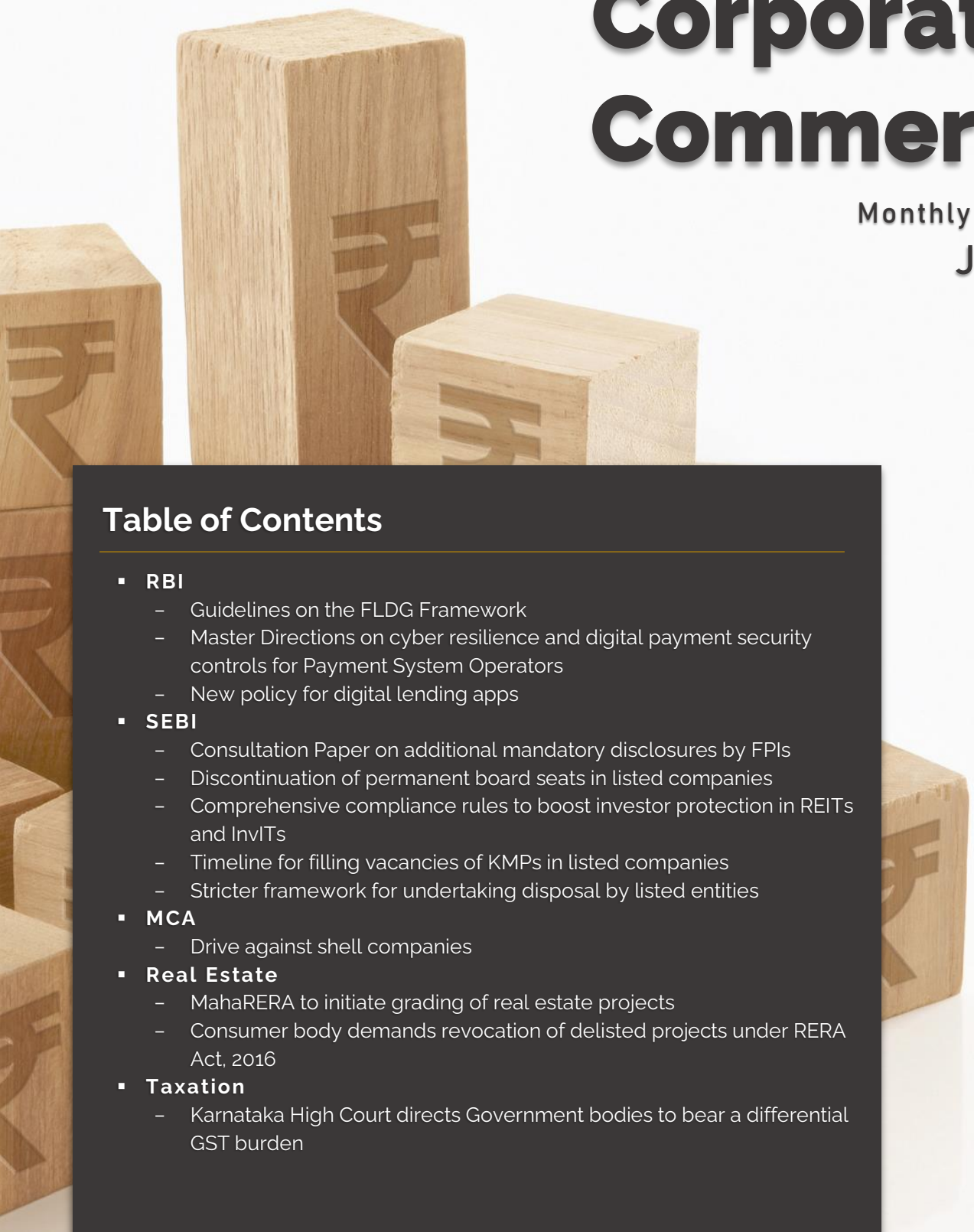

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RBI | Guidelines on the FLDG Framework

Arrangements between Regulated Entities[1] (**RE/REs**) and Lending Service Providers (**LSPs**) or between two REs involving Default Loss Guarantee (**DLG**)[2] are commonly known as First Loss Default Guarantee (**FLDG**).

When the FLDG was introduced, there were concerns about the guarantee arrangement limit that fintech 'mainly unregulated' gives to banks, which could be as high as 100%. In August 2022,[3] the RBI issued a total ban on FLDG, referring to them as synthetic securitization[4] in terms of which it was stated that the recommendation pertaining to FLDG was under examination with the Reserve Bank. It was examined by the RBI and now, it has been decided to permit such arrangements subject to certain guidelines. Such DLG arrangements conforming to these guidelines shall not be treated as 'synthetic securitization' and shall also not attract the provisions of 'loan participation'.[5]

On June 8, 2023, the Reserve Bank of India (**RBI**) issued Guidelines on Default Loss Guarantee in Digital Lending (**Guidelines**)[6]. The Guidelines are issued under the provisions of the Banking Regulation Act, 1949, Reserve Bank of India Act, 1934, National Housing Bank Act, 1987 and Factoring Regulation Act, 2011.

