PANORAMIC

FINANCIAL SERVICES M&A

India

Financial Services M&A

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MARKET AND POLICY CLIMATE

Market climate
How would you describe the current market climate for M&A activity in the financial services sector in your jurisdiction?

There continues to be tremendous M&A activity currently in the financial services sector in India. There were more than 15 large M&A deals announced in the financial services sector by the end of the third quarter of financial year 2023, worth a total value of more than US$2.6 billion. The M&A activity increased throughout the year, and by the third quarter of 2023, M&A activity had increased by 44 per cent as compared to the previous quarter.

Combined factors, including improved synergies, the need for size and scale, geographical diversification, proven track record of robust financial returns and promotion of financial inclusion, have contributed towards keeping the sector and market incredibly lively and active in 2023, witnessing some of the largest M&A deals of India emanating from this sector.

The banking sector accounted for some of the remarkable M&A deals in 2023, including the merger of IDFC and IDFC First Bank, the merger of AU Small Finance Bank and Fincare Small Finance Bank and Kotak Mahindra Bank's acquisition of Sonata Finance Private Limited.

The fintech landscape witnessed significant activity despite the slow funding of fintech startups compared with previous financial years. According to the annual report published by the Reserve Bank of India (RBI), total digital payments recorded growth of 57.8 per cent and 19.2 per cent in volume and value terms, respectively. Further, India outpaced other nations to emerge as the largest player in real-time transactions at the global level, with a 46 per cent share in 2023.

Non-banking financial and microfinance industries also witnessed significant strategic investment deals, such as Svatantra Microfin's acquisition of Chaitanya India Fin Credit, TPG's acquisition of Poonawalla Housing Finance Limited, Kedaara Capital's significant minority investment in Avanse Financial Services Limited and the merger of L&T Finance, L&T Infra Credit and L&T Mutual Fund Trustee with L&T Finance Holding.

Significant deals in the insurance sector included Bharti group's acquisition of AXA's entire stake in Bharti AXA General Insurance, Zurich Re's acquisition of a 51 per cent stake in Kotak General Insurance, Bandhan Financial Holdings' acquisition of the entire stake of Aegon and Benette Coleman in Aegon Life Insurance Company, and True North's partial exit from Niva Bupa Health Insurance and the resultant transfer of control to Bupa along with minority primary investment by marquee investors such as Temasek, Paragon, Motilal Oswal and SBI Life Insurance in Niva Bupa Health Insurance.

Law stated - 1 January 2024

Government policy
How would you describe the general government policy towards regulating M&A activity in the financial services sector? How has this policy been implemented in practice?

Government policy regulating M&A activity in the financial services sector has liberalised cautiously but progressively, to make the sector more attractive for investors and to enable ease of doing business.

The current policies and legal framework provide for regulatory supervision in case of change of control of entities and other M&A activities. Further, restrictions in case of foreign investment have been significantly reduced by either increasing the percentage threshold above which foreign investment in a particular financial sector (such as insurance) requires government approval or removing the requirement of government approval altogether. Various financial services regulators are also opening up to financial sponsor investments in their respective sectors, realising that there is immense interest from global as well as Indian financial sponsors in this sector. More specifically, in 2023, addressing a long-pending request of the private equity and venture capital industry, the Securities Exchange Board of India (SEBI) introduced regulations to permit financial sponsors to become sponsors of asset management companies (AMCs) and prescribed specific eligibility norms in this regard. SEBI has also enhanced the role of trustees of mutual funds to safeguard unit holders' interest. Further, in keeping with its vision statement released at the end of 2022 (for, inter alia, encouraging the setting up of greenfield insurance companies in India), the insurance regulator has since November 2022, granted one general insurance licence and two life insurance licences. This is the first general insurer registration since 2017 and the first life insurer registration since 2011. The regulator is considering nearly 20 other applications – which are at various stages of registration – in the life, general and reinsurance sectors.

The implementation of liberalised policies and regulations has led to increased M&A activity in the financial sector and has specifically helped in improving the financial health of the sector, upgrading the technology and ensuring better efficiency of scale.

Law stated - 1 January 2024

LEGAL AND REGULATORY FRAMEWORK

Legislation

What primary laws govern financial services M&A transactions in your jurisdiction?

