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ARTICLES

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IMPACT OF THE DIGITAL PAYMENTS, AND NEO BANKS ON FINANCIAL INCLUSION IN INDIA AND ITS INTERPLAY WITH THE DATA-PROTECTION AND CYBER SECURITY REGULATIONS

Abir Lal Dey,[⊥] Satyadarshi Kunal[*] & Ananya Ghosh[ɜ]

ABSTRACT

Digital Payment and Neo Banks (branch of fintechs) are emerging as the future of the banking system in India. These mediums can boost the financial inclusion tremendously resulting into an enormous growth potential for the banking sector. The Government is promoting digital payments and neo banks through various measures. However, the regulatory system is not completely developed in India, thus hindering financial inclusion in its entirety due to the lack of digital data protection. Since these entities rely on digitally collected data, there is a need for adequate data protection and cyber security compliance requirements; however, the Indian legal system in relation to data protection and cyber security is yet to matchpace with the growth of technology in recent times.

The purpose of this paper is to analyse the impact of digital payments and neo banks on financial inclusion with a focus on concerns, laws and regulations regarding data protection and cyber security.

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INTRODUCTION

The gradual shift towards digitalisation in India has fuelled the growth of financial technologies (**"fintechs"**)[1] that help to set up a buoyant alternative credit mechanism.[2] Due to the rapid growth of use of smartphones in India, availing digital services has become the norm of our life. This has led to an enormous growth of the fintech sector in India and at the same time promoted financial inclusion. The use of technology aids in developing prediction models backed by artificial intelligence (**"AI"**) that help in designing loans as per customer requirements. Technology also assists in assessing the borrower and risks associated to ensure the avoidance of bad loans.

Fintechs nowadays cover a wide range of financial services ranging from mobile payment applications to cryptocurrency. Fintech firms/ platforms help in choosing from a spectrum of financial products across categories like insurance, saving account and mutual funds. Digital payment and neo banks also come within the umbrella of fintech. Over the last few years, investment in fintechs has grown rapidly in India[3] with an approximation of six times.[4] Since the fintechs work online, there is a low operational cost and a wider reach in comparison to a traditional setup requiring brick-and-mortar infrastructure.

Any financial system has few risks associated with it and so is the case with fintechs. For instance, digital payments generally involve three parties, i.e. source bank, payment system platform and customer, hence the customer shares significant sensitive personal information with the other two parties

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[1] Anne Sraders, *What is Fintech*, THE STREET (Feb. 11, 2020), https://www.thestreet.com/technology/what-is-fintech-14885154.

[2] Zafar Imam, *How fintech firms can keep the consumer liquidity flowing,* YOURSTORY (Sept. 17, 2020) https://yourstory.com/2020/09/fintech-firms-digital-lending-consumer-liquidity.

[3] Savannah Dowling, *In Q1 2018, FinTech Startups Raise Record Amounts While Deal Counts Fall,* CRUNCH BASE NEWS (Apr. 11, 2018) https://news.crunchbase.com/news/q1-2018-fintech-startups-raise-record-amounts-deal-counts-fall/.

[4] PWC Analysis, *Security challenges in the evolving fintech landscape* (July 2016) at 2, https://www.pwc.in/assets/pdfs/consulting/cyber-security/banking/security-challenges-in-the-evolving-fintech-landscape.pdf.

involved in the transaction, posing trust on the other two parties that not only the transaction is secured but also his/her personal data is safe with the other two participants. If any of the parties (other than the customer) fails to maintain adequate security in relation to the transaction concerned or the data shared with them, the customer may suffer significant loss and damage. It may also be noted that since there is a significant degree of online verification, there are a host of permissions and accesses granted by the customer to these digital payment platforms, which *inter alia* involve, reading customer's messages, using microphone and camera of the customer, access their photo gallery etc.

Further any bank or non-banking financial institution, would generally conduct some basic due diligence on their customers and require such customers to submit few documents in relation to their identity and address with the financial institution concerned, prior to offering their services. This process is generally known as 'know your customer' ("**KYC**"). Consequently, neo banks would require KYC of the customers to be processed before offering their services to their customers. Given that the idea behind a neo bank is to push digital banking, such banks would tend to provide an option for conducting the KYC digitally.

As the online mechanism has associated potential cyber security and data protection risks, there are a host of regulations and guidelines to ensure that the cyber security and data protection issues are taken care of while interacting with such digital platforms.

AN OVERVIEW OF DIGITAL LENDING AND NEO BANKS

As stated above, fintechs encompass a host of services including digital payments and neo banks. The RBI Ombudsman Scheme for Digital Payments[5] defines a digital transaction as - *a payment transaction in a seamless system effected without the need for cash at least in one of the two legs, if not in both. This includes transactions made through digital/electronic modes wherein both the originator and the beneficiary use digital/electronic medium to send or receive money*.[6] Digital payment comprises of payment gateways, digital wallets etc.[7] For instance, Paytm, GooglePay, Paypal etc. are digital payment platforms.

Neo banks are types of digital bank except that in neo banks the entity is exclusively an online entity.[8] Thus, a digital bank can be an additional service or subsidiary of a recognised financial institution whereas a neo bank is a 100 percent digital entity without any physical branches. These are fintech firms that offer banking as a service, ranging from mobile deposits, debit and credit cards, payments etc. without a physical counterpart. Neo banks may also have their specific target customer base. For instance, 'NiYo' focuses on blue collar workers and 'Open' focuses on SMEs.[9]

However, it can be concluded that both, neo banks and digital payments, operate digitally and make the most use of internet access and electronic medium such as laptops, tablets and smartphones which are at the disposal of

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[5] The Reserve Bank of India, Ombudsman Scheme of Digital Transaction, 2019, Ref. CEPD. PRS. No. 3370/13.01.010/2018-19 (Issued on January 31, 2019).

