Year 2023 in retrospect:

Regulatory changes for NBFCs

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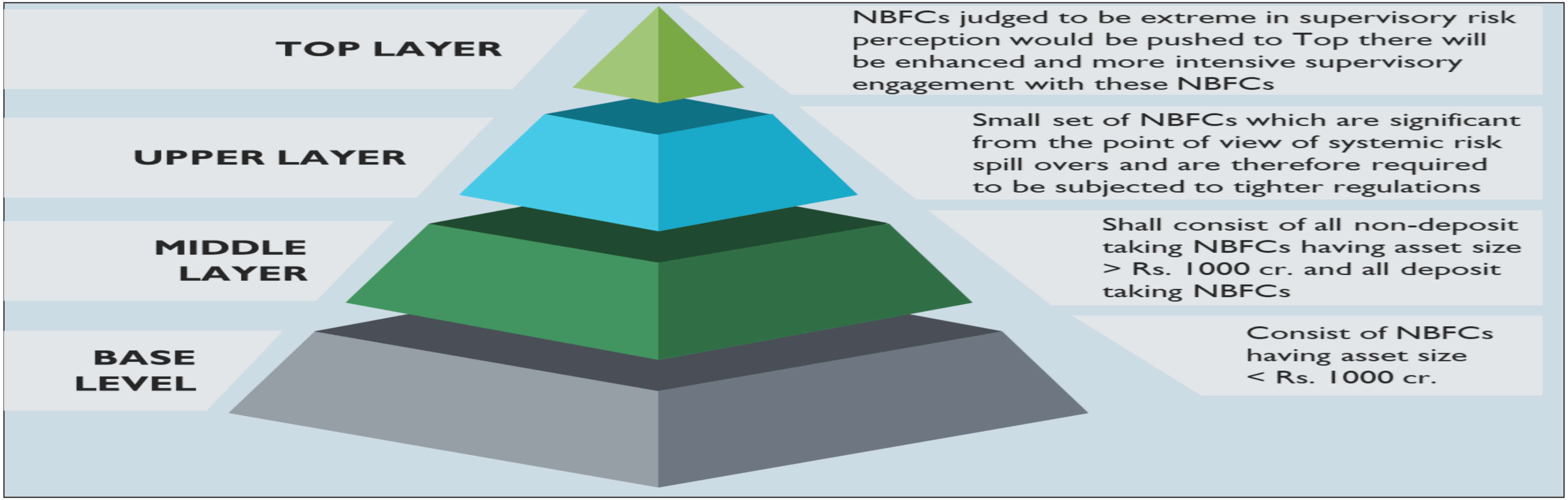
List of Circulars

- **SBR Framework:**
  - Circulars applicable from 2023
  - SBR Master Directions, 2023
- **Fair Practices in Lending:**
  - Penal Charges in Loan Accounts
  - Reset of Floating Interest Rate on EMI based Personal Loans
  - Display of information - Secured assets possessed under SARFAESI
  - Release of Movable / Immovable Property Documents on Repayment/ Settlement of Personal Loans
- **Prudential measures:**
  - Regulatory measures towards consumer credit & bank credit to NBFCs
  - Framework for Compromise Settlements and Technical Write-offs
  - Guidelines on Default Loss Guarantee in Digital Lending
- **Lending and investment segments:**
  - PM Vishwakarma Scheme
  - Framework for Green Deposits
  - Expanding the Scope of Trade Receivables Discounting System
  - REs' Investment in AIFs
  - Amendments to the KYC Master Directions
- **Credit Information:**
  - Framework for compensation to customers for delayed updation/ rectification of credit information
  - Strengthening of customer service rendered by CICs and Credit Institutions
  - Data Quality Index for Commercial and Microfinance Segments by CICs
- **Information Technology:**
  - Master Direction on Information Technology Governance, Risk, Controls and Assurance Practices
  - Master Direction on Outsourcing of Information Technology Services
- **Innovations and newly introduced concepts:**
  - ONDC for Financial Services
  - Operation of Pre-Sanctioned Credit Lines at Banks through Unified Payments Interface (UPI)
  - DPDP Act, 2023
- **Draft regulations for comments:**
  - Wilful Defaulters (Draft)
  - Master Directions on Outsourcing of Financial Services (Draft)



Scale-based Regulations

Applicability of SBR Framework- Timelines

April 1, 2022

Limit on IPO Financing

October 1, 2022

ICAAP
Director's relevant experience
Risk Management Committee
Concentration norms

Sensitive Sector Exposure
Loans, advances and awarding of contracts to directors and senior officers

March 31, 2023

Disclosure Requirements
including CG Report
(Annual Financial Statements for FY ending **March 31, 2023**)

April 1, 2023

Compensation Guidelines

Reporting on implementation of CFSS

October 1, 2023

Compliance Function

March 1, 2024

NPA transitioning
(**Beginning date** of NPA transitioning. To align with **more than 90 DPD by March 31, 2026**)

March 31, 2025

NOF Requirement
(**Beginning date.** To reach Rs.10 crores By March 31, 2027)

September 30, 2025

Core Financial Services Solution
NBFC-ML with >=10 FUs

Fair Practices Code

Levy of Penal Charges

- Penalty is not in the nature of interest or additional interest and therefore, cannot be capitalised.
- Penal charges may either be
  - standardized across all loans and borrowers or
  - may depend upon the
    - type of loan,
    - level of credit risk, and
    - the terms and conditions as mutually agreed by the borrower and the lender.
- Penal charges should be
  - reasonable and
  - commensurate with the non-compliance of material terms and conditions of loan contract
  - not be discriminatory within a particular loan / product category
- Penal charges levied for individual borrowers, for purposes other than business should not be higher than non individual borrowers

What is penalty?
Penalty or penal charges are imposed for breach of terms or irregularity in performance. For example: • Not meeting payment timelines • Cheque or NACH bounce • Failure to create security or register charges • Breach of important or material representations and warranties • Covenant breaches, such as late reporting • Failure to submit the requisite documents/ information etc.