M&A transactions in the financial sector are governed by certain regulators (the Reserve Bank of India (RBI), the Securities Exchange Board of India (SEBI) and the Insurance Regulatory Department of India (IRDAI)), and the primary laws include the following:

- the Banking Regulation Act 1949, and the rules and regulations framed thereunder;
- the Reserve Bank of India Act 1934, and the rules and regulations framed thereunder, including:
    - Master Direction – Reserve Bank of India (Non-Banking Financial Company – Scale Based Regulation) Directions, 2023;
    - Master Direction – Non-Banking Financial Company – Housing Finance Company (Reserve Bank) Directions 2021;
    - Master Direction – Reserve Bank of India (Regulatory Framework for Microfinance Loans) Directions, 2022;

  - Master Direction on Information Technology Governance, Risk, Controls and Assurance Practices (7 November 2023);
  - Master Direction - Core Investment Companies (Reserve Bank) Directions, 2016 (applicable only to core investment companies);
  - The Asset Reconstruction Companies (Reserve Bank) Guidelines and Directions, 2003 read with Master Circular – Asset Reconstruction Companies (applicable only to asset reconstruction companies);
  - Master Circular – Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances; and
  - Guidelines on Default Loss Guarantee (DLG) in Digital Lending;
- Securities and Exchange Board of India Act 1992, and the rules and regulations formed thereunder, including:
  - Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations 2011;
  - SEBI (Listing Obligations and Disclosure Requirements) Regulations 2015;
  - Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018; and
  - Other sector specific regulations such as Securities and Exchange Board of India (Mutual Funds) Regulations 1996;
- Insurance Act 1938, and the rules and regulations framed thereunder, including:
  - Indian Insurance Companies (Foreign Investment) Rules 2015;
  - Insurance Regulatory and Development Authority of India (Registration of Indian Insurance Companies) Regulations 2022;
  - IRDAI's Master Circular on Registration of Indian Insurance Company, 2023; and
  - Insurance Regulatory Development Authority of India (Other Forms of Capital) Regulations 2022;
- Foreign Exchange Management Act 1999, and rules and regulations framed thereunder, including:
  - Foreign Exchange Management (Non-debt Instruments) Rules 2019; and
  - Foreign Exchange Management (Debt Instruments) Regulations 2019;
- The Companies Act 2013; and
- The Competition Act 2002.

Law stated - 1 January 2024

Regulatory consents and filings

What regulatory consents, notifications and filings are required for a financial services M&A transaction? Should the parties anticipate any typical financial, social or other concessions?

The financial services sector in India is highly regulated with multiple regulatory authorities supervising different types of financial services businesses. For example, banking and non-banking credit institutions are regulated by the RBI, asset management companies, stockbrokers, merchant bankers etc are regulated by SEBI, and insurance businesses are regulated by the IRDAI. Specific regulatory approval is typically required for all M&A transactions that exceed the thresholds prescribed by the applicable regulatory authority and for taking up the role of 'sponsor' or 'promoter'. For example, in the banking sector, the acquisition of more than 5 per cent of paid-up share capital or voting rights requires prior approval from the RBI; in the non-banking financial sector, acquisition or transfer of 26 per cent or more of shareholding requires prior approval from the RBI; and acquisition of shares carrying more than 10 per cent voting rights and change of sponsor (anyone holding 40 per cent or more) in an AMC requires prior approval from SEBI. Additional thresholds pertaining to specific changes in the control of the respective entity may also require approval even if the share capital or voting rights thresholds are not met.

The transfer of an insurance business to another insurer or the amalgamation of two insurance businesses requires that the scheme of such transfer or amalgamation be approved by the IRDAI. Further, the transfer of shares of more than 5 per cent of the paid-up capital of a listed insurance company or 1 per cent in unlisted insurance companies requires prior approval from the IRDAI.

A merger of two regulated entities will require regulatory as well as third-party consents (based on existing contractual arrangements). Such merger will require approval from the relevant sector regulators, such as RBI or SEBI (as the case may be), the registrar of companies and the competition commission of India (if applicable) and third-party consents from its shareholders and creditors. Additional approvals will be required from SEBI, and SEBI-prescribed processes will need to be adhered to if any one of the entities involved is a listed entity.

There are no specific concessions available for a financial services M&A transaction.

Law stated - 1 January 2024

Ownership restrictions

Are there any restrictions on the types of entities and individuals that can wholly or partly own financial institutions in your jurisdiction?

Entities and individuals holding shares in financial institutions are generally required by the relevant regulator to satisfy a 'fit and proper'criterion, ensuring, inter alia, that they have suitable qualifications, experience and a good track record in the relevant business and excluding persons subject to previous criminal convictions.

Any potential acquirer of shares in a non-banking credit institution is required to provide information regarding satisfaction of such criteria as part of prior approval for such acquisition. Further, specific regulators impose additional requirements; for example, SEBI requires a person desirous of owning more than 40 per cent of an asset management

company to demonstrate a five-year track record of profitability to become eligible to own such a stake. Financial services regulators also typically seek information about the ultimate beneficial owners of the acquiring entity and the source of funds to draw comfort on the background and financial capability of the acquirer.

