RECENT DEVELOPMENTS AND EMERGING TRENDS IN INDIA'S DIGITAL ECONOMY

FINTECH EDITION

AUGUST 2022

- RBI'S VISION STATEMENT
- DIGITAL LENDING
- PAYMENT SYSTEMS
- CARDS & DIGITAL BANKING
- ONLINE BOND TRADING PLATFORMS

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As India gears towards a digital economy, Indian Fintech landscape with its dynamic policy framework and infrastructure is fast becoming a global success story. In the last 5 years, Indian Fintechs have raised US$29 billion in funding (i.e., 14% of the global share), of which the last quarter of FY 2021 witnessed a fundraise season of US$9.8 billion.[1] The thriving ecosystem and a surge in digital adoption has catapulted the industry to a high growth and valuation trajectory. While large Fintechs scaled up between 2014 and 2021, funding accelerated at 210% just between CY 2020-2021. As of July 2022, India ranked #4 in the world in unicorn strength with 23 unicorns.[2] This has led to creation of niche segments: PayTechs, LendingTechs, WealthTechs, InsurTechs and Neobanks which are leading the next wave of tech disruption.

Indian Fintechs form a significant segment of the Indian economy and the overall financial services sector, with ~US$800 billion clocked in annual payments transaction value. Earlier this year, RBI released its tri-annual vision statement on payment systems setting out the key objectives for the coming financial years. This paves the way for a dynamic shift in the Indian financial services landscape through partnerships between large incumbents, non-bank players, new and mature Fintechs, aggregators and data and technology service providers. As the industry prepares itself for a 'funding winter', this practice update analyses the fast-evolving regulatory landscape and the way ahead for the Fintech ecosystem:

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[1] State of the India Fintech Union in 2022' (Boston Consulting Group, 18 August 2022) <https://www.bcg.com/publications/2022/indian-fintech-state-of-union > accessed 22 August 2022.
[2] ibid.

01.

RBI'S VISION STATEMENT

RBI's vision statement for India's payments and settlement systems

RBI's vision statements have over the last two decades reflected the consistent approach adopted by the RBI in development of payment systems in India.

On 17 June 2022, the RBI released the 'Payments Vision 2025' (Vision Statement). The core theme of the Vision Statement is, '*E-Payments for Everyone, Everywhere and Everytime*'. Some of the key initiatives under the Vision Statement for the years 2022-2025 include:

(i) creating a Digital Payments Protection Fund, which will seek to provide a security cover to the customers who have been defrauded or to the issuers of the payment instruments;

(ii) examining the feasibility of geo-tagging of digital payment transactions, to understand the digital payments penetration in the country, and to enhance fraud monitoring, among others;

(iii) revisiting the PPI Guidelines;

(iv) creating a regulatory framework for all unregulated significant payment intermediaries such as offline payment aggregators, among others;

(v) publishing a discussion paper encompassing the regulations for big-techs and Fintechs;

(vi) releasing guidelines for the regulation of Buy Now Pay Later (BNPL) products;

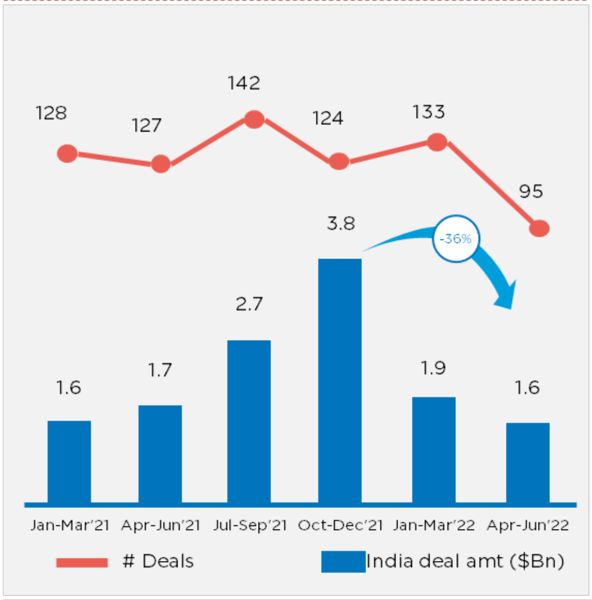
(vii) examining the feasibility of linking credit cards and other credit components of banking products to Unified Payments Interface (UPI); and

(viii) taking UPI, settlement systems and RuPay cards global.