Levy of Penal Charges: Applicability

In case of new loans

The Circular is applicable from January 01, 2024 **(extended till April 01, 2024)**

In case of Existing loans

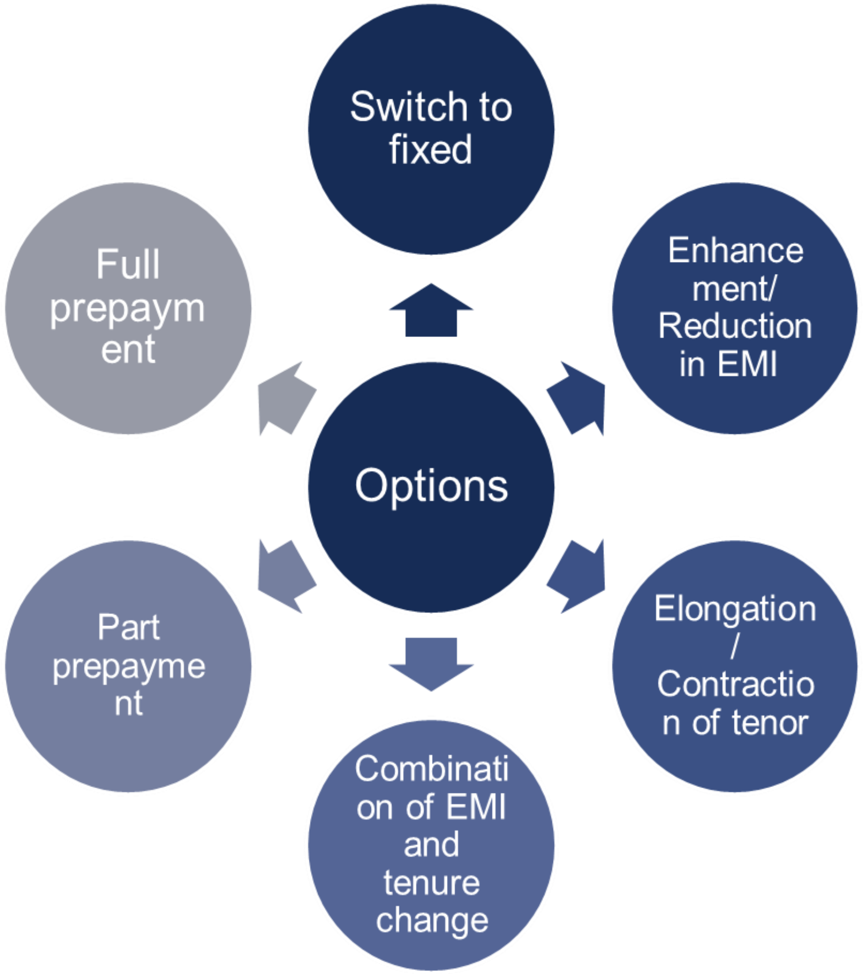
By **next review or renewal date falling on or after April 1, 2024**, or

six months from the effective date of the Circular, whichever is earlier
(extended till not later than June 30, 2024)

For loans that do not have any review date specified, by when should compliance with the Circular be ensured?

Reset of floating rate of interest

- With every reset of floating interest rate on EMI-based personal loans, borrowers should be presented with the following choices:
- Option to switch to a fixed rate:
  - Subject to the lender's approved policy, (limit the frequency of rate switches)
  - Impose switching charges - transparently disclosed.
- Option to increase/decrease the EMI amount, extend/contract the loan tenure, or both:
  - Ensure it does not result in negative amortization.
- Option to partially or fully prepay the loan during its tenure:
  - Foreclosure charges for prepayment penalties
- Default Option:
  - In case a borrower does not exercise any of the above options a default option may be exercised- should be communicated to the borrowers
  - In most cases, this default option is an elongation of the loan tenor.



Communications and disclosures to borrowers

To existing borrowers	To new borrowers	Change in the charges associated with the options	Quarterly statement to borrowers	About reset of interest

• By December 31, 2023,
• Communicate the various options available and also the costs associated with them.
	• At the time of sanctioning the loan demonstrate the potential impact any interest rate reset might have on payment schedule, i.e,
	  • EMI or
	  • Tenor of the loan or
	  • Both (EMI & Tenor)
		• During any change in any of the charges/ costs associated with exercise of any of the options communicated to the customer at the time of the loan sanction	• Statement shall at minimum, enumerate:
			  • principal and interest recovered till date,
			  • EMI amount,
			  • no. of EMIs left
			  • annualized ROI/APR for the entire tenor of the loan.
				• As and when there is an interest rate reset

Display of Information - On repossession under SARFAESI

- RBI vide its notification dated September 25, 2023,
- **Applicable to:** NBFCs (incl. HFCs) as secured creditors under SARFAESI Act
- Display information in respect of the borrowers whose secured assets have been taken into possession by the REs under the Act.
- The said information is to be uploaded on REs website.
- **Timeline:** by March 25, 2024
  - and thereafter monthly updation

- The following information is to be displayed;
  - Sl. No
  - Branch
  - State
  - Borrower name
  - Guarantor name (if applicable)
  - Registered address of the borrower
  - Registered address of the guarantor
  - Outstanding amount
  - Asset classification
  - Date of asset classification
  - Details of security possessed
  - Name of the title holder of the Security possessed

Repossession of Vehicles

Patna High Court

Shashi Kant Kumar vs The State Of Bihar on 19 May, 2023

- For repossession of vehicles
  - Notice should be given to borrower before taking possession of the vehicle, for the period mentioned in loan agreement;
  - The procedure for taking possession of the asset should be as mentioned in the loan agreement;
  - Final chance must be given to the borrower for repayment of loan before repossession of the property;
  - In case repossession is to be given back to the borrower upon repayment of loan or otherwise, procedure given in loan agreement should be followed;
  - The procedure for sale / auction of the property should be as mentioned in loan agreement.
- Agents while interacting with customers for collection of dues and/or for enforcement/ repossession of security/ secured assets will identify himself / herself and display the Identity card/authority letter issued by lender upon request
- Agents will document the efforts made for the recovery of dues, as far as possible and the copies of communication sent to customers, if any, will be kept on record.
- Agents can disclose details pertaining to the credit facilities only to the relevant borrower, co-borrower or the co-guarantor.

Release of Movable / Immovable Property Documents

- To streamline divergent practices followed by REs in releasing all movable / immovable property documents
  - upon receiving full repayment and closure of personal loan account,
- RBI vide notification dated September 13, 2023 has introduced guidelines for responsible lending conduct.
- Applicable to all cases where release of original movable /immovable property documents in case of settlement of Personal Loans, falls due **on or after December 1, 2023.**

- The following amendments are added:
  - All original property docs to be released & charges removed within **30 days** of final settlement
  - Borrower may choose to collect docs from the branch where loan was given or any branch where documents are available.
  - The **timeline and place of return** of original movable / immovable property documents will be mentioned in the loan sanction letters
  - **Delay in release** of docs or charge **beyond 30 days** attracts **daily compensation of Rs 5000 per day**,
  - If borrower dies, documents to be returned to legal heirs. Return procedure to be displayed on website.
  - In case of loss/ damage of title documents, assistance to be provided at RE's cost.

Prudential Measures

Regulatory measures towards consumer credit & bank credit to NBFCs

Increased risk weights in case of Consumer Credit

Regulatory Change	Increased Risk Weight in case of CC for Banks	Increased Risk Weight in case of CC for NBFCs	Increased Risk Weight on Banks lending to NBFCs	Sectoral Limits on Unsecured Credit
Timeline for Implementation	• Effective Immediately • Increased risk weight may be applied in the capital adequacy return filed with RBI			• February 29, 2024 • Effective steps may be taken soonest

What is Consumer Credit?