Most of the financial services regulators do not permit investors from or through non-compliant Financial Action Task Force (FATF) jurisdictions to have direct or indirect 'significant influence' on the investee entities. Significant influence in the context of non-banking financial companies is defined to mean acquisition of 20 per cent or more voting power.

Separately, prior approval of the Central Government of India is required for any investment from any person who is itself or whose beneficial owner is a resident or citizen of or incorporated in any country that shares a land border with India, such as China, Pakistan, Bangladesh, Nepal, Myanmar, Bhutan and Afghanistan. This requirement is sector-agnostic and not specific only to the financial services sector in India.

Law stated - 1 January 2024

Directors and officers – restrictions

Are there any restrictions on who can be a director or officer of a financial institution in your jurisdiction?

Under the Companies Act 2013, the following persons are not eligible for appointment as a director of a company:

- a person declared by a competent court to be of an unsound mind;
- an undischarged insolvent;
- person who has applied to be adjudicated as an insolvent and his or her application is pending;
- person who has been convicted of an offence and sentenced to imprisonment for either a period of more than seven years or a period of more than five years in the previous five-year period;
- an order disqualifying him or her for appointment as a director has been passed by a court or tribunal and the order is in force;
- a person who has due and unpaid amounts against calls in respect of any shares held by him or her for more than six months; and
- a person who has been convicted of an offence dealing with related party transactions during the preceding five years.

Additionally, certain companies (ie, listed companies and certain public unlisted companies) and financial institutions are mandated under law to appoint a certain number of independent directors, for whom the eligibility criteria include, inter alia, the following:

- the person is, in the opinion of the board, a person of integrity and possesses relevant expertise and experience;
-

the person is not or was not a promoter of the company or its holding, subsidiary or associate company and is not related to promoters or directors in the company, its holding, subsidiary or associate company; and

- the person has or has had no pecuniary relationship, other than remuneration and specifically permitted transactions up to the prescribed thresholds.

Further, individuals acting as directors (including independent directors) in financial institutions are required by the relevant regulator to satisfy a 'fit and proper' criterionto ensure that they have suitable qualifications, experience and a good track record in the relevant business and excluding persons subject to previous criminal convictions. This criterion is not a one-time criterion and must be fulfilled by the director throughout the term when he or she acts as the director.

Law stated - 1 January 2024

Directors and officers – liabilities and legal duties

What are the primary liabilities, legal duties and responsibilities of directors and officers in the context of financial services M&A transactions?

Under the Companies Act 2013, a director has a fiduciary duty towards the company and its members. The director's duties and responsibilities include the following:

- to act in accordance with the articles of association of the company;
- to promote the objects of the company for the benefits of its members and in the best interests of the company and its employees;
- to exercise due and reasonable care, skill, diligence and independent judgment in the exercise of his or her duties; and
- to avoid any conflict of interest.

Further, the Companies Act 2013 broadly classifies the following as 'officers who are in default': a whole time director, managing director, any other key managerial personnel or any person who, under the immediate authority of the board or any key managerial personnel, is charged with any responsibility including maintenance, filing or distribution of accounts or records, authorises, actively participates in, knowingly permits, or knowingly fails to take active steps to prevent, any default. A director may be held liable for the acts or omissions of a company which had occurred with his or her knowledge, was attributable through board processes, and occurred with his or her consent or connivance or where he or she had not otherwise acted diligently.

Law stated - 1 January 2024

Foreign investment

What foreign investment restrictions and other domestic regulatory issues arise for acquirers based outside your jurisdiction?

Foreign investment restrictions are different for banks and for other financial service sector entities. Foreign investment in private banks is capped at 74 per cent, with investment above 49 per cent requiring government approval. Further, at least 26 per cent of the paid-up capital must be held by residents, except in regard to a wholly owned subsidiary of a foreign bank, at all times. All foreign investment in public banks requires government approval and is capped at 20 per cent. Foreign investment in insurance companies is capped at 74 per cent.

Further, there may be specific requirements prescribed by the government for foreign investment depending on the sub-sector under the financial services sector. For example, in an Indian insurance company having foreign investment, a majority of its directors, a majority of its key management persons and at least one among the chairperson of its board, its managing director and its chief executive officer, must be a resident Indian citizen.