With the Visions Statement 2022-2025, RBI is actively looking to promote: (i) an increase in PPI transactions by 150%, (ii) annualised growth of 50% for UPI, and (iii) increase by more than 3x in the number of digital payment transactions, among others.

Temperature check for emerging tech

While global equity funding in Fintech declined by 28%, India saw a steeper decline at 36%



- Indian Fintechs saw a drop of 36% in funding from Q4 CY21 to Q2 CY22 indicating the onset of a funding winter.
- Valuations have undergone a market correction.
- However, residual dry powder with financial sponsors (PE/VCs) increased by US$ 3.2bn in the last 6 months which will see deployment to strong assets with proven value proposition and customer base.

Source: State of the India Fintech Union in 2022' (Boston Consulting Group, August 2022)

02.

DIGITAL LENDING

RBI's regulatory stance on digital lending framework in India

The RBI has issued a press release on 10 August 2022 setting out the regulatory stance for digital lending by its regulated entities (i.e., banks and Non-Banking Financial Companies (NBFCs)) in India. The RBI had constituted a Working Group on Digital Lending to study digital lending practices in the Indian market and suggest regulatory interventions (this was in the backdrop of certain unethical practices followed by some market players). The working group had issued its report which the RBI had released for public comments on 18 November 2021.

The RBI has now issued a press release documenting its approach towards implementation of the various recommendations made by the working group. The press release has classified digital lenders into three categories: (i) entities regulated by the RBI and permitted to carry out lending business; (ii) entities authorized to carry out lending as per other statutory / regulatory provisions but not regulated by the RBI; and (iii) entities lending outside the purview of any statutory / regulatory provisions. The current regulatory framework of the RBI is focused on the digital lending ecosystem of RBI's regulated entities and the lending services providers.

The RBI has divided the recommendations into three buckets as set out below, and has also clarified that detailed instructions will be separately issued to its regulated entities (i.e., banks and NBFCs) in this regard:

(i) *Mandatory and immediate implementation*: Recommendations which are being immediately implemented by the RBI, including mandatory credit bureau reporting for all types of loans, certain technology, and data related requirements (such as clear audit trails for data collection and usage, data localisation requirements) and various customer protection and related measures (such as requirement for a nodal grievance redressal officer to be appointed by service providers of banks / NBFCs), procedure for loan disbursal and repayments, introduction of cooling-off period during which a borrower can exit digital loans) and various technology and data requirements.

(ii) *In-principle recommendations*: Recommendations that the RBI has principally approved, but which will require further examination internally for detailed regulations -- these include proposed prohibition on furnishing First Loss Default Guarantee (FLDG) comfort to banks / NBFCs, baseline technology standards for lending apps, auditable underwriting algorithms, ethical AI standards, Self-Regulatory Organisation functions and responsibilities, introduction of guidelines for web aggregators, etc.

(iii) *Further consultation matters*: Recommendations which the RBI believes would require wider consultation with the Central Government and other stakeholders (such as introduction of legislations to ban unregulated lending activities, setting up of DIGITA to verify and authenticate lending apps available on play store / app store, setting up of National Financial Crime Record Bureau, strengthening KYC for issuance of new SIM cards, etc.).

Key highlights of the press release are as follows:

(i) *FLDG*:

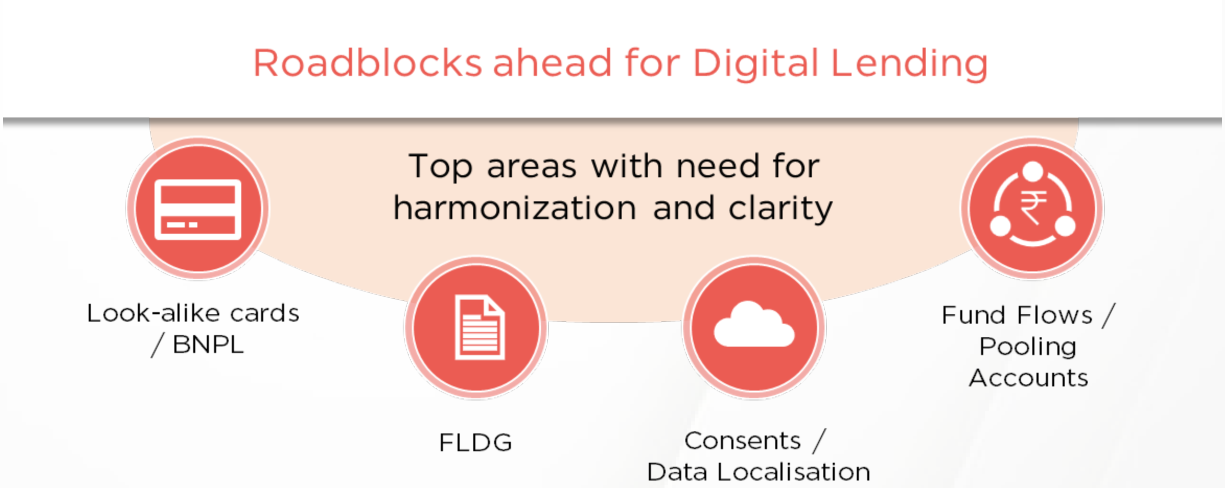
(a) The RBI has mentioned that the recommendation of the working group to completely prohibit FLDG is still under examination. However, the RBI has stipulated that in the interim, banks and NBFCs must ensure that FLDG arrangements (which involve offering of financial products backed by contractual agreements to compensate the lender for up to a percentage of the default in the underlying loan portfolios) adhere to the existing guidelines issued by the RBI for securitisation of standard assets both in letter and spirit.

(b) The securitisation guidelines prescribe conditions for issuance of credit enhancement facilities in the context of securitisation exposures. Such conditions may now apply to FLDG arrangements as well in connection with loan exposures of banks / NBFCs. These conditions include restriction on synthetic securitization (transfer of credit risk of an underlying pool of exposures by way of credit derivatives and credit guarantees), and the requirement for providers of such credit enhancement to be regulated by a financial sector regulator (failing which they must hold capital equivalent to the full value of the underlying exposure). Directionally, it appears that the RBI is not inclined to permit regulated entities to avail FLDGs and the matter is under further consideration.

(ii) *Credit assessment*: The RBI has stated that banks and NBFCs must capture economic profile of the borrowers (such as income, age, occupation, among others) prior to extending any loans through lending apps. This has been prescribed to ensure that borrower credit assessment is conducted in an auditable manner.

(iii) *Bureau reporting*: The RBI has made it mandatory for all banks and NBFCs to report all types of loans irrespective of type or tenor (including BNPL loans) to the credit information companies. It is unclear as to whether such reporting would need to be completed for each transaction (for which payment is made by the customer through BNPL payment options). Such mandatory bureau reporting requirements could also adversely affect the credit scores of customers (as more credit facilities would be reported going forward). Further, extension of new digital lending products by banks and NBFCs over a merchant platform involving short term, unsecured / secured credits or deferred payments needs to be reported to the credit bureaus by the banks and NBFCs.