[6] The Reserve Bank of India, Report of the High Level Committee on Deepening of Digital Payments (Issued on May 17, 2019).

[7] Tanya Khandelwal, *Explained | From payments banks to neo banks – how India's fintech ecosystem has evolved*, MONEYCONTROL (Dec. 4, 2019, 7:51 PM), https://www.moneycontrol.com/news/business/companies/explained-from-payments-banks-to-neo-banks-how-indias-fintech-ecosystem-has-evolved-4700551.html.

[8] Tinesh Bhasin, *What do neo-banks offer and should you try them?*, LIVEMINT (Jun 1, 2020, 11:01 PM), https://www.livemint.com/money/personal-finance/what-do-neo-banks-offer-and- should-you-try-them-11591032340062.html.

[9] Anushruti Singh, *Neo-banks: The next revolution in Indian banking sector*, SMEFUTURES (August 9, 2020), https://smefutures.com/neo-banks-the-next-revolution-in-indian-banking-sector/.

over 500 million internet users. Digital lending provides an opportunity to this significant population to access credit in an affordable manner. Digital payment and neo banks shall be dealt with in-depth in the paper.

Key Regulations Governing Digital Payments and Neo Banks in India

There is a lack of a consolidated set of guidelines on digital payments and neo banks. A summary of laws, regulations and guidelines (including that of National Payment Corporation of India) applicable to digital payments and neo banks are provided below:

- The Payment and Settlement Systems Act, 2007 (**"PSSA"**). It is the principal legislation governing payment systems in India.
- The NPI Guidelines on Unified Payment Interface ("**UPI**") which enumerate the procedural guidelines to be followed by UPI platforms.
- Notifications, circulars and directions in relation to Non-Banking Financial Companies ("**NBFCs**") by Reserve Bank of India ("**RBI**") (applicable in case a digital platform comes within the category of NBFC, as defined in the RBI Act, 1934).
- The Guidelines on Regulation of Payment Aggregators and Payment Gateways dated 17 March 2020, issued by RBI, apply to the payment intermediaries, namely the payment aggregators and payment gateways.
- The RBI's Master Direction on KYC provides guidelines on the KYC of customers during risk assessment to tackle cyber security issues.
- The Data privacy and Protection Laws including the Information Technology Act, 2000 and the Technology (Reasonable Security Practices and Procedures and Sensitive Personal Data or Information) Rules, 2011.

- Besides the aforesaid, the Personal Data Protection Bill, 2019 ("**PDP Bill**") is pending before the Parliament of India. The PDP Bill is modelled along the General Data Protection Regulation ("**GDPR**") and is inspired by its key principles like purpose limitation, data storage restriction amongst others.

DIGITAL PAYMENT AND NEO BANKS BRING IN FINANCIAL INCLUSION

A modern, growing economy grows on the pillar of financial inclusion which comprises providing access to financial services to individuals across the social and economic barriers at affordable costs, in a timely manner. Thus, financial inclusion nurtures social inclusion and reduces poverty.[10]

Financial inclusion widens the capital base of the financial system by encouraging savings and building a system for borrowing credit and accessing financial services like investment and insurance. By increasing the participation of low-income groups in the financial service sector, the financial wealth of the customer is protected through savings and investments. Thus, financial inclusion not only benefits consumers but also boosts the economy.

Financial inclusion also benefits the financial service provider. The reach to a wider base of depositors breaking geographical boundaries through digital medium helps in diversifying the sources of funding and lending opportunities. They also help in fortifying the hold against sudden external economic shocks. Affordable alternative lending practices can help digital payment and neo banks explore the huge untapped market for loans and bring in more inclusion. They provide generally small-ticket size products that help increase the market size of financial products on account of an increase in customer participation due to the ease of access to those products by way of technology. This form of 'sachetise' financing promotes financial inclusion.

[10] Robin Burgess & Rohini Pande, Do Rural Banks Matter? Evidence from Indian Social Banking Experiment, 95(3) AMERICAN ECONOMIC REVIEW, 780 (2005).

Financial Inclusion in MSMEs

Micro, Small & Medium Enterprises ("**MSMEs**") play a crucial role in the economy and around 65 million MSMEs in India employ approximately around 80 million people. These MSMEs account for around 95 percent of India's manufacturing output.[11] Although MSMEs account for most of the manufacturing in India, mostly, they lack uniformity in terms of mode of operations, leading to difficulty by the banks and NBFCs to assess their credit worthiness. Assessing the creditworthiness of an MSME can also be difficult because of information asymmetry, specifically with respect to the financial performance of the MSMEs. As a result, MSMEs suffer with a massive credit demand-supply mismatch.[12] Since MSMEs have an informal nature of operation, they lack access to formal credit like banks.[13] They also lack the varied kinds of documents required to avail a formal loan. Traditional banks consider loans below INR 1 lakh as highly risky. Several MSMEs cannot offer worthwhile collateral and these factors make the traditional banking system incapable of addressing the MSMEs borrowing needs. This coerces them to borrow from outside the formal financial system, like money lenders, thereby making them fall prey to the exorbitant terms and conditions and a reduced financial inclusion.

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[11] Gaurav Kumar, *How Alternate lending models are facilitating better access to credit for the MSME sector,* ECONOMIC TIMES (Dec. 29, 2018, 01:42 PM), https://economictimes.indiatimes.com/small-biz/sme-sector/how-alternative-lending-models-are-facilitating-better-access-to-credit-for-the-msme-sector/articleshow/67298802.cms?from=mdr.

[12] As per estimates, the overall demand for both debt and equity finance by Indian MSMEs was around INR 87.7 trillion, of which the debt demand alone was INR 69.3 trillion and formal sources catered to only 16% of the total MSME debt, i.e. INR 10.9 trillion – V. Bhatia, *Micro-financiers bridge credit gap for undeserved MSMEs*, MONEYCONTROL (March 04, 2020, 08:53 PM), https://www.moneycontrol.com/news/technology/fintech-micro-financiers-bridge-credit-gap-for-underserved-msmes-5002761.html.