There is no additional restriction on foreign investment in other financial services that are under the purview of any specific financial services regulator in India (such as the RBI, SEBI or IRDAI), and the regulations applicable to domestic investment (regulatory approval, fit and proper criteria, etc) continue to apply. For financial services activities that are not regulated by any financial sector regulator or where only part of the financial services activity is regulated or where there is doubt regarding the regulatory oversight, foreign investment up to 100 per cent is allowed under the government approval route, subject to conditions including a minimum capitalisation requirement.

Further, investors from or through non-compliant FATF jurisdictions are not permitted to have direct or indirect 'significant influence' on the investee entities. Significant influence in the context of non-banking financial companies is defined to mean 20 per cent or more voting power.

Separately, prior approval of the Central Government of India is required for an investment from any person who is itself or whose beneficial owner is a resident or citizen of or incorporated in any country that shares a land border with India, such as China, Pakistan, Bangladesh, Nepal, Myanmar, Bhutan and Afghanistan.

Law stated - 1 January 2024

Competition law and merger control
What competition law and merger control issues arise in financial services M&A transactions in your jurisdiction?

The merger control laws under the Competition Act 2002 will be applicable to an M&A transaction in the financial services sector only if the assets or turnover of the transacting parties exceed the jurisdiction threshold and the transaction is not eligible for any exemption under the Competition Act 2002 read with regulations and notifications thereunder.

The Competition Act 2002 contains certain exemption provisions specifically designed to exclude share subscriptions, financing facilities and acquisitions by a public financial institution, foreign institutional investor, bank or venture capital fund, further to a covenant or loan agreement or investment agreement, from the ambit of the suspensory pre-closing provisions of the Competition Act 2002. Such transactions are still required to be notified on a post-closing basis to the Competition Commission of India (CCI).

At the same time, in exercise of its powers under the Banking Companies (Acquisition and Transfer of Undertakings) Act 1970, the Central Government of India, through the Ministry of Corporate Affairs, has passed a notification exempting all M&A transactions involving nationalised banks from the scope of the merger control provisions of the Competition Act for a period of 10 years from 2017 to 2027.

According to the Competition Law (Amendment) Act, 2023, it has been made mandatory for the parties who are involved in the merger to notify the CCI about the transaction if the value of any transaction in connection with the acquisition of any control, shares, voting rights or assets of an enterprise, merger or amalgamation exceeds 200 billion rupees (2,000 crore) and the target enterprise has 'substantial business operations in India' (Deal Value Threshold Test). The Deal Value Threshold Test has not been enforced yet. It will be independent of the assets or turnover-based test to assess the requirement of seeking approval from the CCI.

Considering the stringently regulated nature of the financial services markets in India and the presence of numerous players and stakeholders across the value chain, no significant competition issues have been witnessed in this sector.

Law stated - 1 January 2024

DEAL STRUCTURES AND STRATEGIC CONSIDERATIONS

Common structures

What structures are commonly used for financial services M&A transactions in your jurisdiction?

The regulatory framework has a significant influence on the structuring of M&A transactions in the financial services sector. Any change of control requires prior approval of the regulators for most financial services activities. Share acquisitions are also subject to cross-holding restrictions whereby significant shareholders in one type of financial services entity are restricted from holding significant shareholding in another type of financial services entity. For example, no sponsor of a mutual fund (an entity holding 40 per cent or more of an asset management company (AMC)) or its associate or group company including the AMC itself can hold more than 10 per cent of any other AMC or trustee company of any other mutual fund or have representation on the board of another AMC, and such restriction also extends to the shareholder of the AMC or trustee company of a mutual fund holding 10 per cent or more of its shareholding or voting power.

Other structures, such as mergers, business transfers or asset transfers, are also commonly employed for financial services M&A transactions (except for the insurance sector). However, such structures also trigger certain other considerations. For example, merger is a time-consuming process, asset transfers can be tax-inefficient and business transfers may be subject to restrictions like minimum retention requirements if such business transfer does not amount to full exit from the line of business.

Further, as per the restrictions imposed by the Insurance Regulatory Department of India, business transfer is not permitted in the insurance sector. Accordingly, different types of structures are used in financial services M&A transactions in India depending upon the commercial and other considerations of the entities involved. There is no 'one size fits all' kind of structure given that the financial services sector is heavily regulated.

Law stated - 1 January 2024

Time frame

What is the typical time frame for financial services M&A transactions? What factors tend to affect the timing?

Financial services M&A transactions typically require 4–6 months for completion, but may extend beyond that in certain complex cases and depending upon the sector or sub-sector.

The time taken by regulators in granting permissions and approvals is one of the key factors in determining the timelines for completion. Other factors include completing the due diligence processes, drafting and negotiating transaction documents, obtaining approvals from third parties (if applicable) and finalising the commercials of the transaction.