Key aspects:

- Under the framework, RBI mandates that the total amount of DLG cover on any outstanding loan portfolio must not exceed 5% of the loan portfolio's value.
- This limit is specified upfront[7]. In the event, where there are implicit guarantee arrangements, the DLG provider (the entity providing the guarantee) is not permitted to take on performance risk greater than 5% of the underlying loan portfolio.[8]
- The REs responsible for managing the distressed loan portfolio are required to invoke the DLG within a maximum overdue period of 120 days, unless the borrower has made good the overdue amount before that[9].
- Individual loan assets in the portfolio must be identified as Non-Performing Asset (**NPA**) and provisioned as per existing asset classification and provisioning criteria, regardless of any DLG coverage available at the portfolio level.
- The DLG amount invoked shall not be adjusted against the underlying individual loans. If the RE manages to recover any amount from the loans on which the DLG has been invoked and realizes the funds, the REs can share this recovery with the DLG provider as per the terms of the agreement.[10]
- The duration of the DLG agreement shall not be less than the longest tenor of the loan in the underlying loan portfolio.[11]
- The RE shall establish a method to guarantee that LSPs with whom they have a DLG arrangement announce on their website the total number of portfolios and the respective value of each portfolio on which DLG has been offered.[12]
- REs are required to establish a board-approved policy before engaging in any FLDG arrangement. This policy will have to be carefully drafted from a legal and regulatory perspective to ensure that it encompasses the eligibility criteria for FLDG providers, the nature and scope of the cover, the process for monitoring and reviewing the arrangement, and the details of any fees payable to the DLG provider[13]. Additionally, robust credit underwriting standards must be implemented regardless of the presence of DLG cover[14].
- In the event when a RE enters into or renews a DLG arrangement, it must procure sufficient information to ensure that the entity extending the DLG can honour it. This information must include, at a minimum, a declaration from the DLG supplier, confirmed by the statutory auditor, on the total amount of DLG outstanding, the number of REs, and the number of portfolios against which DLG has been issued. The disclosure must also provide past default rates on comparable portfolios.[15]
- Guarantees covered under the following schemes/entities shall not be covered within the definition of DLG[16]:
  - Guarantee schemes of Credit Guarantee Fund Trust for Micro and Small Enterprises (**CGTMSE**).
  - Credit Risk Guarantee Fund Trust for Low Income Housing (**CRGFTLIH**).
  - Individual schemes under National Credit Guarantee Trustee Company Ltd (**NCGTC**).
  - Credit guarantee provided by Bank for International Settlements (**BIS**).

[1] The guidelines apply to DLG arrangements entered into by REs in 'Digital Lending' activities.
[2] Guidelines on Default Loss Guarantee (DLG) in Digital Lending, Regulation 2.1,
Default Loss Guarantee (DLG): A contractual arrangement, called by whatever name, between the Regulated Entity (RE) and an entity meeting the criteria laid down at para 3 of these guidelines, under which the latter guarantees to compensate the RE, loss due to default up to a certain percentage of the loan portfolio of the RE, specified upfront. Any other implicit guarantee of similar nature linked to the performance of the loan portfolio of the RE and specified upfront, shall also be covered under the definition of DLG.
https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=12514&Mode=0
[3] https://rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=54187
[4] https://yourstory.com/2023/06/fldg-explained-new-rules-changes-impact-borrowers-fintechs-banks
[5] *Supra* note 2, paragraph 2 of the RBI circular issuing the First Loss Default Guarantee (FLDG) guidelines as on June 8, 2023.
[6] https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=12514&Mode=0
[7] Guideline 6.
[8] *Id.*
[9] Guideline 9.
[10] Guideline 7.
[11] Guideline 10.
[12] Guideline 11.
[13] Guideline 12.1.
[14] Guideline 12.2.
[15] Guideline 12.3.
[16] Guideline 14.1,14.2.

- International Monetary Fund (**IMF**) as well as Multilateral Development Banks[17].

RBI | Master Directions on cyber resilience and digital payment security controls for Payment System Operators

RBI, in exercise of powers conferred under Section 10 (2) read with Section 18 of the Payment and Settlement Systems Act, 2007 (**PSS Act**), released the Draft Master Directions on Cyber Resilience and Digital Payment Security Controls for Payment System Operators (**Master Directions**) for inviting comments from all stake holders.

In furtherance of the objectives of the PSS Act, which is the overarching governing law for Payment System Operators (**PSOs**) in India, the Master Directions aim to ensure that the PSOs are resilient to traditional and emerging information systems and cyber security risks; have robust governance mechanisms for identification, assessment, monitoring, and management of such risks; and in addition, to also maintain baseline security measures for ensuring system resiliency for safe and secure digital payment transactions.

Key aspects:

- **Payment system and PSOs:** The PSS Act defines 'payment system' as a system that enables payment to be effected between a payer and a beneficiary, involving clearing, payment or settlement service or all of them, but does not include a stock exchange. Thus, transactions undertaken through credit or debit cards, online transfer of money, any money transfer operations or similar operations would be included under the definition of 'payment system'. Therefore, a PSO is someone who operates an authorized payment system.
- **Categorization of PSO's in the Master Directions:**
  - Large non-bank PSOs (such as Clearing Corporation of India Ltd (**CCIL**), National Payments Corporation of India (**NPCI**), NPCI Bharat Bill Pay Ltd, etc.
  - Medium non-bank PSOs (such as cross-border (in-bound) money transfer operators under Money Transfer Service Scheme)
  - Small non-bank PSOs (Small Prepaid Payment Instruments issuers and Instant Money Transfer Operators).
- **Governance controls:**
  - As per the Master Directions, the Board of Directors (**Board**) of the PSO shall be responsible for ensuring adequate oversight over information security risks, including cyber risk and cyber resilience. However, primary responsibility may be delegated to a committee of the Board which must meet at least once every quarter.
  - The PSO is also responsible for developing a Board approved Information Security (**IS**) policy to manage potential information security risks covering all applications and products concerning payment systems as well as management of risks that have materialized, which will be reviewed annually. The IS policy shall cover at the minimum:
    - Roles and responsibilities of Board/Sub-Committees of the Board, senior management and other key personnel;
    - Measures to identify, assess, manage and monitor cyber security risk which shall also include various types of security controls for ensuring cyber resiliency along with processes for training and awareness of employees/stakeholders.
- **Cyber security preparedness:** The PSO is required to prepare a distinct Cyber Crisis Management Plan (**CCMP**) to detect, contain, respond, and recover from cyber threats and attacks, which is to be approved by Board and should refer to relevant guidelines for guidance from CERT-In; National Critical Information Infrastructure Protection Centre (**NCIIPC**); IDRBT etc.
- **Risk assessment and monitoring:** The Board of a PSO is required to entrust the responsibility and accountability for implementing the IS policy and the cyber resilience framework to a senior level executive, such as a Chief Information Security Officer (**CISO**), etc. Further, the PSO will define appropriate Key Risk Indicators (**KRIs**) to identify potential risk events and Key Performance Indicators (**KPIs**) to assess the effectiveness of security controls which will be continuously monitored by the sub-committee of the Board referred to above.
- **Business continuity plan:** The draft master Directions also provides, amongst others, that the PSOs shall develop a Business Continuity Plan which includes comprehensive cyber incident response, resumption, and recovery plans to manage cyber security events or incidents.
- **Employee awareness/training:** Emphasis has also been placed on employee awareness and training programs that will play a vital role in ensuring information security and mitigating cyber risks. The Master Directions states that regular evaluations of cyber security awareness among employees is to be conducted and employees with an awareness level below a benchmark score may be restricted/prohibited from accessing information assets.

By putting these governance controls in place, the Master Directions has provided the PSOs a framework for overall information security preparedness as well as entrusted them with the responsibility of protecting their customers from cyber threats and monetary losses.

[17] Master Circular – Basel III Capital Regulations, May 12, 2023, ***See*** Clause 5.5 Claims on MDBs, BIS and IMF : (a) World Bank Group: IBRD and IFC, (b) Asian Development Bank, (c) African Development Bank, (d) European Bank for Reconstruction and Development, (e) Inter-American Development Bank, (f) European Investment Bank, (g) European Investment Fund, (h) Nordic Investment Bank, (i) Caribbean Development Bank, (j) Islamic Development Bank and (k) Council of Europe Development Bank (l) International Finance Facility for Immunization (IFFIm) (m) Asian Infrastructure Investment Bank (AIIB). 31MCE5308DBA8F0D411C80989DDF3259E843.PDF (rbi.org.in)

RBI | New policy for digital lending apps

Digital lending, via websites and apps, has changed the way customers borrow money, by combining technological advancement with traditional banking services. Due to exponential growth of digital lending during the Covid-19 pandemic, it has panned out to be a seamless loan disbursal method in the digital lending sector, expanding access to credit to a larger group of people.

Due to surge in consumer grievances and concerns in relation to mis-selling to unsuspecting customers, deceptive/harmful financial products and services, data privacy breaches, misuse of data collected, hidden costs, unethical business conduct (including recovery agents resorting to harassment and unethical debt recovery practices), and illegitimate operations, RBI issued a set of Guidelines on Digital Lending in September 2022 and FAQs to the Guidelines in February 2023 (hereinafter collectively referred to **RBI Guidelines** or **Guidelines**), which comprehensively deal in relation to customer and data protection and is applicable not just to regulated entities (banks and/or NBFCs), but also covers third parties (lending service providers and/or digital lending apps) in its ambit.

Key aspects:

- The RBI Guidelines examine the functioning of regulated entities (banks and/or NBFCs) and their linkages to digital lending apps and websites and issued disclosure requirements.
- The Guidelines mandate that any outsourcing by regulated entities (banks and/or NBFCs) to third party providers (lending service providers and/or digital lending apps) do not diminish obligations to conform to existing RBI Guidelines.
- The Guidelines provide the scope of data protection by mandating data collection by lending service providers and digital lending applications to be need-based with explicit consent of the borrower at every stage and explicit consent for data sharing with third parties.
- It also discusses impact on various business models and entities such as payment aggregators, buy now pay later platforms, and first loss default guarantee arrangements.

Based on the RBI Guidelines and to assure compliance and enforcement, Google introduced a rigorous policy for personal loans on Google Play Store to safeguard Borrower's privacy and promote good financial practices which can be accessed here.

Obligations imposed on digital lending apps on the Google Play App:

- **Restrictions:** Through the Google internal policy, digital lending apps are prohibited/forbidden to: (i) access sensitive user data such as images/videos, contacts, location, external storage files etc, and (ii) promote short term person loans which require repayment in 60 days or less from the date the loan is issued.
- **Mandatory disclosures:** Digital lending apps must mandatorily disclose information such as: (i) minimum and maximum repayment tenures, (ii) interest rates (including maximum annual percentage rates), (iii) other costs/fees/charges, and (iv) a privacy policy that comprehensively discloses the access, collection, use and sharing of personal and sensitive user date, subject to limitations placed by Google's internal policy.
- **Personal loan app declaration form:** Furthermore, the internal policy mandates all digital lending players listed on its PlayStore will have to complete the personal loan app declaration form and provide necessary documentation to support the declaration, for instance (i) furnish their lending license issued by RBI or furnish details of their lending agreement if it is a third-party fintech providing a platform to facilitate lending in partnership with duly licensed lenders (banks or NBFCs); (ii) disclose names of all registered banks and NBFCs in the description of the digital lending apps. This is to ensure that every digital lending player/participant is verified through their requisite licenses and documentation and regulate the space to ensure operation of only verified and legitimate businesses in compliance with local laws and regulations and ween out dubious and illegal digital lending apps.