(iv) *Fund-flows*: The RBI has clarified that all fund-flows relating to loan

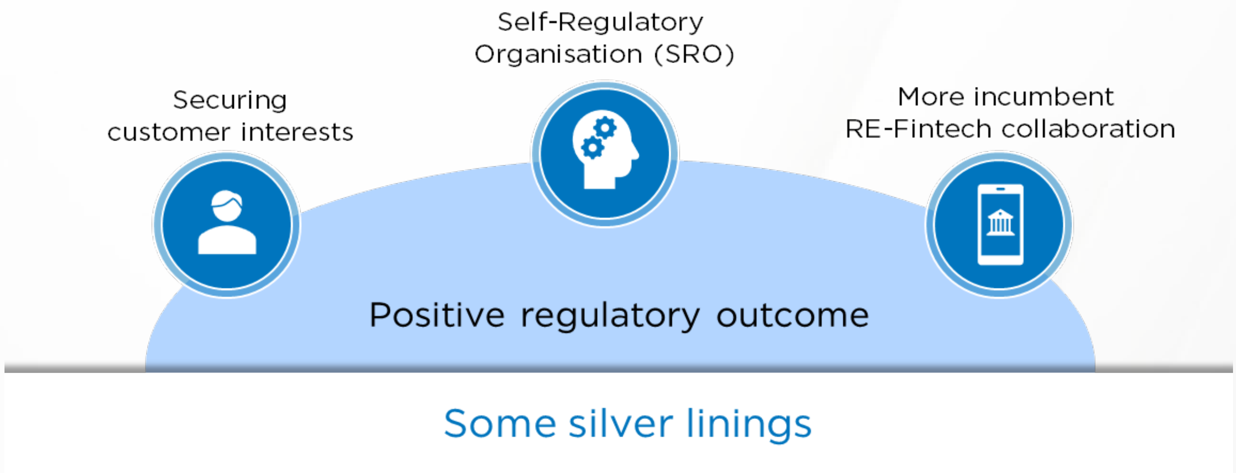


disbursement, repayment and servicing must be directly between the lender to the borrower's bank account without any pass-through / pool account of any third party. The RBI has mentioned that exceptions to this general rule would be considered only in limited circumstances, including for disbursements covered under statutory / regulatory mandate, under co-lending transactions, or where loans are mandated for specified end-use as per the extant guidelines issued by the RBI or any other regulator. This may potentially impact existing operational arrangements between lenders and Fintech companies, including usage of payment aggregators to assist with fund-flow movements, usage of escrow accounts offered by escrow service providers and related virtual accounts, as well as other fund-flow related solutions which are designed to ensure smooth disbursement and repayment processes.

(v) *Customer data*: The RBI has prescribed that any collection of customer data by lending apps must be need-based and with prior and explicit consent (which must be auditable). The RBI has also clarified that lending apps must collect minimal customer data and refrain from accessing cell phone resources of customers (such as contact list, call logs, and other file and media logs). The RBI has however permitted one-time access to the camera, microphone, location, or any other data which is necessary for the purpose of on-boarding and completing KYC of the customers. Customers must also be provided an option to give or deny consent for use of specific data, restrict disclosure to third parties, data retention, revoke any consent provided for data sharing, and if required, make a digital lending application delete or forget data collected by it. Any sharing of data with third parties must be publicly disclosed, along with privacy policies of all the parties involved which must be comprehensive and must clearly set out the purpose for which customer consent has been requested at each stage of interface with the borrowers. Additionally, details of third parties that are allowed to collect personal information through lending apps must be disclosed in the privacy policy.

(vi) *Data localisation*: The RBI has mentioned that banks and NBFCs must ensure that all data is stored only in local servers. Going forward, banks and NBFCs may also be required to ensure that service providers appointed by them comply with these data localisation requirements.

(vii) *Nodal officer*: The RBI has stated that all banks / NBFCs engaged in digital lending, as well as any service providers appointed by them (who



may or may not operate lending apps) must appoint a nodal grievance redressal officer to deal with customer complaints. The contact details of such officer must be displayed on the websites of all the entities involved, and any complaints which remain unresolved beyond 30 days would entitle customers to get relief under the Integrated Ombudsman Scheme introduced by the RBI.

(viii) *Cooling-off / look-up period*: It has been stipulated that all banks and NBFCs must mandatorily offer borrowers a window to back out of the loan arrangement (as determined by its board of directors) without additional penal costs (other than repayment of principal and proportionate costs). The working group report mentions that such period typically varies from 3 to 14 days globally.

(ix) *Charges / fees*: The RBI has indicated that going forward all types of charges / fees payable by the customer must only be to the relevant bank or NBFC which is lending to the borrower. Any outsourced service provider or operator of a lending app cannot charge the customers directly and must only route its revenues from the relevant lenders.

(x) *Obligation to adhere with the guidelines*: The RBI has clarified that the obligation to ensure implementation of the extant guidelines by the service providers / lending app falls on the respective banks / NBFCs. Any kind out outsourcing arrangement involving a bank / NBFC, and a service provider / digital lending application will be subject to the RBI's extant guidelines on outsourcing.

(xi) *Customer protection measures*: The RBI has prescribed that all banks and NBFCs engaging in digital lending must comply with various measures designed to promote customer protection and product transparency. These include requirements to provide a standardised Key Fact Statement to borrowers, disclosing the annual percentage rate, obtaining customer consent for increase in credit limits, disclosure of all service providers of the banks / NBFCs, among others.