Law stated - 1 January 2024

Tax

What tax issues arise in financial services M&A transactions in your jurisdiction? To what extent do these typically drive structuring considerations?

The key tax considerations typical of any M&A transaction in India are the withholding tax obligation of the buyer, compliance with tax valuation norms, title protection measures and the structuring of earn-out and employment-linked payments.

In terms of valuation requirements, Indian tax law prescribes strict pricing norms where the sale or acquisition of any shares or securities at a discount to fair market value is taxable in the hands of the transferor and investor respectively; and issuance of shares by closely held companies to Indian residents at a premium in excess of fair market value is taxable in the hands of the issuing company – fair market value for each of these provisions is to be determined as per prescribed rules. Thus, to avoid tax on a deeming basis, the pricing of any M&A transaction should be within the contours of the prescribed 'fair market value' rules, and hence this issue often drives structuring discussions, especially in cases where the transaction is taking place at a differential price vis-à-vis different investments or different investors.

Additionally, it should be noted that in case of closely held companies, unabsorbed tax losses would not be available for carry forward or set-off if there is a change in shareholding exceeding 51 per cent, although relief is provided in certain specified cases, including where the transaction is undertaken in the form of an amalgamation of certain specified banking companies with a specified bank and in case of notified start-ups. This aspect generally forms part of diligence and commercial discussions, wherein a valuation adjustment is often sought by the buyer to address the issue.

Another relevant issue is the taxability of earn-outs and deferred consideration and employment-linked pay-outs. Under Indian tax law, the 'tax trigger' arises on transfer of the relevant assets, and hence in case of deferred payments (say, linked to the EBITDA of the target company etc) there is lack of clarity regarding the timing of taxability of such

amounts (ie, whether upfront or at the time of receipt of such deferred payment). As far as employment-linked payments are concerned, such payments are taxable at a higher rate (as compared to capital gains). Further, in case of employee stock ownership plans or other shares receivable based on a vesting schedule, tax trigger arises at the time of exercise itself and is not deferred up to eventual transfer of shares, except for certain specified start-ups wherein such taxability is deferred up to the date of transfer of shares. Thus, structuring such transactions to avoid any tax leakage is becoming more and more critical given the significant investment activity in the fintech and start-up space and often drives the discussions between investors and founders or promoters.

From a practical standpoint, investors generally seek indemnity protection from the sellers or target to ensure that such seller or company tax issues do not flow to the investor in any form. Additionally, tax insurance and warranty & indemnity products have been gaining popularity in recent times, especially in the context of tax treaty relief positions taken by the seller and in the context of business tax warranties provided by the target.

In terms of structuring of the investments, the mode of investment (ie, whether in the form of debt or equity instrument) requires careful planning based on the jurisdiction of presence of the investor and any potential relief that may be claimed by the investor on dividend or interest income and exit gains as per the terms of the relevant tax treaty between India and the jurisdiction of residence of the investor (tax treaty benefits being subject to conditions and requiring a detailed analysis).

Another important aspect of discussion in a typical M&A deal is title-related risk. Under Indian tax law, any transaction involving transfer of specified assets (shares, securities, land, plant, etc) requires the seller to obtain a prior no objection certificate (NOC) from the Indian tax authorities where such seller has any pending tax proceeding or outstanding tax demand, failing which the Indian tax department has the power to treat the transaction as void and recover the tax demand against such assets transferred. In practice, obtaining an NOC is cumbersome and time-consuming, and thus the parties generally agree to a certificate from a chartered accountant certifying that the seller does not have any pending tax dues or proceedings, along with an indemnity.

Law stated - 1 January 2024

ESG and public relations

How do the parties address the wider public relations issues in financial services M&A transactions ? Is environmental, social and governance (ESG) a significant factor?

India is on the cusp of witnessing a paradigm shift in its approach to ESG issues. This shift may be attributed to several factors, including greater legislative supervision, India's commitment to the United Nations Sustainable Development Goals SDGs and heightened awareness among stakeholders. The existing sustainability reporting framework (ie, Business Responsibility and Sustainability Reporting (BRSR)) was introduced by the Securities and Exchange Board of India (SEBI) with effect from 1 April 2022. The BRSR makes it mandatory for the top 1,000 public listed companies (by market capitalisation) to make non-financial reporting against certain mandatory (essential) and leadership (non-essential) indicators based on several international sustainability frameworks. In July

2023, the SEBI introduced nine incremental essential (mandatory) ESG key performance indicators (BRSR Core) along with mandatory assurance requirements. Additionally, on 28 June 2023, the Carbon Credit Trading Scheme was notified – reinforcing India's renewable energy commitments and alignment with the European Union's Carbon Border Adjustment Mechanism.