SEBI | Consultation Paper on additional mandatory disclosures by FPIs

Recently, the Securities and Exchange Board of India (**SEBI**) released a Consultation Paper for inviting comments on its proposal to introduce additional mandatory disclosures for Foreign Portfolio Investors (**FPIs**) with the aim to guard against possible circumvention of Minimum Public Shareholding (**MPS**) and to guard against the possible misuse of the FPI route for opportunistic takeover and acquisition of Indian companies by an entity from a country sharing land border with India, circumventing the stipulations of Press Note 3, dated April 17, 2020 (**PN3**).

Concerns regarding circumvention of the MPS requirement:

- It has come to SEBI's notice that some FPIs tend to concentrate a substantial portion of their equity portfolio in a single investee company or a company group.
- In some cases, these concentrated investment does not change and remain static for several years, raising the concern and the possibility of the promoters and other investors acting in concert to circumvent the MPS requirement by using the FPI route.
- In such cases, the apparent free float in a listed company may not be the true free float, which increases the risk of price manipulation in such scrips, thereby defeating the purpose behind listing it on a stock exchange.

Concerns regarding circumvention of PN3:

- The Government of India enforced PN3 through the Foreign Exchange Management (Non-Debt Instruments) Amendment Rules, 2020 dated April 22, 2020 in order to counter the risk of opportunistic takeovers of Indian companies by entities, persons including beneficial owner of entities based in countries sharing land border with India. As

per PN3, investment by such entities and persons into Indian companies shall be only through the Government route.

- While PN3 is not applicable to FPIs per se, however, there is a potential risk of the FPI route to be misused to circumvent the PN3 stipulations, where FPI entities may be based in countries not sharing land border with India but owned or controlled by beneficial owners based in countries sharing land border with India.

Extant legal framework in India:

- The Prevention of Money Laundering Act, 2002 (**PMLA**) and the Prevention of Money Laundering (Maintenance of Records) Rules 2005 (**PML Rules**) lay down the framework for identifying beneficial owners of legal entities. Under Section 2 (fa) of the PMLA, a beneficial owner (**BO**) has been defined as '*the individual who ultimately owns or controls a reporting entity or the person on whose behalf the transactions are conducted or who exercises effective control over a juridical person*'.
- Rule 9 (3) of the PML Rules, establishes a threshold of 10% in either the overall ownership, or entitlement to capital or entitlement to profit in case of a company to certify a person or an individual as a beneficial owner. It also specifies that BO includes those natural persons who exercises ultimate effective control over a legal person. Where no natural person is identifiable on the basis of ownership, economic interest or control, the BO is the natural person who holds the position of senior managing official.
- Further, the SEBI (FPI) Regulations, 2019 require designated depository participants to look into beneficial ownership of all FPIs through the lens of the PMLA and PML Rules to identify the natural person at the end of the chain of holdings and maintain a list of such BOs.
- Additionally, under Rule 9 (14) of the PML Rules, regulatory authorities, including SEBI, are empowered to prescribe enhanced measures to verify identity of clients.

Suggested measures:

- **Classification of FPIs:** It has been suggested that the FPIs be classified basis the risk involved into low risk, moderate risk, and high risk. Low risk FPIs shall comprise of governments and government related entities such as central banks and sovereign funds, the ownership of which can be traced back to the government of that respective country. Moderate risk FPIs shall include pension funds and public retail funds where a designated depository participant shall be able to trace and validate the identity of the BOs. All other FPIs shall be deemed to be high risk.
- **Filter based on overall equity Assets Under Management (AUM):** For high risk FPIs, the FPIs holding more than 50% of their equity Asset Under Management in a single corporate group would be required to comply with the requirement of additional disclosures i.e., the requirement of tracing back the granular ownership to the ultimate BO and in case of any material change then intimating the same within 7 days.
- **Qualification based on Overall Equity Holding:** Amongst others, an FPI with overall equity holding of more than INR 25,000 crore shall also comply with the requirement of additional disclosure of granular analysis of BO.

SEBI | Discontinuation of permanent board seats in listed companies

On February 21, 2023, SEBI released a consultation paper titled 'Consultation Paper on Strengthening Corporate Governance at Listed Entities by Empowering Shareholders – Amendments to The SEBI (LODR) Regulations, 2015 (**Consultation Paper**)[18]. Based on public comments received, SEBI in its press release dated March 29, 2023[19] announced SEBI Board decision to amend the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (**LODR**) to increase the involvement of shareholders of listed companies in decisions and situations that may directly or indirectly impact their interests adversely. The main objective of this amendment is to strengthen corporate governance at listed entities by empowering shareholders to substantially address the concerns around the grant of board permanency to certain selected persons and the issue of perpetuity of special rights granted to a shareholder of listed entity.

On June 14, 2023, SEBI amended the LODR vide the SEBI (Listing Obligations and Disclosure Requirements) (Second Amendment) Regulations, 2023 (**LODR Amendment**).[20] This amendment mandates all categories of directors to seek mandatory periodic shareholders' approval once every 5 years and alleviates concerns relating to board permanency.