[13] PWC, *A wider circle: Digital lending and the changing landscape of financial inclusion* (Nov. 2019), at 2, https://www.pwc.in/assets/pdfs/consulting/financial-services/fintech/publications/a-wider-circle-digital-lending-and-the-changing-landscape-of-financial-inclusion.pdf,

Digital lending on the other hand boosts credit provision to MSMEs by providing small-ticket loans and collateral-free loans. Alternative data also helps salaried professionals and freshers who seek to venture into business and lack credit scoring. The model which neo banks adopt keeps the fixed costs nominal and provides a large number of low-value loans. This makes it attractive to small businesses. Easy access to low-ticket credit helps businesses to purchase more and this facilitates the credit-starved MSMEs to grow thereby creating jobs and a positive ripple effect in the economy.[14]

GOVERNMENT ENHANCING DIGITAL LENDING IN INDIA TO PROMOTE FINANCIAL INCLUSION

Government of India's push for financial inclusion through Jan Dhan-Aadhaar-Mobile trinity (**"JAM"**)[15] since 2014 has increased the percentage of adults in India having bank accounts to 80 per cent, as per the 2017 Global Findex Report.[16] As per government data, 37.3 crore bank accounts have been opened under the Pradhan Mantri Jan Dhan Yojana ("**PMJDY**") initiative till October 2019.[17]

There is also an impetus towards digital growth. Use of advanced technologies and initiatives by the digital medium is gradually resulting in availability of financial services to the bottom of the pyramid segment, at the grass-root levels in India. This sector of population was earlier largely devoid of basic credit and other financial services.[18] This is the reason why financial inclusion through digitalisation has also been an important part of Government of India's pro-growth policy.

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[14] *Supra* note 13, at 11.
[15] Pradhan Mantri Jan Dhan Yojana, Aadhaar and mobile connectivity is collectively referred to as 'JAM'.
[16] DEMIRGUC-KUNT, ASLI; KLAPPER, LEORA; SINGER, DOROTHE; ANSAR, SANIYA; HESS, JAKE, GLOBAL FINDEX DATABASE 2017: MEASURING FINANCIAL INCLUSION AND THE FINTECH REVOLUTION (Washington DC, World Bank 2018).
[17] Department of Financial Services - Ministry of Finance, Pradhan Mantri Jan Dhan Yojana (PMJDY), https://www.pmjdy.gov.in/account.
[18] *Supra* note 13, at 5.

The Government of India and the National Payments Corporation of India ("NPCI") launched IndiaStack. It has an open application programming interface ("**API**") that can be utilised by banks, digital lenders amongst others to gain insight into consumers across segments and provides them with innovative lending solutions. Financial companies can perform QR or XML-based KYC verification.[19] These forms of verification do not require sharing of biometric details and Aadhaar number of an individual, thus ensuring privacy. Digital signatures and e-submissions are also permitted. Thus, by connecting credit-seekers and lenders digitally, the process is made smoother and hassle-free.

Besides, several other initiatives of the government have indirectly benefitted financial inclusion. The launch of the Goods and Services Tax ("**GST**") has also led to a wider availability of digitised data that can be used for credit assessment, Digital India movement has promoted greater digital literacy amongst the rural and urban population and cost-efficient internet services have led to greater internet usage. The UPI system has hugely increased the usage of online payments to provide consumers with a seamless and reliable payment experience, including utility bills, within seconds. Also, Startup India has promoted the growth of startups significantly, including neo banks.[20] In 2019, neo banks in India raised more than USD 90 mn.[21]

RBI released the Enabling Framework for Regulatory Sandbox dated 13 August 2019[22] ("**Regulatory Sandbox Framework**"). As per the Regulatory Sandbox

[19] Harshvardhan Lunia, *Digital Lending – Looking back at FY19 and the road ahead,* ET BFSI BLOG (Jun. 13, 2019), https://bfsi.economictimes.indiatimes.com/blog/digital-lending-looking-back-at-fy19-and-the-road-ahead/3621.
[20] Fintech Report 2020, STATISTA DIGITAL MARKET OUTLOOK (2020).
[21] Anmol Dethe, *Neo Banks in India are rising but will take some time to disrupt,* ET BFSI (Sept. 22, 2020) https://bfsi.economictimes.indiatimes.com/news/fintech/neo-banks-in-india-are-rising-but-will-take-some-time-to-disrupt/78251059.
[22] The Reserve Bank of India, Enabling Framework for Regulatory Sandbox, (Issued on August 13, 2019).

Framework, the financial services sector, including digital payments platforms, may roll out regulatory sandboxes on a small scale to test their viability before launching them in a full-fledged way.[23] This is an encouraging step for digital platforms to experiment with innovative solutions and may also lead to greater investment in the digital payment space.

COVID CRISIS HAS PROMOTED NEO BANKS AND DIGITAL PAYMENTS

The COVID-19 pandemic has had an economic ripple effect across various sectors including the traditional banking system. According to the Centre for Monitoring the Indian Economy, an approximation of 122 million Indians lost their job due to the pandemic.[24] This means that steady income sources have been lost with an increased liquidity crunch. This unprecedented situation has led to the rise of reluctance on the part of the banks to lend.

In this backdrop, digital lending has acted as a saviour for the borrowers, satisfying their liquidity requirements.[25] Thus, the popularity of the so-called 'niche' neo banks has increased significantly during the COVID-19 pandemic.[26] The virtual, branchless nature of the neo banks at the time of lockdown and social distancing imposed by the government to tackle the medical exigency on account of the pandemic has also added to its wide-scale acceptance.