INCLUDES

- Loans for consumer durables
- Credit Card Receivables
- Auto Loans (other than loans for commercial use)
- Loans given for other consumption purposes
- Personal loans to professionals (excluding loans for business purposes)
- Secured personal loans secured by gold, gold jewellery, immovable property, fixed deposits

EXCLUDES

- Education loans
- Consumption loans given to farmers under KCC
- Loans given for investment in financial assets
- Loans given for creation/ enhancement of immovable assets

Sectoral Exposure on Consumer Credit

- Self imposed caps depending on the business, diversification, asset focus, etc
- No absolutism in the regulatory prescription
- Risk Management Committee to set these sectoral caps
- In absence of Risk Management Committee the Board of Directors may monitor the sectoral caps

- Sectoral Limits are based on Asset Under Management (AUM)
- For monitoring risk exposure in FLDG the entire portfolio value has to be considered.
- Portfolio concentration may be corrected by securitisation, direct assignment or Co-lending transactions.

Understanding the DLG Guidelines

- RBI on June 8, 2023, took the first step in recognising first loss default guarantees ('FLDG'), provided by regulated or non-regulated entities, subject to restrictions
  - **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.

Forms of Guarantee

- Cash deposited with the RE
- Fixed Deposits maintained with an SCB with a lien marked in favour of the RE
- Bank Guarantee in favour of the RE

DLG Structure

- Eligibility of Guarantor
  - LSP or other RE with which it has entered into an outsourcing (LSP) arrangement
  - Must be company under the Companies Act, 2013
- DLG Agreement
- DLG arrangements should be backed by an explicit contract that shall at least contain the following -
  - Extent of DLG cover
  - Form in which DLG cover is to be maintained with the RE
  - Timeline for DLG invocation
  - Disclosure requirements with respect to information to be published on the LSP's website
- Tenure of DLG
  - DLG agreements shall remain in force for shall not less than the longest tenor of the loan in the underlying loan portfolio
- Limit or capping of DLG cover
  - Total amount of DLG cover on any outstanding portfolio shall not exceed 5% of the amount of that loan portfolio
- NBFC/Bank availing DLG
  - Put in place a Board approved Policy
  - Ensure NPA classification as per the extant asset classification and provisioning norms irrespective of any DLG cover available at the portfolio level
  - Amount of DLG invoked shall not be set off against the underlying individual loans
  - Share the recovery, if any, from the loans on which DLG has been invoked and realised, with the DLG provider as per the terms of the contract.

Actionables for DLG Provider and Beneficiary

LSP providing DLG

- Must be incorporated as a company under the Companies Act, 2013,
- Provide a declaration certified by its statutory auditor on
  - the aggregate DLG amount outstanding,
  - the number of REs and the respective number of portfolios against which DLG has been provided,
  - past default rates on similar portfolios, and
  - such other information to satisfy the lender that it would be able to honour the DLG commitment
- Publish on their website the total number of portfolios and the respective amount of each portfolio on which DLG has been offered

NBFC/Bank availing DLG

- Put in place a Board approved Policy
- Ensure NPA classification as per the extant asset classification and provisioning norms irrespective of any DLG cover available at the portfolio level
- Amount of DLG invoked shall not be set off against the underlying individual loans
- Share the recovery, if any, from the loans on which DLG has been invoked and realised, with the DLG provider as per the terms of the contract.

Understanding Compromise Settlement and Technical write off

Compromise Settlement

- Any negotiated arrangement with the borrower
  - to **fully settle the claims** of the RE against the borrower
  - **in cash**
- Such settlement may entail
  - some sacrifice of the amount due from the borrower on the part of the REs
  - corresponding waiver of claims of the RE against the borrower to that extent

Technical Write-off

- The Framework defines the term as
  - cases where the non-performing assets
  - remain outstanding at borrowers' loan account level
  - but are written-off (fully or partially) by the RE only for accounting purposes,
  - without involving any waiver of claims against the borrower
  - without prejudice to the recovery of the same.

Lending and Investment Segments

PM Vishwakarma Scheme

- Participating Financial Institution
  - SCBs, RRBs, SFBs, Cooperative Banks, NBFCs and MFIs, are eligible to lend under this Scheme
- Roles and Responsibilities of the various Stakeholders
  - Ensuring timely disbursement of collateral free credit.
  - Streamlining and simplifying the process for smooth credit disbursement at grassroot level.
  - Continuous reporting of loan portfolio
- Eligible Borrowers
  - An artisan and craftsman from 18 specified sectors as mentioned in para 2.3 of the guidelines will be eligible to borrow under this scheme.
  - Minimum age 18 years
  - The borrower should be engaged in the trades concerned on the date of registration and should not have availed loans under other CG or SG schemes.
  - A person in government service and his/her family members shall not be eligible under the Scheme.
- The registration and benefits under the Scheme shall be restricted to one member of the family.

- Type of loan- Enterprise Development Loan
- Maximum amount of credit support- Rs.3,00,000/-
  - First loan tranche upto Rs. 1,00,000
  - Second loan tranche upto Rs 2,00,000
- No collateral will be required to avail the loan.
- No prepayment penalty will be charged from the borrowers after 6 months of loan disbursement.
- To be repaid in monthly installments.
- PAN requirements for the credit facilities will be as per the banking norms (KYC Directions).
- Credit information report will be required for those who have a credit history, for availing benefits under the credit component, so as to exclude any defaulter from availing credit again under the Scheme.
  - However, not having credit history should not be a ground of declining of loan.
- The eligible borrowers will be given loan at concessional rate of fixed interest at 5% .

Framework on Green Deposits

The Green Deposits Framework

- Banks and deposit-taking NBFCs/HFCs may raise green deposits, in accordance with the Framework, from 1st June, 2023
- Money raised by Green deposits to be deployed only for "green finance"
- India's taxonomy for the same to be developed. In the meantime, a list of eligible green activities/ projects has been announced, in line with SEBI's definition of green bonds under NCS Regulations
- Third party assessment/verification of use of proceeds mandatory
- Impact assessment to be optional for FY 23-24, and mandatory from FY 24-25
- Requirement of disclosure of green deposits and utilization in the annual financial statements

Actionables under the Framework

- Policy on green deposits – Such policy shall be put on the website of the RE.
- Financing Framework for allocation of proceeds to be framed and put on website
- Review of Financing Framework by an external reviewer and the opinion of the external reviewer is also required to be put on the website prior to implementation of the Financing Framework.
- Third-party verification of allocation of funds- The Report shall also be put on the website of RE.
- Impact assessment of use of proceeds – The Report has to be put on the website of the RE.
- Reporting Requirements – FRE shall place before the Board, within 3 months from the end of the financial year, a review report covering details as prescribed. Further, the entity shall also make appropriate disclosures in its annual financial statements in the prescribed format.