With this backdrop, public relation issues in financial services M&A transactions are gaining prominence in India. Investee companies are being examined from an 'ESG lens' by the inclusion of ESG-specific due diligence prior to any investment. Asset allocation and ESG linked liability from underlying assets are being closely examined and suitably addressed through deal commercials. Greater emphasis is also being placed on setting internal controls, checks and balances towards maintaining data privacy in line with global standards, adopting best in class governance standards and voting polices, and anti-bribery, corruption and ethics monitoring for internal and external stakeholders. Stakeholder compliance of ESG norms has also gained prominence, with institutional investors being required to adhere to stewardship principles vis-à-vis their investee companies.

Law stated - 1 January 2024

Political and policy risks

How do the parties address political and policy risks in financial services M&A transactions?

Changes in law or policy that have an impact on a transaction are generally addressed by including such significant amendments in law as part of the 'material adverse change' in the transaction documents. In case of any such material adverse change, the buyer is not obligated to close the transaction. Additionally, changes in law having retrospective effect can also be included as a trigger event for indemnification.

Law stated - 1 January 2024

Shareholder activism

How prevalent is shareholder activism in financial services M&A transactions in your jurisdiction?

Shareholder activism is gaining significance in the Indian context and has gained more relevance over the past 8–10 years in transactions involving listed companies. As several financial services entities are listed, shareholder activism is prevalent in such companies. Recent trends indicate that shareholder activism is more prevalent by institutional investors and has been fuelled by shareholders voting in relation to the appointment and compensation of executives. However, due to the increasing sophistication of investors coupled the with implementation of digital voting and increased disclosure requirements, further developments of shareholder activism are expected.

Law stated - 1 January 2024

Third-party consents and notifications
What third-party consents and notifications are required for a financial services M&A transaction in your jurisdiction?

Third-party consents and notifications required for a financial services M&A transaction include approvals from the regulators, banks and financial institutions who have provided financing to the target companies, debenture-holders, creditors, trustee companies and other third-party vendors (if so required under the contractual terms). In addition to this, as per the data privacy regime in India, consent is also required for sharing any personal information or sensitive personal information of any person (including the customers).

Further, specific consent or notification may be required depending on the type of financial services involved; for example, an asset management company undergoing any change in control is required to inform the mutual fund unit holders of such change and give them an option to exit their investments, and include an advertisement in both a nationally circulated English newspaper, and in a newspaper published in the vernacular of the head office location.

Depending on the structure for the M&A transaction, additional consents may be required – for example, a merger will require consent from the National Company Law Tribunal, and an asset transfer or business transfer will require third-party approval for such asset transfer or business transfer.

Law stated - 1 January 2024

DUE DILIGENCE

Legal due diligence
What legal due diligence is required for financial services M&A transactions? What specialists are typically involved?

For financial services M&A transactions, regulatory and compliance diligence (compliance with regulatory conditions and requirements as well as separately data privacy and protection aspects) and secretarial diligence are significant. Most financial services entities (including banks, non-banking credit institutions, insurance companies and asset management companies) are required to make periodic disclosures and regulatory filings, and delays or failures in each case are subject to penalties ranging from fines to cancellation of licences or permission to operate.

Further, the respective regulators usually conduct periodic inspections and audits to identify non-compliance (including operational). As part of the legal due diligence, such reports are reviewed along with the company's response to the issues raised in the reports and the corresponding corrective actions that the company has undertaken. Other than the aforesaid, legal due diligence also covers other aspects, including review of material contracts, employment-related compliances, ongoing litigations, borrowings, insurance, intellectual property, information technology, data privacy and real estate aspects.

Law stated - 1 January 2024

Other due diligence
What other material due diligence is required or advised for financial services M&A transactions?

Financial services entities are generally required to comply with certain prudential norms, such as the requirement of minimum net owned funds, minimum capital ratio and leverage ratio. Hence, specific diligence to verify compliance with such norms is important in addition to the typical financial and tax diligences. Other than these, insurance M&A also warrants an actuarial due diligence to ascertain the financial aspects of the business, including solvency margins.

Law stated - 1 January 2024

Emerging technologies
Are there specific emerging technologies or practices that require additional diligence?

Financial services entities collect and store financial information of individuals, which is classified as sensitive personal data or information (SPDI). As per the legal requirement, entities collecting or handling SPDI need to communicate their privacy policy to the data subjects detailing, inter alia, the nature of the information collected and the purposes of use. In addition, the Indian government has enabled customer identification using Aadhaar, which is a 12-digit biometric based identification number that can be used to comply with the strict 'Know Your Customer' requirements.