During the lockdown, 'Instamojo', a payment gateway application, introduced 'InstaCash' – a short term loan facility.[27] InstaCash enables merchants to avail loans for an amount upto INR 1 lakh for a time period of either 7 or 14 days.

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[23] FINTECH 2020, GLOBAL LEGAL GROUP (2nd ed. 2020).
[24] *Data | An estimated 12.2 crore Indians lost their jobs during the coronavirus lockdown in April: CMIE*, THE HINDU DATA TEAM (May 07, 2020, 09:45 PM) https://www.thehindu.com/data/data-over-12-crore-indians-lost-their-jobs-during-the-coronavirus-lockdown-in-april/article31520715.ece.
[25] *Supra* note 9.
[26] *Supra* note 9.
[27] Chethna, *Introducing InstaCash – Short Term Loans to Get Business Going,* INSTAMOJO BLOG (Jun. 29, 2020), https://www.instamojo.com/blog/instacash-short-term-loans-to-get-business-going/.

The company has grown by a 30 per cent rate post the lockdown caused due to the COVID-19 pandemic.[28]

Further, U GRO Capital is an end-to-end digital lending platform which was launched on 1 July 2020.[29] It offers unsecured loans in the range of INR 10 lakh to INR 25 lakh for a time period of 2 months to 36 months. Secured loans are provided between INR 50 lakh and INR 2 crore for a period of 7 years to 10 years. There is also a moratorium of up to 3 months to help businesses that have suffered an economic slowdown due to the lockdown. Apart from the foregoing examples of growth in digital payment during the COVID-19 crisis, we have seen several similar platforms growing leaps and bounds in the said period.

In light of the above, it may not be wrong to suggest that neo banks and digital payment space in India have a bright future. However, digital payments and neo banks have their constraints of appeasing to the masses which have inherent dilemmas with respect to the privacy and cyber security aspect of digital payments and neo banks.

The customer shares a significant amount of his/her sensitive personal information with the other two parties in the digital payment medium, namely, the source bank and the payment system platform. While entrusting the data, the customer expects that both, the transaction and his/her personal data will be safe with the other two parties, failure of which can lead to significant loss and damage to be suffered by the customer.

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[28] Surabhi, *Fintech, digital lenders launch schemes for MSME credit*, THE HINDU BUSINESS LINE (Jun. 29, 2020), https://www.thehindubusinessline.com/money-and-banking/fintech-digital-lenders-launch-schemes-for-msme-credit/article31943343.ece.

[29] *Id.*

Since there is a significant degree of online verification, there are a host of permissions and accesses granted by the customer to the digital payment platforms. This includes reading the messages, using the microphone and camera of the customer's electronic medium and accessing the customer's photo gallery, amongst others. Also, a bank or a non-banking financial company conducts basic due diligence on the customer before granting credit which is known as KYC. This process of KYC necessitates the customer to deliver a few documents in relation to their identity and address with the financial institution. Since neo banks promote the push towards a digital medium, such banks would tend to provide an option to conduct a digital KYC. This online mechanism has potential cyber security and data protection risks associated with it. Security and privacy implications need to be adequately considered to ensure that the data is protected from cyber-crimes.[30] Therefore, there are a host of regulations and guidelines to ensure that the cyber security and data protection issues are taken care of during the interactions with these digital platforms.

DEVELOPMENT OF DATA PROTECTION AND CYBER SECURITY TO TACKLE THE PRIVACY CONCERNS

The Government of India had presented the Personal Data Protection Bill, 2006, before Parliament of India, which seeks to protect personal data of individuals. However, the bill was not passed; hence the same could never become law. In the meanwhile, the Information Technology Act, 2000 ("**IT Act**") was amended ("**Amendment**")[31] to include S. 43A and S. 72A to protect personal data and sensitive personal data and information ("**SPDI**"). On 11 April 2011, the Government brought into effect the Information Technology (Reasonable Security Practices and Procedures and Sensitive Personal Data or

[30] Nandkumar Saravade & Ambuj Bhalla, *Emerging trends and Challenges in Cyber Security* (ReBIT Whitepapers), https://rebit.org.in/whitepaper/emerging-trends-and-challenges-cyber-security last visited Oct. 30, 2020).
[31] The Information Technology Amendment Act, 2008.

Information) Rules, 2011 ("**Rules**") which define SPDI in depth[32], apply to body corporates or persons located within India and relate to information about natural persons. A bank collecting SPDI has to abide by the Rules for collection, storage and disposal of data. In case a wrongful loss or wrongful gain to any person is caused by the negligence on the part of a body corporate in possessing, dealing or handling his/her SDPI then such body corporate shall be liable to pay damages by way of compensation to the person affected.[33] As per S. 72A of the IT Act,[34] in case any person including an intermediary, while providing services under a lawful contract, accesses any personal information of a person with an intent to cause wrongful gain or wrongful loss, and discloses such information to any other person without the person's consent or in breach of the lawful contract, then the penalty imposed shall be of imprisonment up to a term of three years and/or fine which may extend to INR 5 lakh.

It can be conceded that the Amendment and Rules laid the ground for recognising SPDI and the necessity to safeguard it. However, one had to acknowledge that the Amendment and Rules came into force in the years 2009 and 2011 respectively. The punishments as per the Amendment are trivial in comparison to the potential harm that can be caused. Thus, they are not adept enough to take into consideration the newest cyber security issues concerning neo banks.

Also, the Amendment does not provide for any framework for data localisation, consequently, the Amendment does not make it mandatory for hosting the servers of big data collecting companies like Facebook and Google, locally within India. This leads to a scenario, where suing these big players becomes an

[32] Any information, not freely available relating to a person's password, financial information, health condition, sexual orientation, medical records and history, biometric information or any detail relating to the above clauses as provided to body corporate for providing service or for processing, stored or processed under lawful contract or otherwise is defined as SPDI.
[33] The Information Technology Act, 2000, S. 43A.
[34] The Information Technology Act, 2000, S. 72A.

impossible dream with merely their marketing subsidiaries within the geographical boundaries of India. This free flow of data outside the country without the person's consent makes the entire mechanism to safeguard personal data, futile.