Expanding the scope of Trade Receivables Discounting System

- RBI has permitted insurance companies to participate as a "fourth participant" in TReDS, alongside MSME sellers, buyers, and financiers.
  - TReDS platform operators shall have the flexibility to specify the stage at which insurance facilities can be availed
  - TReDS platforms can, with the consent of financiers and insurance companies, facilitate automated processing of insurance claims
- RBI has expanded the pool of financiers on TReDS.
  - In addition to banks, NBFC-Factors, and select financial institutions authorized by the RBI, other entities and institutions permitted by the Factoring Regulation Act, 2011 ('Factoring Act') to partake as financiers in TReDS
- RBI has allowed TReDS platform to undertake the settlement of all uploaded Financing Units (FUs), whether financed/discounted or not, using the National Automated Clearing House (NACH) mechanism
- TReDS platforms facilitate transparent and competitive bidding by the financiers.
  - The platforms have been allowed to display details of bids placed for an FU to other bidders; the name of the bidder shall, however, not be revealed.

RE's investment in AIFs

Investments in AIFs where the AIFs have investments in 'debtor companies':

- Prohibited all regulated entities (REs), including banks, cooperative banks, NBFCs and All India Financial Institutions from making investments in Alternative Investment funds (AIFs), if the AIF has made any investment into a "debtor company".
  - Debtor company means a company in which the RE currently has or previously had a loan or investment exposure anytime during the preceding 12 months
- The bar applies immediately, that is, effective 19th Dec 2023.
- No further investments to be made. If investments already exist, the RE shall exit within 30 days, that is, by 18th Jan 2024
- Further, if an RE has made an investment in an AIF, and the AIF invests in a debtor company, the RE shall make an exit within 30 days.
- The objective of the circular is to prevent evergreening:
  - Since several REs have affiliated AIFs, routing the money through AIFs to borrowers might have led to evergreening.

Investments in subordinated units of any AIF scheme

- Investment by REs in the subordinated units of any AIF scheme with a 'priority distribution model' subject to full deduction from RE's capital funds.

Impact of the circular

- Likely to impact of the flow of funds of the AIFs
- While the bar is only for those AIFs which have invested in "debtor companies", it will be practically tough for REs to avoid overlapping investments. Given the severe implications of a breach, compliance-sensitive REs will avoid investing in AIFs.
- There is an immediate disinvestment pressure on AIFs, as there may be overlapped investments. AIFs' assets are mostly illiquid – ensuring exit to RE investors may be tough. In many cases, there are lock-in restrictions as well.

Amendments in KYC Master Directions (April)

- Insertion of various definitions – The definitions of "Non-profit organizations" and "Politically Exposed Persons" have been amended to align those with the definitions in the PML Rules. Also, the RE shall be required to ensure the registration of customers, in case of NPO, on the DARPAN Portal of NITI Aayog, if not already registered. Further, the definition of "Group" has been added.
- Group-level monitoring – Section 4 has been amended and a provision has been inserted advising regulated entities to ensure that a group-wide policy is implemented for the purpose of discharging obligations under the provisions of Chapter IV of the PML Rules.
- Revised criteria for Beneficial Ownership – The threshold for "Controlling ownership interest" for the purpose of determination of Beneficial Owner (BO) has been revised to 10 percent for both companies and trusts from the earlier threshold of 25 percent and 15 percent, respectively
- Additional documentation requirements – Additional recognized documents have been specified that are required to be submitted by companies, partnership firms, and trusts for the purposes of conducting client due diligence.
- Non-face-to-face KYC (other than through the Aahaar OTP-based e-KYC mode)- REs have been instructed to ensure additional enhanced DD measures and high risk categorisation-
  - V-CIP to be conducted, if provided by RE
  - Contact point address verification
  - PAN verification
  - First transaction from KYC compliant customer bank account
  - Transactions shall be permitted only from the mobile number used for account opening

Amendments to KYC Master Directions (October)

Identification of Beneficial Owner (BO)

Identify BOs of existing customers (partnership firms) as per new threshold and complete KYC procedure for such BOs.

Carry out KYC for new customer (partnership firms) by identifying BOs as per new threshold.

Principal Officer (PO)

If the existing PO is not designated at management level, then designate PO at such level.

In case of appointing a new PO ensure that the officer part of the management cadre.

Periodicity of ML/TF risk assessment

NBFCs may consider delegating authority to determine periodicity of ML/TF risk assessment.

Group AML policy

NBFCs to ensure that Group AML policy is being implemented by the regulated entities within the group.

Filing of STR

NBFCs are required to file STR where company Is unable to apply appropriate CDD measures.

Record acquisition for outsourced KYC function

NBFCs shall make necessary arrangements with third-parties to acquire KYC records immediately when KYC-related tasks are performed by such third party.

Record maintenance for walk-in customers

It is expected that NBFCs are already maintaining records of walk-in customers along with records of account based customers for the purpose of KYC.

Accounts opened using simplified procedure

NBFCs shall monitor accounts opened using simplified procedure on a continuous basis.

File STR and perform KYC as per normal procedure in case suspicious activity is detected in such accounts.

Disclosure of status by trustee

Seek disclosure of the status of the trustee at the time of commencement of account-based relationship, transactions exceeding ₹ 50k (walk-in customers) or where NBFC has grounds for suspicion that the trust is intentionally structuring transaction below ₹ 50k threshold.

Credit Information

Framework for compensation to customers for delayed updation/ rectification of credit information

- **Customer Alerts for Default/DPD**
  - CIs are now required to send SMS or email alerts to customers when they submit information to CICs related to defaults or Days Past Due (DPD) in existing credit facilities.
  - This proactive communication keeps customers informed about their credit status.
- **Awareness Campaigns:**
  - CIs should organize special awareness campaigns to educate their customers about the benefits of providing mobile numbers and email addresses.
  - This empowers customers with the knowledge of how these details can be essential for timely communication regarding their credit information
- **Dedicated Nodal Point:**
  - CIs must designate a dedicated nodal point or official for CICs to address customer grievances promptly.
  - This streamlines the grievance redressal process.
- **Root Cause Analysis:**
  - CIs should undertake a RCA of customer grievances at least semi-annually.
  - Top management should review the RCA annually to identify and rectify the underlying issues leading to complaints.
- **Reasons for Data Rejection:**
  - CIs should inform customers of the reasons for the rejection of their requests for data correction.
  - This transparency helps customers better understand issues in their CIR.