03.

PAYMENT SYSTEMS

A. Restrictions on loading credit lines into prepaid payment instruments (PPIs) issued by non-bank entities

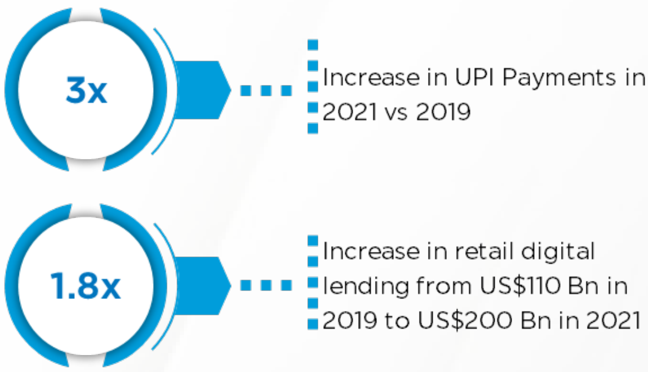
On 20 June 2022, the RBI issued a circular to all non-bank prepaid payment instrument operators (NBPPIs) to cease the loading of their prepaid issued instruments with credit lines, failing which penal action under the Payment and Settlement Systems Act, 2007 would be triggered.

Multiple banks and PPI issuers in the market source customers through co-branding arrangements where cards issued by the licensed entities with branding of the co-branding partners are distributed to the large customer base of the co-branding partner. With the advent of BNPL payments, various Fintech companies had also partnered with banks or NBFCs through co-branding arrangements to allow their users to load wallets with a credit line or use credit through prepaid co-branded cards. These products provide the customers the look and feel of credit cards but were offered as prepaid wallet / card products into which credit facilities sanctioned by the banks or NBFCs were disbursed. Such products blur the difference between a credit card (which is subject to various prescribed regulatory compliances) and credit line-backed PPI products (which is regulated primarily as a prepaid instrument with the credit line being separately offered by the bank or NBFC to the customer).

The RBI has now clarified that the loading of PPIs through credit lines is not permitted and has reiterated that the regulations only permit PPIs to be loaded or reloaded through cash, debit to a bank account, debit or credit-cards, PPIs and other payment instruments issued by regulated entities in India.

It appears that the RBI is wary of PPIs issued with credit lines being akin to credit card products. In terms of the impact of this circular, several Fintech companies have now put a pause on their BNPL payment products facilitated through credit line funded PPIs and have updated their terms and conditions to adhere to the directive. NBFCs operating in the digital lending space are also expected to see an increased scrutiny in their credit lending arrangements with customers.

Considering that the directive was only issued to NBPPIs, several market players have sought clarity from RBI on whether bank operated PPIs can be permitted to be loaded with credit lines. In case the RBI intends to differentiate between banks and non-banks in the issuance of PPIs with credit lines, it would contradict the intention to bring uniformity across all PPI issuers, as advocated by the RBI in the Governor's Statement dated 7 April 2021. Representations have also been made to the RBI on various use-cases for lenders to fund credit into PPI wallets / cards (instead of customers' bank accounts), and the requirement for RBI to treat a full KYC PPI account akin to a bank account.



Source: Past Perfect, Future Tense – Future of Fintech (Boston Consulting Group Report)

B. New regulatory approval / intimation requirements affecting M&A in the regulated payments domain

On 4 July 2022, the RBI issued a notification, *inter alia*, introducing requirements for obtaining prior approval of the RBI in case of: (i) takeover / acquisition of control of non-bank PSOs (with or without change in management); or (ii) sale / transfer of payment system activity of non-bank PSOs to an entity not authorized to undertake such activity.

Under the notification, non-bank PSOs include card payment networks, white label ATMs and PPI issuing companies. The RBI has also set out the procedural details for obtaining this approval, which include:

(i) *Process*: The application for prior approval will have to be shared with the Department of Payment and Settlement Systems, Central Office, RBI along with the prescribed supporting documents / information.

(ii) *Timeline for granting approval:* The RBI shall endeavour to respond within 45 calendar days after receipt of complete details, except in certain identified circumstances.