To tackle this issue, the PDP Bill was introduced to ensure better data protection. One of the stipulations under the PDP Bill is that SPDI can be transferred outside India provided such data shall continue to be stored in India.[35] Also, as per the PDP Bill, SPDI can be transferred abroad only for processing after obtaining explicit consent from the data principal.[36] At the same time, SPDI can be transferred abroad only if the other jurisdiction has a secured infrastructure to provide adequate protection. This will ensure that there is a positive change in the current scenario of data protection thereby strengthening the mechanism.

I. Behavioral Analysis in Digital Payment and Privacy Concerns

The traditional banking system uses GST filings, bank statements etc. as proof of authenticity before granting loans. Since neo banks opt for e-KYC and video KYC, the process becomes hassle-free, speedier and paperless. Also, while applying for collateral-free loans, most of the time, the borrowers are not required to provide details beyond their Aadhaar, PAN and income details.[37] Neo banks also use alternative credit mechanisms to assess their MSME borrowers. This is primarily because MSMEs as entities have a shortage of credit data[38] and are an important market for neo banks. To cater to the

[35] The Personal Data Protection Bill, 2019, S. 33(1).
[36] The Personal Data Protection Bill, 2019, S. 34(1).
[37] Anuj Kacker, *How Digital Lending is Revolutionising the Financial Landscape in India,* OUTLOOK MONEY (Mar. 13, 2020), https://www.outlookindia.com/outlookmoney/technology/how-digital-lending-is-revolutionising-the-financial-landscape-in-india-4494#:~:text=Digital%20lending%20platforms%20offer%20borrowers,consider%20personal%20loans%20below%20Rs.
[38] Pratibha Chhabra and Shalini Sankaranarayanan, *How can alternative data help Micro, Small and Medium Enterprises (MSMEs) access credit?* WORLD BANK BLOG (May 2, 2019),

demands of the MSME space amongst others, neo banks opt for instant alternative data to assess creditworthiness and grant instant loans.[39] This includes an evaluation of the financial history and habits of an individual. Some of the sources of data comprise activities in Amazon and Facebook.[40] Digital lending has thus embraced cloud technology to scale up the business. This extends from non-core areas like human-resource and customer relationship management to core areas of customer assessment.[41] Digital lending uses predictive algorithms to assess the data and calculate the borrower's repayment abilities. Thus, digital lending couples alternative data with machine learning to assess behaviour pattern.

It can be summed up that not only an income side but also an expense side analysis is adopted before digital lending. Digital lending can therefore tackle the credit related challenges in India by ensuring speedier approval of credit. However, this kind of a behavioural analysis will have its own privacy concern. A large chunk of this data is sensitive, personally identifiable information. Protecting such data and providing it to customers and third party in a secured, law-abiding manner needs compliance with the data protection laws.

There is an RBI Privacy Policy on storage and processing of data.[42] There are also Guidelines on Information Systems Security Guidelines for the Banking and Financial Sector[43] and Guidelines on Internet Banking in India.[44] However,

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https://blogs.worldbank.org/psd/how-can-alternative-data-help-micro-small-and-medium-enterprises-msmes-access-credit-0.

[39] World Bank, *Alternative Data Transforming SME Finance* (May, 2020) at 20, http://documents1.worldbank.org/curated/en/701331497329509915/pdf/116186-WP-AlternativeFinanceReportlowres-PUBLIC.pdf.

[40] *Supra* note 19.

[41] PWC, *Financial Services Technology 2020 and Beyond: Embracing disruption* (2020) at 22, https://www.pwc.com/gx/en/financial-services/assets/pdf/technology2020-and-beyond.pdf.

[42] The Reserve Bank of India, Privacy Policy, https://www.rbi.org.in/Scripts/PrivacyPolicy.aspx (last visited Dec. 5, 2020).

[43] The Reserve Bank of India, Information Systems Security Guidelines for the Banking and Financial Sector (Issued on March 11, 2002).

these policies have been passed in the early 2000s and are therefore not abreast with the current days. RBI and SEBI have yet not released a detailed and conclusive guideline for digital payment or neo banks, in particular. The PDP Bill, on the other hand, shall have compliance requirements. Digital lending and neo banks provide services that are API based banking. API based banking allows third party applications to access the data from a bank and disburse salaries from an enterprise's bank account to the employee's bank account. However, this falls outside the limit of the RBI's account aggregator framework ("**RBI Framework**").[45] The RBI Framework permits exchanges between regulated entities like two banks. It ensures explicit consent with stringent restrictions on data usage. However, the services provided by digital payment platforms and neo banks are governed contractually and mostly without much regulatory interference. The PDP Bill is trying to ensure similar data protection compliance requirements as the RBI Framework.

Since the PDP Bill classifies all forms of personal financial data as "sensitive personal data", neo banks should be categorised as "data fiduciaries".[46] As per the PDP Bill, to remain compliant, the data fiduciaries should ensure that they acknowledge the rights of the data principals. The personal data shall be processed after the consent of the data principal at the commencement of the processing. Thus, consent shall not be assumed for processing data.[47] Personal data shall also be collected only to the extent necessary for the purpose of processing.[48] Therefore, the reason for the collection of data has to be known

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[44] The Reserve Bank of India, Internet Banking in India – Guidelines, DBOD.COMP.BC.No. 130/ 07.03.23/ 2000-01 (Issued on June 12, 2001).

[45] The Reserve Bank of India, Master Direction – Non-Banking Financial Company – Account Aggregator (Reserve Bank) Directions, 2016, RBI/DNBR/2016-17/46 (Updated as on Nov. 22, 2019).