Strengthening of customer service rendered by CICs and Credit Institutions

- **Resolution of Complaints:**
  - To prioritize the prompt resolution of customer complaints, related to credit information discrepancies, forward corrected particulars of the credit information to the CIC within a period of 21 days from the date when informed of inaccuracy
- **Tracking and Communication:**
  - Maintain a system for tracking the progress of complaints and their resolution timelines.
  - Inform the concerned CIC and the complainant about the total delay & the compensation amount to be paid, if applicable, after the final resolution.
- **Incorporate Compensation Provisions:**
  - Integrate provisions in their complaint submission formats, both online & offline, to allow complainant to submit their contact details, email IDs, bank account details or UPI IDs for compensation disbursement
- **Compensation Disbursement:**
  - Ensure compensation amounts are credited to the complainant's bank account within 5 working days
- **Recourse for Wrongful Denial:**
  - If complainant believes they were wrongfully denied compensation, they can approach the RBI Ombudsman (if covered) or Consumer Education and Protection Cell (CEPC) at the Regional Offices of the RBI
- **Training and Awareness:**
  - Train the staff to understand and implement the compensation framework effectively.
  - Make sure that customers are aware of their rights and the compensation process.
- **Compliance Monitoring:**
  - Regularly monitor institution's compliance with the compensation framework.

Data Quality Index for Commercial and Microfinance Segments by CICs

Information Technology

Master Direction on Information Technology Governance, Risk, Controls and Assurance Practices

- On 7th November, 2023, the RBI notified the Master Directions on Information Technology Governance, Risk, Controls and Assurance Practices
- Unified IT framework across all regulated entities
- **Effective from April 01, 2024** and are applicable to:
  - Commercial banks, including Banking Companies, Corresponding New Banks, and the State Bank of India.
  - NBFCs falling under the 'Top Layer,' 'Upper Layer,' and 'Middle Layer' categories
  - Credit Information Companies (CICs).
  - All India Financial Institutions (AIFIs) such as EXIM Bank, NABARD, NaBFID, NHB, and SIDBI.
- However these are not applicable on:
  - Local Areas Banks;
  - NBFC – Core Investment Companies

- **What happens to existing functional classification?**
  - These regulations shall apply on the following NBFCs (except NBFC-CICs) as per the SBR framework ('Specified NBFCs'):
    - Top Layer;
    - Upper Layer;
    - Middle Layer.
  - Base layer entities are expressly excluded
  - NBFC-BL shall continue to follow existing IT Framework (Section-B)
    - 2017 Master Direction - Information Technology Framework for the NBFC.

Governance Structure

Committees

Board Level

- Board of Directors ('Board')
- Audit Committee
- IT Strategy Committee (ITSC)
- Risk Management Committee (RMC)

Management Level

- IT Steering Committee
- Information Security Committee (ISC)

Officers/ Personnel

- Head of IT Function (CTO/ CIO)
- Chief Information Security Officer (CISO)
- CEO/ Senior Management
- IS Auditor(s)

Policies

- IT & IS
- BCP & DRM
- Information and Cyber Security
- ERM Policy (incl. IT-related risks)
- Change and Patch Management
- Data Migration
- IS Audit

Roles and Responsibilities

Board's responsibilities

- Establish and review IT-related policies **annually** (IT & Information Asset, Business Continuity, Information & Cybersecurity)
- Constitute IT Strategy Committee (ITSC) with 3 directors, Independent Chairperson, and technically competent members

ITSC Responsibilities:

- Establish effective IT planning process
- Align IT Strategy with overall business objectives
- Ensure accountable and efficient IT and information security governance
- Implement processes for assessing and managing IT and cybersecurity risks
- Allocate and utilize budget for IT systems
- Review adequacy and effectiveness of BCP and DRM

Senior Management/ IT Steering Committee responsibilities:

- Ensure execution of Board-approved strategy
- Ensure robust cybersecurity
- Oversee Business Continuity and Disaster Management processes
- Periodically update ITSC and CEO on IT Steering Committee activities
- Ensure IT infrastructure meets regulatory and statutory requirements
- IT Steering Committee to meet quarterly

Head of IT Function Responsibilities:

- First line of defense for effective assessment, evaluation, and management of IT controls and risks
- Secure information assets & ensure compliance with internal policies, regulatory, legal requirements on IT aspects

Committees - Composition and ToR

Committee	Constitution	Composition	Meeting Frequency (minimum)
IT Strategy Committee (ITSC)	Board level	• Three directors • Independent Chairperson • Technically competent members	Quarterly
IT Steering Committee	Management level	• Minimum of three directors as members • Chairperson to be an independent director with substantial IT expertise • Technically competent members	Quarterly
Information Security Committee (ISC)	Management level -Under the oversight of the ITSC	• CISO & other representatives from Business & ITSC on recommendation of ITSC	Not specified

List of Policies to be maintained

Policy Area	Approving Authority	Review Frequency (minimum)
Information Technology/ Information System	Board	Annual
Business Continuity (BCP) and Disaster Recovery (DRM)	Board	Annual (to be updated based on major developments/ risk assessment)
Information Security	Board	Annual
Information and Cyber Security **(incl. Incident Response and Recovery Management/ Cyber Crisis Management and Cyber Security Policy and Cyber Crisis Management Plan (CCMP))**	ISC (reviewed by the Board)	Annual
Enterprise-wide risk management policy/ operational risk management policy needs to incorporate IT-related risks	RMC in consultation with the ITSC	Periodic
Change and Patch Management	Not specified	Not specified
Data Migration	Not specified	Not specified
IS Audit	Audit Committee	Annual