Collection of SPDI or use of Aadhar-based identity authentication is subject to various legal and technical requirements. For example, all entities collecting or using Aadhaar must obtain a licence and comply with prescribed information security requirements. Additional diligence is required to review compliances with such emerging technologies and practices undertaken by the financial services entities.

In recent years, we have witnessed increased funding activities in tech-enabled financial services in India, including fintech and insurtech. In such transactions, additional diligence is required with respect to technological, digital and cyber security aspects.

Law stated - 1 January 2024

PRICING AND FINANCING

Pricing
How are targets priced in financial services M&A transactions? What factors typically affect valuation?

Target prices are determined on the basis of the competitive strengths of the target business in its domain. In the insurance space, distribution channels have heavily influenced valuation, with franchises having access to bancassurance networks with good penetration or scalable insurtech distribution models commanding a significant premium. In the lending and consumer banking space, the availability of affluent customers with good credit scores have influenced valuation. In the asset management space, assets under management

have influenced valuation. In fintech, practical use cases and active users have influenced valuation.

Law stated - 1 January 2024

Purchase price adjustments
What purchase price adjustments are typical in financial services M&A transactions?

Post-closing adjustments and earn-outs have become common in financial services M&A transactions. In addition, in certain financial services practices, such as in the case of an asset management company, the purchase price is typically linked to the quantum of assets under management (AUM), and in case of a significant change between the execution date and completion date, buyers would build in a downward purchase price adjustment if the AUM reduces beyond a specific threshold; and any change of control requires giving an option to the unit-holders of the mutual funds administered by such asset management company to exit at the prevailing net asset value without any exit load. In such cases, the pricing of the transactions is typically subject to an adjustment mechanism to accommodate for the cost burden of providing such exit to the unitholders.

Law stated - 1 January 2024

Financing
How are acquisitions typically financed? Are there any notable regulatory issues affecting the choice of financing arrangements?

Acquisitions in the financial services sector are generally funded by internal accruals and reserves. These entities tend to be cash-rich and are averse to raising debt for acquisition transactions. Separately, debt financing may also affect the respective entities' ability to meet legally prescribed financial and prudential norms.

If the acquiring entity does not want to use the internal reserves, it may raise equity funding. Such an infusion may be through raising capital either from its holding companies or family offices or from third-party investors. Regulatory restrictions such as approval for a change in management, change in control or change of shareholding, beyond prescribed thresholds, should be considered for the raising of funds. These factors will be crucial to account for the timing of the acquisition and the raising of funds prior to the acquisition.

In addition, there are certain restrictions from a regulatory perspective; for example, while non-bank financial companies are permitted to avail themselves of loans under the external commercial borrowing route, the minimum average maturity period of such borrowing is required to be seven to 10 years, depending on the end use of such borrowing.

Law stated - 1 January 2024

DEAL TERMS

Representations and warranties

What representations and warranties are typically made by the target in financial services M&A transactions? Are any areas usually covered in greater detail than in general M&A transactions?

In financial services M&A transactions, all the representations and warranties typically made in general M&A transactions are made, including authority, capacity and power to enter into the transaction and representations and warranties in relation to the financials, operations, material contracts, employment related compliances, ongoing litigations, borrowings, insurances, real estate and intellectual property rights.

Furthermore, certain additional areas are covered in greater detail in the case of financial services entities; for example, warranties in relation to all the licences required for the business of the company, compliance with such licences and their terms and conditions and other regulatory aspects, compliance with prudential norms, Know Your Customer requirements, ability to enforce remedies against the borrowers, absence of non-performing assets (other than as set out in the accounts of the company) and the specific financial position of the company.

Law stated - 1 January 2024

Indemnities

What indemnities are typical for financial services M&A transactions? What are typical terms for indemnities?

Sellers in M&A transactions typically provide indemnities against breach of representations and warranties, breach of material covenants of the transaction documents and fraud, in addition to any specific indemnification matters that may be identified based on the due diligence exercise.

The seller's liability for indemnification is normally capped at the amount invested by the buyer. Indemnification claims for business warranties usually survive for 18 months to three years, tax liabilities or breach of tax-related warranties usually survive for seven or eight years, and the survival period for specific indemnification matters may vary depending on the nature of the matter.

A common requirement for an indemnification claim is a de minimis and basket threshold, wherein a buyer cannot claim indemnification unless the damages sustained by the buyer exceed a certain monetary threshold. Typically, the de minimis is 0.1 per cent of the purchase consideration and the basket is 1 per cent of the purchase consideration.

Representation and warranties indemnity insurance is also increasingly being used in financial services M&A transactions.