Key aspects:

- There are various provisions of Companies Act, 2013 (**Act**) relating to mandatory retirement of a specific percentage of directors every year through rotation.
- As per the Act, unless the articles of association provide for retirement of all directors at every annual general meeting, at least 2/3 of the total number of appointed directors shall be persons whose tenure is liable to be determined by 'retirement by rotation'[21].
- At the first annual general meeting of a public company held next after the date of the general meeting at which the first directors are appointed and at every subsequent annual general meeting, 1/3rd of such directors as are liable to retire by rotation, shall retire[22]. Not all directors'

[18] Consultation Paper on Strengthening Corporate Governance at Listed Entities by Empowering Shareholders – Amendments to The SEBI (LODR) Regulations, 2015, available at- https://www.sebi.gov.in/reports-and-statistics/reports/feb-2023/consultation-paper-on-strengthening corporate-governance-at-listed-entities-by-empowering-shareholders-amendments-to-the-sebi-lodr-regulations-2015_68261.html

[19] SEBI board meeting, available at- https://www.sebi.gov.in/media/press-releases/mar-2023/sebi-board-meeting_69552.html

[20] [20] SEBI LODR (Second Amendment) Regulations, 2023, available at- https://www.sebi.gov.in/legal/regulations/jun-2023/securities-and-exchange-board-of-india-listing-obligations-and-disclosure-requirements-second-amendment-regulations-2023_72609.html

[21] Section 152 (6) (a) of the Act

[22] Section 152 (6) (c) of the Act

appointment or re-appointment is subject to shareholder's approval.

- An executive director is either whole-time director or a managing director. As per the Act, after the completion of tenure of executive directors (maximum of 5 years), such a person can be re-appointed to the board after the approval of shareholders of the company[23]. They may also be subject to 'retirement by rotation' at the time of appointment or re-appointment. The concept of 'retirement by rotation' does not apply to independent directors, the tenure of such directors on the board is fixed (a term of maximum 5 years) and there is a mandatory requirement of shareholders' approval for their re-appointment.[24] Those appointed as non-executive non-independent directors would not be liable to 'retirement by rotation' and are appointed without any defined tenure.
- The LODR Amendment came into effect on June 14, 2023. As per the amendment, in regulation 17, after sub regulation (1C), a sub regulation (1D) shall be inserted, stating the following:
  - With effect from April 1, 2024, the continuation of a director serving on the board of directors of a listed entity shall be subject to approval by the shareholders in a general meeting at least once in every 5 years from the date of their appointment or reappointment.
  - The continuation of the director serving on the board of directors of a listed entity as on March 31, 2024, without the approval of the shareholders in the last 5 years or more shall be subject to the approval of shareholders in the first general meeting to be held after March 31, 2024.
- The requirement specified in this regulation shall not be applicable to the following:
  - The whole-time director, managing director, independent director or a director retiring as per the Sub-Section (6) of Section 152 of the Act, if the approval of the shareholders for the reappointment or continuation of the aforesaid directors or manager is otherwise provided for by the provisions of these regulations or the Act and has been complied with.
  - The director appointed pursuant to the order of a Court or a Tribunal or to a nominee director of the Government on the board of a listed entity, other than a public sector company, or to a nominee director of a financial sector regulator on the board of a listed entity.
  - A director nominated by a financial institution registered with or regulated by the Reserve Bank of India under a lending arrangement in its normal course of business or nominated by a debenture trustee registered with the SEBI Board under a subscription agreement for the debentures issued by the listed entity.

[23] Section 196 of the Act

SEBI | Comprehensive compliance rules to boost investor protection in REITs and InvITs

SEBI recently issued comprehensive compliance rules for Real Estate Investment Trusts (**REITs**) and Infrastructure Investment Trusts (**InvITs**). These new regulations aim to enhance transparency, investor protection, and operational efficiency in the REITs and InvITs sectors. The move by SEBI reflects its commitment to promoting the growth and development of these investment vehicles in the Indian market.

Key aspects:

- Emphasis on increased disclosures and reporting by REITs and InvITs regarding comprehensive information about their assets, financials, related-party transactions, and risk factors.
- Mandatory appointment of independent directors and requirement for majority of the directors on the board of these investment vehicles to be independent.
- Prohibition on preferential allotment of units by REITs and InvITs to ensure fairness and equal treatment of all investors, preventing any preferential treatment towards certain unit holders.
- Introduction of a minimum subscription amount (minimum number of units or a minimum investment threshold) for subscribers to participate in REITs and InvITs.
- Guidelines for valuation and asset management of REITs and InvITs to ensure transparent and consistent valuation methodology for their assets, and accurate pricing of units.
- SEBI empowered to monitor the operations, disclosures, and compliance of these investment vehicles, ensuring adherence to the prescribed framework.

SEBI | Timeline for filling vacancies of KMPs in listed companies

SEBI, vide notification dated June 14, 2023, amended (Listing Obligations and Disclosure Requirements) (Second Amendment) Regulations, 2023 (**Amendment Regulations**). The Amendment Regulations have introduced key amendments pertaining to the appointment of Key Managerial Personnel (**KMPs**) in SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (**LODR**). These amendments are in line with the consultation papers issued by SEBI on February 20, 2023 and shall come into effect from July 14, 2023.