Master Direction on Outsourcing of Information Technology Services

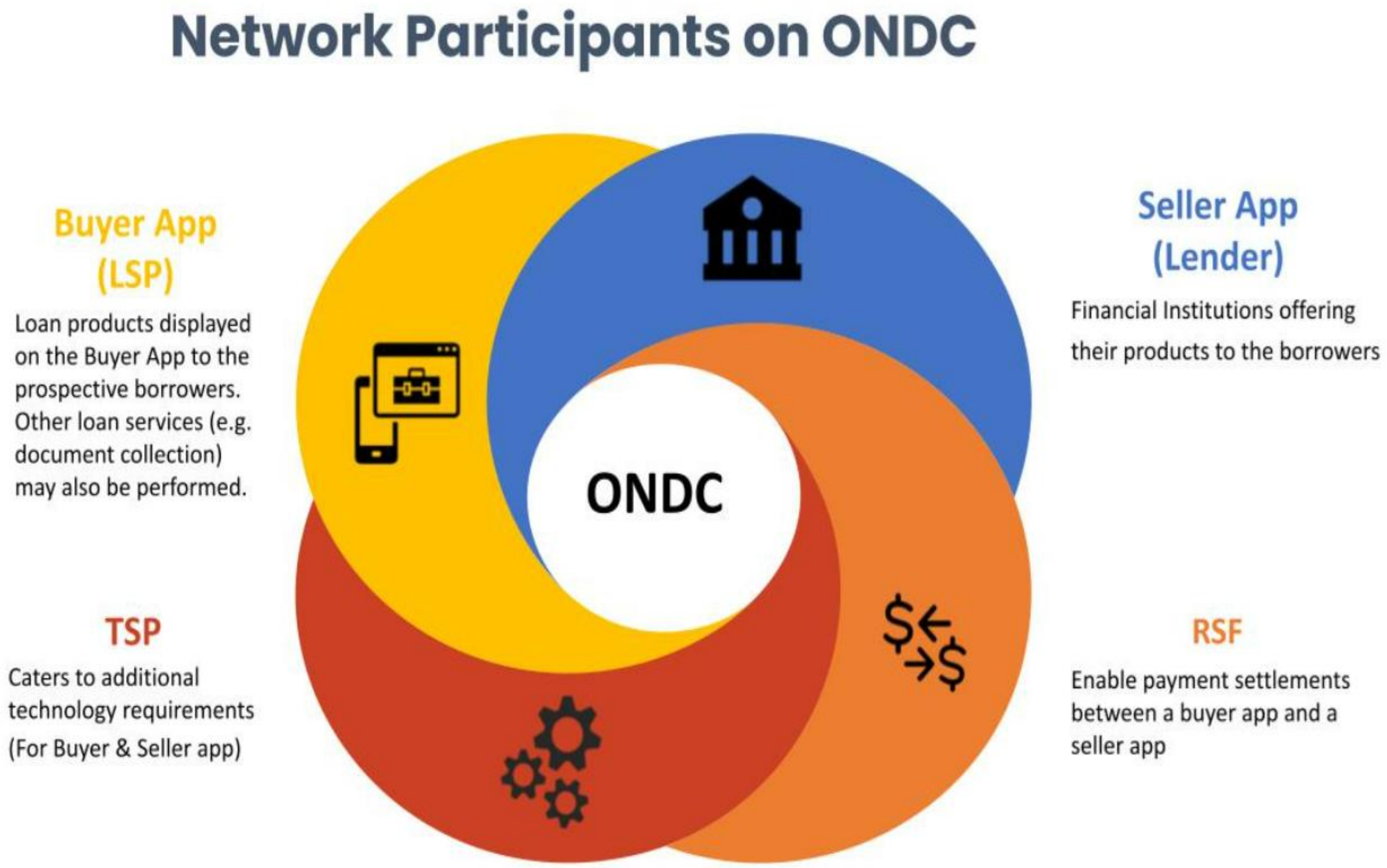
- The RBI published the *Master Direction on Outsourcing of Information Technology Services* on April 10, 2023
- These Directions apply to the regulated entities of the RBI (RE) including non-banking financial companies in the Middle-layer and above ('Specified NBFCs') and are effective from October 1, 2023
- The Directions apply to "Material Outsourcing"
- The Directions, inter alia, provide for -
  - Role of the RE to oversee and monitor the activities of service providers
  - Assessment of need for outsourcing and attendant risks
  - Creating an inventory of services provided by the service providers
  - Governance framework in terms of having a Board-approved IT outsourcing policy with responsibilities demarcated among the Board, senior management and IT function
  - Undertaking due diligence before engaging a service providers on a risk-based approach
  - BCP and DR
- IT outsourcing activities of Specified NBFCs were previously covered under *Section - A of the Master Direction - Information Technology Framework for the NBFC Sector*
- Such NBFCs as well as the other REs to whom the new Directions apply are required to comply with the provisions of the new Directions as per below timelines-
  - New agreements/ agreements renewable before effective date: Preferably by the agreement/ renewal date but not later than 12 months from the issuance of new Directions
  - Agreements coming into force on or after the effective date: From the date of agreement
  - Agreements due for renewal on or after the effective date: By the renewal date or 36 months from the issue of the Directions, whichever is earlier

Read our article here -
RBI regulates outsourcing of IT Services by financial entities

Innovations and newly introduced concepts

ONDC for Financial Services

- ONDC, a government initiative, undertook the mission of democratising the digital e-commerce space in India. As on November 2023, ONDC was live in 500+ cities with 53 network participants and 2.2 lacs sellers/ service providers
- Building on the success in the e-commerce space, ONDC now aims at leveraging its architecture for the provision of financial services in four domains namely credit, insurance, investments, and gift cards
- The architecture provides a common public digital infrastructure for LSPs and lenders with the aim to reduce operational costs and expand reach
- In the first phase, ONDC plans to enter the credit sector by providing a platform for unsecured personal loans as well as GST-based invoice loans to merchants.



Read our article here - *Introducing Financial Services on ONDC: Opportunities & Challenges for Digital Lenders*

UPI - Operation of Pre-sanctioned Credit Lines

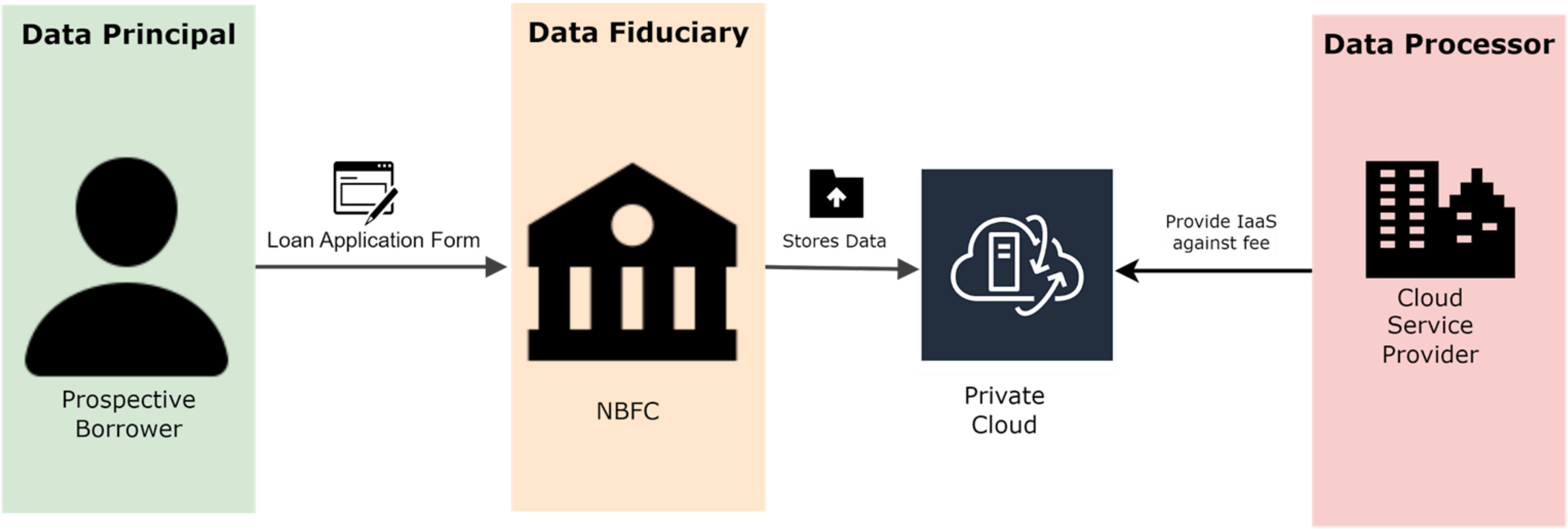
- RBI vide its *circular* dated. Sept. 04, 2023 expanded the scope of UPI by enabling transfer to / from pre-sanctioned credit lines at banks
- Further, NPCI vide its *notification* dated. Sept. 20, 2023 has come out with instructions to enable permitted lenders to effectively enhance their credit offering through UPI
- This change encourages a expansion in credit product offering by banks especially in the short term retail credit segment. NBFCs have often provided the last mile connectivity in such lending and one may expect to witness greater collaboration between banks and NBFCs in credit delivery as a result of this change