(iii) *Requirement for public notice:* After obtaining the approval, a public notice of at least 15 calendar days needs to be given before effecting the changes.

(iv) *Post-facto intimation:* In case of: (a) change in management / directors; or (b) sale / transfer of payment activity to an entity authorised for undertaking a similar activity, the non-bank PSO is required to inform the RBI within 15 calendar days in the prescribed format. Further, the RBI will have to be satisfied with the fit and proper test for the new directors / management.

The notification would result in stricter scrutiny by the regulator of M&A activities relating to payment system operators as it deviates from the existing *post-facto* intimation-based approach to a clear prior approval requirement for change in control of PSOs. This will also impact timelines for mergers and acquisitions for non-bank PSOs in both share acquisition models and asset transfer models.

C. Announcement of new regulatory application window for non-bank payment aggregator (PA) licenses

The RBI's Guidelines on Regulation of Payment Aggregators and Payment Gateways, 2020 require that all non-bank entities qualifying as PAs must obtain prior authorisation from the RBI under the Payments and Settlement Systems Act, 2007.

RBI had opened a window for all non-bank PAs existing as on 17 March 2020 to apply for a PA authorisation, which was to close by 30 September 2021. A condition imposed on the applicants was that they would have to have a minimum net worth

of INR 150 million as on 31 March 2021. Razorpay, Mswipe Technologies, Pine Labs and Stripe are the first few market players to have recently received the in-principle approval from the RBI on their payment aggregator licenses. That said, several applications were returned by the RBI as they did not comply with the aforesaid minimum net worth condition, among others and these applicants were directed to discontinue their operations within 6 months from the date of return of their application.

To avoid a disruption in the country's payments ecosystem, through a notification released on 28 July 2022 (Notification), the RBI announced another window for all such PAs (existing as on 17 March 2020) to apply. Such PAs can apply by 30 September 2022 and meet the minimum net worth requirements of INR 150 million by 31 March 2022 and INR 250 million by 31 March 2023. It has also been clarified by the RBI that PAs can continue their operations till the RBI intimates them about their application's outcome.

The Notification provides a much-needed lifeline to several PAs who were facing operational hurdles (preventing them from meeting the capital requirements) largely due to the pandemic.

D. Data storage restrictions on payment service providers and merchants with respect to storage of customer card data

The RBI had issued specific guidelines relating to storage of customer card data and reiterated its stance that only card issuing banks and card networks will be permitted to store Card-on-File (CoF) data. Consequently, all other entities in the transaction chain were required to purge all CoF data at the earliest.

The RBI has now extended the compliance timeline, and non-bank PAs and their merchants storing CoF data are now required to purge all previously stored CoF data by 30 September 2022. On 28 July 2022, the RBI issued a notification announcing certain interim relaxations for ease of transition for guest checkout transactions.

Under the notification, PAs and their merchants can store CoF data for up to 4 days from the date of a transaction for settlement purposes. Additionally, acquiring banks have been permitted to store CoF data until 31 January 2023 to handle other post-transaction activities such as returns and refunds. The RBI has also warned that any non-compliances would entail imposition of business restrictions and other penal actions.

04.

CARDS, DIGITAL BANKING AND OTHERS

A. Announcement of new regulatory framework for credit, debit, and co-branded cards

On 21 April 2022, the RBI issued Master Direction – Credit Card and Debit Card – Issuance and Conduct Directions, 2022 for regulation of business of credit, debit, and co-branded cards along with prudential, payment and technology and cyber security related norms applicable to credit, debit and co-branded cards. The directions consolidate all the guidelines issued by the RBI in connection with issuance of credit, debit, and co-branded cards.

Some of the key features of the directions are set out below:

(i) *Issuance of Credit Cards*: The directions provide for a requirement of INR 1 billion of net-worth for scheduled commercial banks to undertake credit card business by themselves, based on their board approved policy. In case of such business being undertaken by a subsidiary of the bank, a prior approval of the RBI is required.

Unlike scheduled commercial banks, for NBFCs to undertake credit card business, they need to have net owned funds of INR 1 billion and obtain prior approval of the RBI. NBFCs are also restricted from issuing debit cards, credit cards, charge cards, or similar products virtually or physically without the prior approval of the RBI.