Key aspects:

- Insertion of Regulation 26A which mentions that any vacancy in the office of the Chief Executive Officer, Chief Financial Officer, Managing Director and Whole time Director shall be filled by the listed entity at the earliest within 3 months from the date of such vacancy.
- Appointment of a person in interim capacity will not be allowed unless such appointment is made in accordance with the laws applicable in case of a fresh appointment of a

[24] Section 149 of the Act

KMP and the obligations under such laws are made applicable to such person.

- Interim appointments for KMPs have to be aligned with Companies Act, 2013 and LODR.
- Sub-Regulation 1A inserted after Regulation 6(1) of LODR which mentions that any vacancy in the office of the Compliance Officer shall be filled by the listed entity at the earliest and not later than three (3) months from the date of such vacancy.
- In case the office of the director becomes vacant in such a manner that it makes the listed entity non-compliant with the board composition requirement under LODR, then such vacancy is to be filled on the date of vacancy itself.

By introducing a stricter timeline, SEBI aims to expedite the appointment process and ensure that such key positions are not vacant for a long period, which will ultimately result in smooth functioning of listed entities.

SEBI | Stricter framework for undertaking disposal by listed entities

SEBI recently implemented a more stringent framework for the disposal of undertakings by listed entities. The new regulations emphasize the need to safeguard the interests of shareholders and other stakeholders during the disposal of an undertaking and aim to enhance transparency, protect the interests of investors, and ensure fair market practices.

Key aspects:

- Any disposal of an undertaking by a listed entity would require prior approval from shareholders through a special resolution.
- Listed entities will now be required to disclose detailed information about the proposed disposal, including the rationale, valuation, and potential impact on the financials of the company.
- SEBI has mandated the submission of a detailed report to stock exchanges for any proposed disposal of an undertaking. The report must include information about the entity's financials, assets and liabilities, and any potential material impact on the company's business operations.
- Listed entity is required to provide a valuation report by an independent registered valuer, which will be made available to the shareholders.
- The market regulator will assess the adequacy and accuracy of the information provided by the listed entity during the approval process.
- In case of non-compliance with the regulatory provisions, SEBI will take appropriate enforcement actions to ensure adherence to the prescribed framework.

The new regulations will ensure that decisions regarding the disposal of a company's undertaking are made with the consent of shareholders, thereby promoting accountability.

MCA | Drive against shell companies

Rao Inderjit Singh, a Union Minister, in the budget session stated that 1,27,952 companies have been struck off in the last 3 years, and the government has undertaken a special drive for identification and striking off infructuous companies. Continuing with this drive, the Ministry of Corporate Affairs (**MCA**) is planning to intensify and crackdown the non-functional (shell) companies, given that shell companies are often used to funnel black money and engage in other illegal activities and are reputed for transactions that are prohibited by law such as benami transactions. The reason for such planning can be ploughed back to the informal statement used by

Provisions of the Companies Act, 2013 that provide for actions against the shell companies:

- Section 248(1)(c) of the Companies Act, 2013 provides that the name of a company shall be removed suo-moto by the Registrar of Companies (**ROC**) from the Register of Companies if it comes to the attention of the ROC that a company has not carried on any business operation for a period of 2 immediately preceding Financial Years and has not made an application for procuring the status of dormant company under Section 455 within the said period. In furtherance to this, MCA shall be conducting physical verifications of non-functional or non-compliant firms through ROC. This will be in addition to the existing verification process, which is based on data analysis and risk assessment.
- Section 12(9) of the Companies Act, 2013 gives power to the ROC to conduct such physical verification of the registered office of the company if ROC has reasons to believe that a company has not fulfilled with the requirements of Section 12(1) which states that 'A company shall within thirty days of its incorporation and at all times thereafter, have a registered office capable of receiving and acknowledging all communications and notices as may be addressed to it'. Once ROC is satisfied that the company has not complied with the provisions of Sub-Section 1 of Section 12 then ROC may initiate an action for the removal of the name of the company from the register of companies under Chapter XVII of the Companies Act, 2013.

Actions taken and anticipated to be taken by the MCA:

- MCA is working on a new database that will be used to track shell companies, it will be integrated with the MCA 21 portal, which is a portal for various filings under the Companies Act, 2013 and the LLP Act, 2008 and is also a recent development by the MCA.
- MCA and the Enforcement Directorate and tax officials shall work in consonance through an ongoing drive to eliminate illegal financial practices.
- MCA may conduct physical verification of non-functional or non-compliant firms by the ROC
- As per an official data, a huge number of companies found themselves struck off from the register of companies on being non-compliant under Section 12(1) of the Companies Act, 2013.

- MCA has been working to curb or crack down and set limits on number of companies that can be incorporated by a single individual.
- According to data available in the public domain around 3,09,619 directors were disqualified under Section 164(2)(a) read with Section 167(1) of the Companies Act, 2013 due to non-compliance of filing of financial statement for preceding three years.

The MCA's decision to intensify its crackdown on shell companies is a welcome move. It demonstrates the government's commitment to combat illegal financial activities and create a more transparent and accountable corporate landscape. It is also anticipated that the government is anticipated to continue with the steps to curb the menace of such companies and come with some fresh amendments.