- UPI Apps are also set to become credit cards but better:
  - Virtual facility - No plastic
  - Users will be able to discover credit line a/c through mobile
  - phone App
  - Existing devise binding controls continue to apply
  - Online Disputes Resolution
  - Speedy settlement as per existing UPI settlement process
  - Inward payment to UPI ID to be auto-treated as repayment if only credit line a/c linked
  - AutoPay may be used to pay dues

Read our article here -
UPIs become virtual credit cards: A game changer in credit delivery

Digital Personal Data Protection Act, 2023

- The Digital Personal Data Protection Act, 2023 is a comprehensive act on data privacy and protection
- The Act introduces the concepts of Personal Data, Data Principal, Data Fiduciary and Data Processor
- Financial services industry, including lenders like Banks and NBFCs, will get covered under the ambit of the proposed Act, as information shared by customers/ borrowers of such entities will involve "Personal Data" and actions of lenders amounting to "processing" will come under this law



Digital Personal Data Protection Act, 2023 (contd.)

- The Act **mandates an explicit and informed consent from the Data Principal, subject to a carve-out for "legitimate** uses", which is regarded as 'deemed consent'.
- Data Fiduciaries are required to provide **prior notice to Data Principals** for all cases where data processing requires consent of the Principal.
- The Act is light in prescribing any specific cybersecurity measures. **Personal data protection breaches are, however, subject to heavy penalty.**
- The Act requires Data Fiduciaries to provide **notice of data breaches to the Data Protection Board** that will be established under the Act and also to every Data Principal whose personal data is affected by such breach.
- Data Fiduciaries mandated to have grievance redressal mechanism for any complaints from Data Principals under the law. Unaddressed grievance may be escalated to the Data Protection Board established under the Act.
- Additional requirements place upon **"Significant Data Fiduciaries"** -
  - Appointment of DPO
  - Performance of data protection impact assessments/ audit
- The Act allows personal data to be retained by the Data Fiduciary or its authorised Data Processor, **till a "reasonable period" post completion of the specified purpose or from withdrawal of consent by the Data Principal to store/ process such data,** whichever is earlier.
- The Act, however, allows the Data Fiduciary to retain personal data for a longer period **if any law so requires.**
- The Act **does not impose any data localisation requirement on the Data Fiduciaries**, however, it confers on the Central Government the authority to restrict, by notification, transfer of personal data by a Data Fiduciary for processing to such country/ territory outside India as notified.

Read our article here -
Digital Personal Data Protection Bill 2023: Analysing the Impact on Digital Lenders

Draft regulations for comments

Wilful Defaulters

- Upper Layer and Middle Layer NBFCs get right to tag defaulters as wilful
- Major obligations of NBFCs include:
  - Identification of an NPA as to whether it may fall into the category of Wilful Defaulter
  - Having an Identification Committee, Review Committee, etc. for the process of declaration
  - Post declaration, appropriate filing with Credit Information Companies(CICs)
  - Review of status of Wilful Defaulters by the audit committee
  - Reporting of Wilful Defaulters in the List of Wilful Defaulters with CICs
- Once classified as a Wilful Defaulter, the tag can only be removed if the defaulting borrower undertakes either of the following:
  - The defaulting borrower clears his dues
  - The defaulting borrower enters into a compromise settlement with the lender, and the entire settlement consideration is cleared
  - The defaulting borrower clears so much of his dues as to bring the outstanding amount to less than Rs 25 lacs
  - The defaulting borrower undergoes a CIRP which is implemented; however, the promoters of the defaulter will continue to be classified as Wilful Defaulter
- Large defaulter is based on two conditions:
  - Size of the default: Rs 1 crore of outstanding
  - Vintage of the default: Should have been classified as doubtful or loss by the lender
- Monthly filing of large defaulters to all CICs

Master Directions on Outsourcing of Financial Services (Draft)

- Issued the Draft Master Direction on October 26,2023
- In line with RBI's Monetary Policy Statement on Development and Regulatory Policies dated 5 August 2022
- **Objective:-**
  - Ensuring harmonisation of extant guidelines issued to the different categories of regulated entities.
  - Consolidation of the guidelines under one guideline.

Applicability

- Regulated Entities (REs)
  - Commercial Banks (LAB's, RRB's, PB's & SB's)
  - AIFI's
  - NBFCs
  - Cooperative Banks
  - Credit Information Companies.
- Type of Outsourcing
  - Material
  - Non Material Outsourcing
  - Sub-contracted Outsourcing

Meaning

Distinction:

- **Outsourcing:** The functions which, in normal course, are expected to be undertaken by the financial services entity itself, and which form a part of its ordinary business
- **Professional Service procurement:** Sourcing and buying of services for business from professionals/companies.

Meaning:

- As per the Basel 2005 document,

"a RE's use of a third party (either group entity or external entity) to perform activities on a continuing basis that would normally be undertaken by the regulated entity, now or in the future"

- 'continuing basis' would include:
  - agreements for a limited period,
  - **perpetual agreements - not permitted**

- Application processing (loan origination, credit cards);
- Middle and Back office operations (EFT, payroll & order processing);
- Claims administration (loan negotiation, processing, collateral management, collection of bad loans);
- Document processing (cheques, credit card and bill payments);
- Cash management, Manpower Management (training);
- Marketing and research (Product development, media relation, telemarketing.

- Function legally required to be performed by a service provider;
- Telecommunication services,
- Postal and Courier services and public utilities;
- Market information services,
- Common network infrastructure;
- Global financial messaging infrastructure subject to oversight by relevant regulators;
- Acquisition of services that would otherwise not be undertaken by the RE;
- Correspondent Banking services.

Functions which cannot be outsourced:

- Core management functions:
  - Decision-making
  - Ensuring compliance with KYC norms;
- Policy formulation; (currently applicable to co-operative banks, now been extended to all REs)
- According sanction of loans through a service provider as per a pre-decided criterion - **permitted,** provided RE can demonstrate the decision to lend was solely its own, and the service provider is merely acting as a facilitator.
- For NBFCs in a group or conglomerate, certain activities were permitted to be outsourced within the group, subject to compliance with the instructions specified- Reference to the same has now been removed in the draft MD.
- Outsourcing of the Internal Audit function (experts including former employees can be hired on a contractual basis).