In the context of credit cards, the RBI has also imposed certain operational directions relating to consent-based activation of cards, no charges for inactivated cards, breach of credit limits, restrictions on capitalisation of unpaid charges, justifiable interest rates, conveying the most important terms and conditions of the cards to the customers as well as non-reporting of in-activated credit cards to credit bureaus.

(ii) *Issuance of Debit Cards*: Debit cards can only be issued by banks providing savings or current account facilities to its customers and to such customers having savings or current account facilities. Banks are not entitled to issue debit cards to loan account holders, with the exception that banks can provide the debit cards to overdraft facility provided along with Pradhan Mantri Jan Dhan Yojana accounts.

(iii) *Issuance of Co-Branded Credit Cards*: Banks (other than urban cooperative banks) and (authorised) non-bank entities are entitled to issue co-branded credit / debit / prepaid cards without any prior approval of the RBI. The directions prescribe certain specific conditions for co-branding arrangements which include:

(a) the co-branded credit / debit card to explicitly indicate that the card has been issued under a co-branding arrangement;

(b) restriction on the co-branding partner to not advertise / market the co-branded card as its own product. In all marketing / advertising material, the name of the card-issuer shall be clearly shown. The co-branded card to prominently bear the branding of the card-issuer;

(c) the role of the co-branding partner entity to be limited to marketing and distribution of the cards and providing access to the cardholder for the goods / services that are offered, with no access to information relating to transactions undertaken through the co-branded card; and

(d) post issuance of the card, the co-branding partner to not be involved in any of the processes or the controls relating to the co-branded card except for being the initial point of contact in case of grievances.

Co-branded Credit Card Arrangements

- No RBI approval for issuance by banks and authorized non-bank entities
- Consent based activation of credit cards
- Express consent for credit limit enhancement
- Strict regulatory scrutiny for data sharing
- Marketing and advertisement guardrails for co-branded cards

The directions came into effect from 1 July 2022 except regarding the following restrictions for which RBI has provided an extended time until 1 October 2022 for implementation:

(i) credit card issuers to seek OTP based consent from cardholders for activating a credit card if it has not been activated by the customer within 30 days of issuance;

(ii) credit card issuers to ensure that credit limit is not breached at any time without seeking explicit consent from card holders; and

(iii) no capitalisation of unpaid charges / levies / taxes for charging / compounding of interest.

While the directions mainly consolidate the existing guidelines on the governance structure for credit, debit and co-branded card businesses, the two outstanding features of these directions are: (i) bringing in greater customer centric norms that will go a long way in cleaning up the mess of the existing unsolicited and unfair card issuance practices undertaken by banks, and Fintech, and ensuring greater transparency and fairness towards customers; and (ii) encouraging NBFCs to apply for and obtain the requisite license for undertaking direct credit card business since other forms of co-branding arrangements, data sharing from card issuers and look-a-like products are now under greater regulatory scrutiny. Overall, the directions are a welcome step towards a coherent payments and card industry. With respect to co-branding arrangements, the RBI has reiterated its regulatory position on the role of the co-branding partner, and regulated entities entering into such co-branding arrangements must now ensure strict compliance with the restrictions imposed by the RBI on access to transaction data by the co-branding partner.

B. Digital banking units and the future

The RBI on 7 April 2022 allowed India commercial banks to launch digital banking units (DBUs) in a huge boost to the digital ecosystem for pure-play banking and finance sector. Until now, Indian commercial banks were required to be manned by either the bank's staff or its business correspondent for services including acceptance of deposits, encashment of cheques / cash withdrawal or lending of money in certain circumstances.

The circular now provides banks with the flexibility to set up self-service / assisted units, and inter-alia regulates: (i) facilities which DBUs may offer and monitoring of its functions; (ii) cyber security measures which DBUs must adopt; (iii) permission for outsourcing of operations of DBUs in compliance with the provisions; and (iv) infrastructure that the DBU must have for providing digital banking services such as interactive teller machines, interactive bankers, among others; and grievance redressal and customer education.