Real Estate | MahaRERA to initiate grading of real estate projects

- Maharashtra Real Estate Regulatory Authority (**MahaRERA**) has made recommendation under Section 32(f) of MahaRERA to promote a healthy and transparent mechanism for real estate sector. The grading system shall prove to be a positive development in the real estate sector. This system provides homebuyers with necessary and relevant information and empowers them to make more informed decisions.
- One of the key functions of MahaRERA as per Section 32(f) is to facilitate and encourage grading of projects on various parameters of development including grading of promoters. MahaRERA has therefore released a consultation document inviting suggestions and objections from the public and stakeholders by July 15, 2023. It is significant to note that Maharashtra is the first and the only state in India to adopt the practice of rating projects in real estate sector to foster transparent and consumer centric environment.
- Internationally, countries like Singapore, Dubai and Australia have already approached the practice of grading of real estate projects which shall facilitate an easier understanding of project details of homebuyers, the particulars of which are elaborated hereinbelow:
  - Singapore has lately introduced an assessment framework for rating which is known as Integrated Construction Quality Assurance Scheme (ICQA)
  - Dubai Land Department has introduced 1 to 4-star ratings for its buildings. As of now, 4 Star ratings have been assigned to around 20% of existing buildings.
  - Property Council of Australia has provided framework for classification of Australian office buildings.
- Ratings and gradings have been broadly used by Regulators in India to enable the consumers/customers to take reliable assessment on financial and investment risks, namely:
  - SEBI registered Credit Rating Agencies
  - RBI accredited Credit Rating Agencies
  - Star Rating of Hotels
- It has been witnessed that several customers/buyers have invested in projects on basis of the false representations provided by builders/promoters. The consequences of such instances led to the implementation of Real Estate (Regulation and Development) Act, 2016 which has regulated true and timely disclosure of real estate projects by the builders and promoters.
- The practice of maintaining transparency and providing full disclosure has furthermore elevated to implementing real estate grading which shall highlight the major risks like financial, legal, technical, and timely completion risks involved in selecting a project for its investment.
- MahaRERA shall conduct the grading of real estate projects in Maharashtra in a phase wise manner:
  - **Phase 1:** This phase shall include disclosure of objective information of the project which shall include Project details, Technical details, Financial Details and Legal details. Homebuyers will be displayed with such information in Phase 1 to enable them to make informed decision.
  - **Phase 2:** This phase includes four important parameters based on which the ranking of the project shall take place i.e., Project Overview (location, Developer, amenities and other relevant details), Technical Snapshot (Status of various approvals like Commencement Certificate (CC) promoters quarterly & Annual Compliances, Booking percentage), Financial Snapshot (Financial encumbrances, Financial progress of projects, annual audit certificate) and Legal Snapshot (Litigation & Complaints against this project, warrants issued, legal encumbrances).
- **Eligibility:** The grading of all projects shall be applied to the projects registered after January 2023.
- **Frequency:** The ranking of the projects shall be declared twice a year i.e., first period shall commence from October 1, 2023, to March 2024 and the final list to be announced for the public may be uploaded in the last quarter QPR i.e. by April 20, 2023
- Based on the information provided to MahaRERA, the grading shall be automatically generated through Maharera IT Solution MahaCRITI.
- MahaRERA on May 29, 2023, has introduced Quick Response (**QR**) code for each project to assist the homebuyers to get the project related information easily. The promoter shall notably display the QR code with effective from August 1, 2023, on every promotion, advertisement, brochures, websites of projects or any other advertisements where QR codes can be published in a manner that is legible and detectable with software application.
- Overall, the grading system shall help to weed out unscrupulous developers and protect homebuyers from fraud which will lead the developers to improve the quality of their real estate projects. On the other hand, this system shall lead to a clear bifurcation between projects which in turn can create price disparities. This may result in builders quoting higher prices of their highly rated projects, wherein the projects with low ratings will have less demand and their builders shall have no option but to sell property in less rate.

Real Estate | Consumer body demands revocation of delisted projects under RERA Act, 2016

The Maharashtra Real Estate Regulatory Authority (**MahaRERA**) announced that it had received numerous applications from real estate developers for de-registration of the projects under the Real Estate (Regulation and Development) Act, 2016 (**RERA Act**). These applications, if accepted, will have concomitant ramifications including withdrawal of the projects from the ambit of the RERA Act.[25]

Historically, decisions of deregistration of real estate projects have been met with harsh criticisms from the consumer bodies and homebuyers. In the present scenario also, the Mumbai Grahak Panchayat has expressed its concerns regarding the vires of deregistration of projects, bolstering its arguments by stating that such deregistration renders nugatory, the very object of the RERA Act, that is to protect the homebuyers and consumers and to provide for a robust grievance redressal mechanism. Deregistration brings the project out of the ambit of the RERA Act which may have grave implications on the remedies available to the homebuyers, including seeking compensation for any losses that they suffer, for reasons attributable to the real estate developers.

The MahaRERA vide its order dated February 10, 2023, has laid down the following conditions (**Guidelines**), that it may take into consideration while deciding the applications for deregistration:

- De-registration may be considered only for those real estate projects where there are no allotees. This condition shall also be applicable in the event the developer is desirous of de-registering a portion out of the project.
- In the event the first condition is not fulfilled, the de-registration will be subject to settlement of the rights of the allotees. The applicant would be mandated to file necessary documents verifying and confirming such settlement along with its application for de-registration.
- Where partial de-registration of a project is sought, but such de-registration may have adverse impacts on the other allotees, then the MahaRERA has mandated submission of consent from 2/3rd allotees along with the application for de-registration.