What is Material Outsourcing?

- Material Outsourcing arrangement has been redefined as:
  - an outsourcing arrangement that –
    - in the event of failure of service or breach of security, has the potential to either materially impact the Company's
      - business operations, reputation, strategies, or profitability; or
      - ability to manage risk and comply with applicable laws and regulations ; or
    - in the event of any unauthorised access or disclosure, loss or theft of customer information, may have a material impact on the RE's customers.
- Materiality of an outsourcing arrangement will be considered on a **gross basis**,
  - Prior to application of any risk mitigations or controls.

Factors to classify outsourcing arrangement as material

Existing Factors	Factors newly added

Existing Factors

- Level of importance of the activity being outsourced;
- Significance of the risk posed by the same;
- Potential impact of the outsourcing on earnings, solvency, liquidity, capital and risk profile
- Potential impact on Company's brand value and reputation,
- Ability to achieve business objectives, plans and, strategies if the service provider fail to perform the service;
- Cost of outsourcing as a proportion of total operating cost.
- Aggregate level of dependency to that particular service provider, (various functions are outsourced to the same service provider);
- Significance of activities outsourced in context of customer service and protection

Factors newly added

Additional criteria to determine materiality:

- Degree of difficulty, including the time taken, in:
  - finding an alternative service provider or
  - bringing the business activity in-house.
- Impact on the Company's counterparties and the financial market, if the service provider fail to perform the service.

Company can classify other outsourcing arrangements as material apart from the above given factors.

Parameters to evaluate the service provider's capability

Existing Factors

- Past experience and competence to implement the proposed activity;
- Financial soundness and ability to service commitments under adverse conditions;
- Business reputation and culture, compliance, complaints and outstanding or potential litigation;
- Business continuity management, audit coverage, internal controls, security, and reporting and monitoring environment;
- Due diligence by service provider of its employees;

Factors newly added

- conflict of interest
- ability of the service provider to effectively service all customers with confidentiality (currently applicable to **cooperative banks** now been extended to all REs)
- disaster recovery arrangements and track records,
- degree of reliance on sub-contractors,
- adequacy of service providers insurance coverage;
- external factors such as:
  - Economic,
  - Legal,
  - Political and social environments of the jurisdiction where service provider operates.

Compliance Obligations for Material Outsourcing Arrangements

- Maintain a centralised record of all material outsourcing agreements
- The outsourcing agreement must specify:
  - service locations,
  - data processing regions,
  - outline procedures for notifying the RE if the service provider changes its location
- Mandatory periodic joint testing and recovery exercises by RE and Service provider **at least annually**
- Report to RBI **on a quarterly basis** of the material outsourcing arrangements (format may be specified later)
- RBI shall review during inspections:
  - Effective implementation
  - Robust risk management systems.

Additional requirements to be added in the Outsourcing Agreement

- Service-level agreements (SLA), (specifically mentioned);
  - SLA - clearly formalise the performance criteria to measure quality and quality of the service levels;
- Approval for the use of subcontractors shall be subject to compliance with the provisions of the draft MD;
- Preservation of documents and data by the service provider;
- Specify the type of material adverse events (e.g. data breaches, service unavailability,etc.) and incident reporting requirements under which the service provider should report to the Company;
- The events of default and the indemnities, resolution process, remedies and recourse of the respective parties in the agreement;
- Storage of data must be in compliance with extant regulations notified by the RBI.

Monitoring and Control Obligations

- Reports on the monitoring and control activities - reviewed periodically by Senior Management.
  - Any adverse development- place before the board or committee for information.
- Perform comprehensive pre-and post-implementation review:
  - new outsourcing arrangements;
  - amendments to the current outsourcing arrangements.
- **Submit Annual Compliance Certificate to RBI giving the particulars of:**
  - outsourcing contracts,
  - prescribed periodicity of the audit by the internal or external auditor,
  - major findings of the audit,
  - actions taken by the board.
- Publicise in leading local newspaper the termination of outsourcing agreement (indicative reasons such as fraud, leakage or breach of information, etc.) - where SR interacts with customers
- Immediately notify RBI - any significant problems - potential to materially affect the outsourcing arrangement & the business operations, profitability, reputation or strategies.
- Provisions of the RBI guidelines on 'Outsourcing of Cash Management – Reconciliation of Transactions', - applicable in case of outsourcing of cash management (currently applicable to banks extended to all the REs.)
- Formulate effective process to review and approve any Incentive Compensation that may be embedded in the contracts.

Role of Board and Senior Management

Role of the Company

- Establish an inventory of services provided by SR (including key entities involved in their supply chain), map their dependency on third parties;
- Periodically evaluate the information received from the service providers;
- Company responsible even for the actions of subagents engaged by their service providers;

Role of the DSA/DMA

- Draft MD prohibit intimidation and harassment during recovery practices (inappropriate messages, threats, false representations, or persistent calls) - which includes repeated calling
- Recovery agents cannot contact borrowers/guarantors before 8:00 a.m. or after 7:00 p.m., except MFI Loans.

Role of Senior Management (Additional)

These functions were earlier performed by the Board:

- Regularly reviewing:
  - outsourcing policies and procedures;
  - strategies and arrangements for their continued relevance, safety and effectiveness;
  - to identify new material outsourcing risks as they arise.
- Deciding on business activities of a material nature to be outsourced and approving such arrangements

General Restrictions and Obligations

Outsourcing in the group

- REEs cannot outsource activities to a service provider if it is not a group company where it is owned or controlled by:
  - key managerial personnel of the Company or
  - approver of outsourcing arrangement.
- Exception:- Permitted if approved by the board of directors or committee of the RE & appropriate disclosures being made.
- Other provisions remain the same. Mainly clarified -
  - To maintain an arm's-length relationship with respect to sharing of data and servers in such outsourcing
  - Conditions of the outsourcing agreement must be set on an arm's-length basis &
  - Must explicitly deal with conflicts of interest

Other General Obligations

- **Confidentiality and Security**
  - Company to share data with the service provider through secure channels.
  - Both sharing and storage of data with the service provider in an encrypted manner.
  - Formulate structured process for secured removal, disposal and destruction of data by the service provider.
- **Grievance Redressal**
  - Additional alternative redressal options introduced
    - Customer Education Protection Cell, (If RBI Ombudsman Scheme does not apply) &
    - Grievance Redress Mechanisms of the respective supervisory authorities, etc.
- **Centralised List of Outsourced Agents**
  - Premature termination of a service provider's contract for specified reasons - inform the concerned Self-Regulatory Organisation (SRO).
    - The SRO will have to maintain a caution list of such service provider

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