The typical terms for indemnities in financial services M&A are more or less the same as for M&A in other sectors.

Law stated - 1 January 2024

Closing conditions
What closing conditions are common in financial services M&A transactions?

Some of the common closing conditions in financial services M&A transactions include the following:

- approvals from the relevant regulator (including from the financial service sector regulator) for the transaction;
- issuance of public notice or newspaper advertisements about the transaction;
- approval from the lenders (including banks, financial institutions, debenture-holders and debenture trustees);
- consent from the persons whose personal information or sensitive personal information may be shared or transferred as a result of the transaction; and
- absence of any material adverse effect.

Law stated - 1 January 2024

Interim operating covenants
What sector-specific interim operating covenants and other covenants are usually included to cover the period between signing and closing of a financial services M&A transaction?

In the interim period between execution and closing, buyers require sellers to continue to conduct their business in the ordinary course, and in a manner identified as part of diligence. Generally, sellers are also restricted from taking actions on the most significant matters over which the investor will have a veto right after closing.

Some of the sector-specific interim covenants in financial sector M&A deals include changes in the critical policies of the financial sector entity, such as credit underwriting policy, surrender or modification of the registration of the particular entity, or undertaking any material financial commitment other than in the ordinary course of business.

Further, investors require the sellers to record and disclose any events identified in the transaction documents as a materially adverse event. These may include events that adversely affect the valuation of the seller or its assets, or which materially impair the ability of the buyer to exercise the benefits of any right or privilege under the transaction documents. Adverse events caused by changes in applicable law are also generally included within this requirement.

Law stated - 1 January 2024

DISPUTES

Common claims and remedies
What issues commonly give rise to disputes in the course of financial services M&A transactions? What claims and remedies are available?

Financial services entities are commonly set up in a conglomerate structure. Large financial services conglomerates are involved in multiple sectors with different entities acting as non-banking credit institutions, mutual funds, housing finance companies, insurance companies and other financial services entities, and such structures often result in cross-defaults and disputes.

Other common causes of disputes across the financial services sector include misrepresentations and issues pertaining to valuation such as price adjustment.

Law stated - 1 January 2024

Dispute resolution

How are disputes commonly resolved in financial services M&A transactions? Which courts are used to resolve these disputes and what procedural issues should be borne in mind? Is alternative dispute resolution (ADR) commonly used?

ADR, especially institutional arbitration, is frequently used in dispute resolution in financial services M&A. In transactions involving foreign players, arbitration in neutral venues such as Singapore and London is common. In transactions where a foreign-seated arbitration is chosen, parties contract out of their right to approach Indian courts for interim relief and the tribunal has powers to grant interim relief. Institutional arbitration (as opposed to ad hoc arbitration) is more prevalent in financial services M&A transactions.

Law stated - 1 January 2024

UPDATE AND TRENDS

Trends, recent developments and outlook

What are the most noteworthy current trends and recent developments in financial services M&A in your jurisdiction? What developments are expected in the coming year?

Indian policymakers have been inclined towards making the financial services sector more attractive to investors, which has led to tremendous M&A activity in the sector in recent times.

While strategic investments and acquisitions have been ruling the sector, the regulators have been progressive towards capitalising on the immense interest in the sector from financial sponsors as well. Most recently, the Securities Exchange Board of India has allowed private equity funds to become sponsors of asset management companies. This is the second such relaxation after the similar relaxation in the insurance sector.

Further, in 2023, there has been a paradigm shift in the manner of regulatory supervision in the financial services space from compliance-based supervision to risk-based supervision. In the non-banking financial space, the Reserve Bank of India has notified the Scale Based Regulations, replacing the old classification of systemically important and non-systemically important non-bank financial companies (NBFCs) with four layers of NBFCs – Base Layer,

Middle Layer, Upper Layer and Top Layer. This layered classification is based on the size, activity undertaken and perceived riskiness of the NBFCs.

On similar lines, the Insurance Regulatory Department of India (IRDAI) has also shifted from compliance-based supervision to risk-based supervision, furthering IRDAI's intention to move towards a 'principle-based' regulatory model with more obligations on the boards of the insurance companies as opposed to a 'rule-based' model. Several filing requirements have been done away with or clubbed with existing forms and returns. Further, the IRDAI has now linked the payment of commission to the expenses of management, giving insurers greater freedom for payment of commission, as the commission caps will be unbundled and not dependent on the individual product.

Further developments are expected to make the sector more lucrative. The interplay of digitisation and influence of AI on the one hand and enforcement of the Digital Personal Data Protection Act 2023 and cybersecurity measures will transform the financial services sector in India.

Law stated - 1 January 2024