[46] Meghna Suryakumar, *How personal data protection Bill will impact Indian Fintech sector*, FINANCIAL EXPRESS (Jun. 6, 2020, 8:31 AM) https://www.financialexpress.com/opinion/how-personal-data-protection-bill-will-impact-indian-fintech-sector/1813839/.

[47] The Personal Data Protection Bill, 2019, S. 5.

[48] The Personal Data Protection Bill, 2019, S. 5.

to the data principal. The data principal shall also have the right to ask for the permanent erasure of their personal data after its use.[49] The data principal shall also have the right to receive a copy their personal data in a structured format when such data is being processed by the neo bank through automated means (like eKYC and video KYC).[50] Thus, the data fiduciary must keep a copy of the data so that it can be provided in case the data principal requests for it.[51] These compliance requirements should be kept in mind to ensure adequate adherence.

II. Innovation and Privacy

Innovation in financial inclusion reduces the exploitation of the credit invisible strata by traditionally unorganised channels. This is done by implementing technology solutions across the lending chain. At the same time, innovation has to take into account privacy concerns. Other ways to promote innovation include the RBI's Regulatory Sandbox Framework[52] which has allowed the financial sector to roll out regulatory sandboxes to experiment with their viability before launching a full-fledged scheme. One should note that it mandates express customer consent coupled with data protection law compliance. For a harmonious construction between the Regulatory Sandbox Framework and the PDP Bill, it can be said that there shall be inherent restrictions in the flexibility of repurposing the data through the Regulatory Sandbox Framework since the PDP Bill works on the model of limited purpose usage and data minimisation. The aforesaid inter-linkages between the PDP Bill and the Regulatory Sandbox Framework should be complied with to ensure proper adherence.

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[49] The Personal Data Protection Bill, 2019, S. 18(1)(d).
[50] The Personal Data Protection Bill, 2019, S. 19(1)(a).
[51] Ankit Ratan, *How India's Data Protection Bill Will Impact Lending and Fintech?* INC42 (Jul. 05, 2020), https://inc42.com/resources/how-indias-data-protection-bill-will-impact-lending-and-fintech/.
[52] The Reserve Bank of India, Enabling Framework for Regulatory Sandbox, (Issued on August 13, 2019).

III. Prospective Application of the PDP Bill

The PDP Bill cannot be applied retrospectively. However, there should be efforts by the data fiduciary to ensure that data collection, storage and usage henceforth are complaint with the PDP Bill. Lenders often share customers' personal data with credit bureaus and other third parties too. The information about the parties involved should be explained to the customers by the lender. Lenders should also ensure that the data stored is erased after use, anonymised and also made compliant with the law. These can be difficult due to the enormity of data because there has to be notices provided to customers and reviewing of the activities of the fiduciaries themselves to ensure compliance with privacy laws. However, since the law requires the same and until an alternate form of processing is provided, obtaining proper consent is required to ensure compliance.

Reasonable purpose exemption as provided by the PDP Bill allows for personal data to be processed without obtaining the consent of the data principal. Credit scoring is included under the reasonable purpose exemptions of the PDP Bill. [53] Thus, there can be an argument that credit scoring falls under "reasonable purpose exemption" as provided by the PDP Bill and thus shall not have consent requirements. However, even if it is assumed that credit scoring is a "reasonable purpose exemption", the data principal can still seek the erasure of data in its entirety, as the data involved is personal data.[54] Also, even in the cases where consent is exempted, a notice has to be served mandatorily to the data principal.[55] These factors should be kept in mind by the digital payment platforms and neo banks to ensure compliance.

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[53] The Personal Data Protection Bill, 2019, S. 14(2)(e).
[54] *Supra* note 51.
[55] Asheeta Regedi, *Impact of Data Protection Bill on fintech sector and aligning financial laws with it,* MEDIANAMA (Apr. 8, 2020) https://www.medianama.com/2020/04/223-personal-data-protection-bill-fintech/.

IV. Fines in the PDP Bill

The fine under the PDP Bill is a penalty which may extend to fifteen crore rupees or four per cent of the total worldwide turnover of the preceding financial year, whichever is higher.[56] This shall promote the requirement of indemnities and warranties from the seller. The liabilities, therefore, impose a steep penalty and the fiduciaries shall have to compensate the victim for a breach. This acts as an additional reason to ensure adequate compliance.

GROWTH OF DIGITAL PAYMENT AND NEW BANKS: GLOBALLY V. INDIA

The concept of neo banks started in the UK after the financial crisis ended.[57] Neo banks have had a tremendous growth rate in the US too.[58] India is also moving towards digitisation and the government is facilitating the same. However, there are some lacunae as stated below.

I. Lack of Choice in India

Banks and NBFCs are embracing digital transformation to reduce their cost-income ratio. Many large banks have even set up their subsidiaries (digital bank) to internalise competitiveness and export technology capacity to smaller banks.[59] They are also partnering with neo banks to source loans to individual customers and also to the SME sectors.[60] Neo banks partner with traditional banks and help customers acquire credit seamlessly. For instance, ICICI Bank

[56] The Personal Data Protection Bill, 2019, S. 57.
[57] *What are Neo-Banks and How Will They Shape the Future of Finance?* FINSMES (Mar. 4, 2020) https://www.finsmes.com/2020/03/what-are-neo-banks-and-how-will-they-shape-the-future-of-finance.html#:~:text=It%20all%20started%20in%20the,obtaining%20a%20full%20banking%20license.
[58] *Supra* note 21.
[59] *Supra* note 2.
[60] Indian Lending Fintech Ecosystem, THE DIGITAL FIFTH (July. 10, 2020) https://thedigitalfifth.com/indian-lending-fintech-ecosystem/.

has partnered with neo banks like Open, Insta Pay and Yelo.[61] Strategic partnership with incumbent financial institutions allows digital lenders to reduce the cost of increasing their customer base.[62]

However, the lacuna in India is that virtual banking licenses for neo banks are still not granted[63] thereby forcing them to enter into strategic partnerships with licensed banks. Although there are foreign banks offering digital-only products through their Indian subsidiaries[64], a lack of choice is a huge operational impediment obstructing the growth of neo banks in India. A lack of choice denotes a hierarchical preference which shows that the RBI prioritises brick and mortar set up over a virtual presence in its entirety. This will surely keep neo banks as the second preference always and a belief will be ingrained amongst the Indian consumer that neo banks are capable to function only with the backing of traditional banks.