In matrix of the provision of law juxtaposed to the basis on which the aforesaid guidelines for deregistration have been proposed, our observations are as under:

- Deregistration and revocation of projects cannot be equated, since the latter entails numerous sanctions, penalties and consequential effects upon the developers and promoters. Revocation as a consequence is reserved for contingencies specified in the statutory enactment and cannot be extended to reach an effect of de-registration.
- The conspectus of the Guidelines is to enumerate various scenarios, focussing upon events where equities and interests have been created in favour of third parties, notably the homebuyers. Thus, the Guidelines have attempted to ensure that the interests of the stakeholders are not compromised.
- The legislative mandate emanating from the RERA Act and the Rules suggests that a developer cannot be forced to give effect to the project in respect of which the developer wishes to de-register. This intention of the legislature of strengthened by the fact that the RERA Act permits de-registration even in scenarios where the projects are on-going.
- From the foregoing, it would be apt to construe that the intention behind allowing de-registration is to provide for an unfortunate yet, practical situation where the developers are unsure about the feasibility of the project, and get an opportunity to de-register without suffering serious consequences to the project and opus at a later stage, whilst ensuring protection of the rights of the homebuyers.

Taxation | Karnataka High Court directs Government bodies to bear a differential GST burden

A recent decision by the Karnataka High Court (HC) in the matter of ***Sri Chandrashekaraiah & Ors v. The State Of Karnataka & Ors*** sets a precedent in the construction sector where the question arises on the differential tax burden on contractors for projects falling between VAT and GST regimes.

In this matter, Sri Chandrashekaraiah along with several other petitioners (**Petitioners**) filed Writ Petitions against the State of Karnataka and others (**Respondents**) before the HC, wherein the primary issue was that in view of the introduction of GST w.e.f. July 01, 2017, the Petitioners who have earlier entered into Works Contract and had been assessed during the pre-GST regime either under the Composition scheme (**COT scheme**) or regular VAT assessment scheme (**VAT scheme**) under the Karnataka Value Added Tax Act, 2003 (**KVAT Act**) ,are required and made liable to pay additional tax by way of GST after July 01, 2017. Being aggrieved by the huge differential tax burden not envisaged at the time of entering into agreements under the COT/KVAT schemes during the KVAT regime, the Petitioners filed several Writ Petitions before the HC, which were tagged along and heard together due to common questions of law and facts.

Vide Order dated April 11, 2023, the HC issued directions and guidelines to the State and other government agencies regarding the calculation of tax differences in works contracts entered into by the Petitioners before the implementation of GST i.e., prior to July 01, 2017. These directions pertain to the contract value and aim to address the tax burden imposed on the Petitioners under the KVAT Act. They apply to various scenarios, including situations where the works were completed before GST, but payments were made after GST, contracts were partly executed before GST and partly after GST, tenders were invited before GST but finalized under the GST regime, or contracts were invited under the old schedule of rates before GST but finalized under the GST regime.

[25] *Maharashtra: Reputed builders seek de-registration of housing projects due to govt regulations and lack of funds | www.lokmattimes.com* (2023). Available at: https://www.lokmattimes.com/maharashtra/maharashtra-reputed-builders-seek-de-registration-of-housing-projects-due-to-govt-regulations-and-a475/ (Accessed: 30 June 2023).

At the outset, the HC observed that the subject matter of these petitions is the differential tax amount arising out of change in tax regime from VAT to GST which cast an additional tax burden on the Petitioners. Upon analyzing the State Government's Circulars and the decision in ***MAS Constructions v. Hubballi Dharwad Smart City Ltd*** and several other judgments, the HC noted that the tax component in works contracts was a statutory payment that the Petitioners were obligated to make. Thus, the HC acknowledged that the differential tax burden needs to be determined and honored by the Respondents.

The HC held that contractors, whose projects fell between the VAT and GST regimes, need to pay the applicable tax rate prevalent within that regime. While disposing off the Writ Petitions, the HC directed the Respondents i.e., State and other government agencies who have entered into works contract with the Petitioners, to adhere to the following guidelines:

Calculate the works executed pre-GST (prior to July 1, 2017) under KVAT regime and payments received by the Petitioners.

The payments received by the Petitioners pre-GST for such of the works executed before July 1, 2017, are to be assessed under the KVAT tax regime – either under COT or VAT scheme as applicable.

- Calculate the balance works to be completed or completed after July 1, 2017, in the original contract.
- Derive the rate of materials, KVAT items required or used to complete the balance works.
- Deduct the KVAT amount from those materials and the service tax, if applicable.
- Add the applicable GST on those items.
- Input Credit on the materials is to be arrived at and be set off as against the output GST, for those assessed under regular VAT.
- Further, the tax difference should be calculated on such balance works executed or to be executed after July 1, 2017 separately.
- Based on the result obtained on calculation of the tax difference on the contract value, concerned department/authority has to decide whether agreement needs to be changed or not.
- A supplementary agreement may be signed with the Petitioners for the revised GST-inclusive work value for the balance work completed or to be completed as determined above.

The HC directed the Petitioners to submit their comprehensive representation within a period of 4 weeks to the respective employers/Respondents, irrespective of whether they had completed their work before the GST regime or after it or whether the payments have been received pre-GST or post-GST. The HC directed the Respondents to consider such representations and dispose of the matters within a period of 8 weeks from the date of submission of representation.

It is pertinent to note that there have been many such similar instances in the past wherein there was an issue concerning the applicability of the tax regime, and thus, this judgment serves as a welcome step by issuing standard guidelines for the government authorities. This decision surely provides a relief to contractors since such burden now lies on the government authorities.

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