This is in consonance with the government's vision to provide residents of rural areas with the same access to e-services, communication facilities, and digital resources as urban areas and their residents. Overall, the circular seems to be a step in the positive direction towards financial inclusivity and literacy. However, the rationale behind the exclusion of regional rural banks, local area banks and payments banks from setting up of digital banking units is unclear given their mandate for servicing rural areas and ensuring financial inclusion. Instead, the RBI could have considered prescribing baseline criteria for setting up of DBUs for these entities. Separately, banks will have to incur a significant cost for setting up of DBUs to provide a 'truly digital experience', in consonance with the circular. This may be an added deterrent for implementing these guidelines.

C. Regulatory stipulations for appointment of recovery agents

On 12 August 2022, the RBI had released a circular reiterating its firm stance on its rules on outsourcing financial services and the behaviour and conduct of recovery agents engaged by regulated entities.

As per the circular, recovery agents cannot resort to physical or verbal intimidation or harassment, specifically:

(i) acts to publicly humiliate debtors;

(ii) intrude upon the privacy of debtors' family members, referees and friends;

(iii) send inappropriate messages through mobile or social media;

(iv) make anonymous, threatening, or persistent calls;

(v) call the debtors between 7:00 pm and 8:00 am; and

(vi) make false and misleading representations.

The circular is applicable to all NBFCs, commercial banks (other than Payments Banks), Asset Reconstruction Companies, All-India Financial Institutions, and Co-operative Banks. It however does not apply to microfinance loans covered under Master Direction – Reserve Bank of India (Regulatory Framework for Microfinance Loans) Directions, 2022.

05.

ONLINE BOND TRADING PLATFORMS

Proposed regulatory framework by the SEBI for India's digital bond platforms

Issuance of listed debt securities in India is currently by way of: (i) public issuance through the stock exchanges and depositories; and (ii) private placements to an identified set of mostly institutional investors. Over the last 3 financial years, SEBI has observed that the volume of private placements has far exceeded that of public issuances. It has also noted that, within private placements, the investor class has largely been restricted to institutional investors. This has resulted in an increase in the number of online bond platforms which facilitate investments in both listed and unlisted debt securities by non-institutional investors. So far these bond platforms were not under any regulatory purview.

On 21 July 2022, SEBI released a consultation paper on 'Online Bond Trading Platforms - Proposed Regulatory Framework' (Consultation Paper), making the case for the regulation of online bond trading platforms. In its assessment, SEBI has also evaluated the market share of the current players in online bond trading, some of which operate in a manner akin to organized avenues for trading, bringing together buyers and sellers to trade in debt securities.

SEBI's Rationale for Regulating Online Bond Platforms: SEBI is looking to bring online bond platforms within the regulatory fold to address issues arising out of: (i) lack of regulatory oversight and accountability for the bond platform; (ii)absence of standards for know your client Know Your Customer (KYC) norms; (iii)ambiguity in redressing investor grievances; (iv) conflict of interest, and possible mis-selling; (v) concerns regarding deemed public issuances; and (vi) reporting of trades.

An overview of the proposed regulatory framework is set out below:

(i) *SEBI stock-broker registration*: Online bond platforms play the role of facilitators, where they facilitate transactions by the registered investors on their platforms. SEBI has proposed that all online bond platforms must mandatorily register themselves as stockbrokers (in the debt segment) with SEBI or be run by SEBI registered brokers.

(ii) *Eligible securities*: To mitigate a risk of a deemed public issue, where debt securities issued on private placement basis are down sold by the bond platforms to a large number of investors (i.e., more than 200 persons), SEBI has proposed that online bond platforms must offer only listed debt securities for purchase / sale to their registered investors.

(iii) *Lock-in period*: A lock-in period of 6 months from the allotment date of the debt securities is proposed.

(iv) *Channelizing transactions through specified platforms*: SEBI has proposed that the transactions executed on the online bond platforms can either be routed through the trading platform of the debt segment of the exchanges, or through the Request for Quote Platform (RFQ) of the stock exchanges. It has also been clarified that the bond platforms can continue to maintain their front-end or their present web interface (displaying the available list of debt securities, ratings, associated risks, etc).

This framework will lead to a regulated and bolstered secondary market for debt securities. Excluding unlisted debt securities from the purview of online bond trading platforms would restrict investor choice. The lock-in period would also affect market participants' liquidity. It is imperative that SEBI strikes a fine balance between innovation in the country's corporate bond market and investor protection.

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