The RBI should therefore introduce the regulations on virtual banking. This will facilitate neo banks to provide services to customers independently and increase financial inclusion. With more neo banks in the pipeline and regulatory initiatives in the neo bank space, there shall be greater development of this area in the coming future.

II. Overlap of the PDP Bill with Other Schemes, Guidelines and Frameworks

There can be a confusion regarding the authority of a data protection authority ("**DPA**") under the PDP Bill viz-a-viz the Ombudsman Scheme for redressal of complaints against deficiency in services related to digital transactions

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[61] S*upra* note 21.
[62] S*upra* note 13, at 5.
[63] PWC, *Neobanks and the next banking revolution,* https://www.pwc.in/consulting/financial-services/fintech/fintech-insights/neobanks-and-the-next-banking-revolution.html.
[64] *Id.*

("**Ombudsman Scheme**").[65] The Ombudsman Scheme has the jurisdiction over issues of non-adherence to RBI instructions and this often includes privacy and security issues. The solution to this overlap of authority can be a memorandum of understanding with the DPA which the PDP Bill provides for in S. 56.[66]

Also, there can be the risk of the loan becoming a bad loan in case the risk assessment is not done diligently by the entity lending money digitally. As per the RBI's Master Direction on KYC, proper due diligence of the customer is to be done according to the guidelines. The guidelines highlight that secrecy obligations have to be maintained and proper confidentiality has to be upheld.[67] As per RBI's Master Direction on KYC, banks are granted certain discretionary powers with respect to disclosures. This shall include situations where the interest of the bank requires disclosure or when there is a duty towards the public[68]. However, contrary to this, the PDP Bill imposes obligations on the data fiduciary. The obligation necessitates the disclosure of personal data in situations related to prevention, detection, investigation and prosecution of offence. This interplay between 'discretion' as per the RBI directions on KYC and 'necessity' as per the PDP Bill needs to be clarified.

Besides the aforesaid lacunae, the Regulatory Sandbox Framework[69] lacks inter-operability between different regulatory sandboxes. It is suggested that inter-operability between different regulatory sandboxes should be permitted. This shall ensure harmony between the regulatory sandboxes of RBI and PDP Bill.

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[65] The Reserve Bank of India, Ombudsman Scheme of Digital Transaction, 2019, Ref. CEPD. PRS. No. 3370/13.01.010/2018-19 (Issued on January 31, 2019).
[66] The Personal Data Protection Bill, 2019, S. 56.
[67] The Reserve Bank of India, Master Direction – Know Your Customer (KYC) Direction, 2016, RBI/DBR/2015-16/18, Updated as on April 20, 2020), S. 56.
[68] The Reserve Bank of India, Master Direction – Know Your Customer (KYC) Direction, 2016, RBI/DBR/2015-16/18, Updated as on April 20, 2020), S. 56(c).
[69] The Reserve Bank of India, Enabling Framework for Regulatory Sandbox, (Issued on August 13, 2019).

Since each sandbox has its own authority to allow relaxations (like the RBI will not be able to permit relaxations that the DPA is authorised to under the PDP Bill), inter-operability of regulatory sandboxes shall ensure greater congruence in the digital payment and neo banking space.

III. Need for Greater Clarity

Under the PDP Bill, reasonable purpose exemption is not discretionary. It depends on the activities the DPA selects as exemptions. Neo banks significantly use alternative credit scoring and aid in financial inclusion. Due to this sensitive nature of the data handled, the DPA may be expected to analyse companies on a case-to-case basis and decide the extent of exemption as a reasonable purpose from the consent requirement. However, this shows that there is a significant amount of discretionary powers given to the DPA.[70] Some instances of compliance are ambiguous, for instance, the need to take mandatory consent from the account aggregator and/or the DPA. It is submitted that the DPA should not be given free rein over the data and definite authority with its scope and limitation should be established.

The Steering Committee on Fintech[71] was set up by the Government of India in March 2018. It focuses on key issues with respect to the fintech sector and suggests recommendations to ensure growth. An important suggestion of the Committee was that some obligations of the DPA should be handed to other regulators to ensure greater harmony and checks & balances at the same time.

Also, the PDP Bill has brought in consent managers which are similar to the account aggregators RBI framework. The consent managers shall ensure that both regulated and unregulated entities get consent-based access. The consent managers shall permit data principals to communicate with the fiduciaries to

[70] Regedi, *supra* note 55.
[71] Department of Economic Affairs – Ministry of Finance, REPORT OF THE STEERING COMMITTEE ON FINTECH RELATED ISSUES (2019).

exercise their rights. However, it is important that an amendment is brought in to ensure that there is a single authority for consent instead of an account aggregator under the RBI Guidelines and also a separate consent manager under the PDP Bill.

The Niti Aayog released its discussion paper on a new data-sharing framework called the Data Empowerment and Protection Architecture ("**DEPA**").[72] DEPA proposes account aggregators as a new set of entities to ensure consent. Account aggregators shall themselves not have access to data, however, they will manage the flow of data. Thus they shall bring in a balance between efficiency and innovation. However, data misuse by the data fiduciaries is still not covered under DEPA, therefore leaving a scope for improvement.[73]

The Information Technology Act, 2000 despite providing some degree of data protection does not live up to varied kinds of cyber breaches that can take place in the latest times. It is crucial that the PDP Bill is also modified taking into consideration all the loopholes and thereby passed into an act soon so that its authority is established firmly. It is also essential that a specific set of laws on digital payments and neo banks exists to ensure that they have a clear and concise checklist. This shall ensure that these entities deliver their functions but at the same time do not compromise on privacy. For instance, the European Union ("**EU**") has its Payment Services Directive to harmonise payment regulations across the EU. This gives the data principal greater autonomy over their data. A similar sector-specific compliance checklist which shall not be incongruous with the PDP Bill is the need of the hour in India.

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[72] Niti Aayog, DATA EMPOWERMENT AND PROTECTION ARCHITECTURE, (August 2020) https://niti.gov.in/sites/default/files/2020-09/DEPA-Book.pdf.

[73] *New Niti framework may help improve India's data protection standards,* LIVEMINT (Sept. 15, 2020) https://www.livemint.com/news/india/new-niti-framework-may-help-improve-india-s-data-protection-standards-11600154978292.html.

CONCLUSION

Growth of Digital Lending in India[74]



India's market in digital lending is expected to grow up to USD 350 billion inthe year 2023.[75] It is essential that the data protection and cyber security laws in India develop in their entirety. Currently, there lacks a consolidated set of guidelines to adhere to. Despite the hindrances, such as the lack of virtual licenses to neo banks in India, digital payments and neo banks have grown steadily in India. It is imperative that the RBI facilitates neo banks to operate within the ecosystem of virtual licensing.

To ensure that the digital payment and neo banks grow exponentially in the future, it shall be essential that they bank on secure technology platforms by adhering to a consolidated set of laws provided by the government.

Disclaimer*: The PDP Bill is pending before the Parliament. There may be certain changesin the PDP Bill in case the same is passed into an Act or the Bill may not be passed by the Parliament. The analysis in this paper is based on the existing text of the Bill and the same should not be relied upon as law at the current stage.*

[74] The Boston Consulting Group, *Digital Lending* (Jul. 2018) at 30, https://image-src.bcg.com/Images/BCG-Digital-Lending-Report_tcm9-197622.pdf.
[75] *Id*.

Akash Amati & Namit Bafna, *Decoding Foreign Exchange Derivatives Regulation in India*, 9(1) SCHOLASTICUS 26 (2022)

DECODING FOREIGN EXCHANGE DERIVATIVES REGULATION IN INDIA

Akash Amati[⊥] *& Namit Bafna*[*]

ABSTRACT

Ever since the economic liberalisation of India in the 1990s, management and regulation of foreign exchange became paramount for catering to the hedging needs of market participants and for maintaining the macroeconomic stability of the country. Derivatives as a financial instrument have played a vital role in increasing the efficiency of the Indian foreign exchange market. However, the regulatory framework governing foreign exchange and derivatives was largely undeveloped. This article traces the timeline of the development of this regulatory framework and provides an overview of the same. It examines the lacunae in the regulatory framework in light of prevailing market developments and market trends and further throws light on the efforts taken by the regulatory authorities to fill these lacunae. Drawing on this analysis, this article offers suggestions on further bolstering India's regulatory approach to foreign exchange derivatives in order to attain a balance between the needs of market participants and achieving increased regulatory oversight.

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Disclaimer: The views expressed in this article are personal. The article is intended to provide a general guide to the subject matte

INTRODUCTION

Foreign exchange ("FX") transactions are undertaken by a wide range of actors; ranging from tourists to huge sums paid towards an international exchange of goods and services.[1] Increased interdependence of nations and globalisation has increased the need for FX transactions, leading to an ever-growing FX market. In other words, the FX market enables the transfer of purchasing power from one currency into another; facilitating the international exchange of goods, services, and financial securities.[2]

The FX Market is significantly dominated by major international banks[3] that trade via major financial centres of the world: London, New York, Tokyo, Singapore, Zurich, Frankfurt, Hong Kong, Paris, and Shanghai (the "*interbank market*").[4] It is considered to be the most liquid financial market in the world[5] with trades booked and settled around the clock.

The BIS Triennial Central Bank Survey of 2019 indicates trading in FX markets to have reached $6.6 trillion per day in April 2019,[6] up from $5.1 trillion from 2016 figures.[7] As of 2019, the United Stated Dollar ("USD") is the dominant currency, being on one side of 88% of all trades. Although, the currencies of

[1] EDMUND PARKER AND MARCIN PERZANOWSKI, PRACTICAL DERIVATIVES 537 (Globe Law and Business 2017).
[2] LAURENT L. JACQUE, INTERNATIONAL CORPORATE FINANCE: VALUE CREATION WITH CURRENCY DERIVATIVES IN GLOBAL CAPITAL MARKETS 131 (Wiley 2014).
[3] Fx Survey 2020: Press Note, EUROMONEY (June 25, 2020), https://www.euromoney.com/article/b1lp5n97k4v6j0/fx survey-2020-pressrelease.
[4] LAURENT L. JACQUE *, supra* note 02, at 132.
[5] JOHN N. KALLIANIOTIS, EXCHANGE RATES AND INTERNATIONAL FINANCIAL ECONOMICS, 52 (2013).
[6] *Triennial Central Bank Survey: Foreign exchange turnover in April 2019*, BANK FOR INTERNATIONAL SETTLEMENT (Sept. 16, 2019), https://www.bis.org/statistics/rpfx19_fx.pdf.
[7] *Triennial Central Bank Survey: Foreign exchange turnover in April 2016*, BANK FOR INTERNATIONAL SETTLEMENT (Dec. 11, 2016), https://www.bis.org/publ/rpfx16fx.pdf.

emerging market economies gained market share, reaching 25% of overall global turnover[8] despite capital controls.

The exchange rates are prone to constant change as they are affected by various economic and political factors, so much so that even news of the United Kingdom Prime Minister to meet the president of European Commission caused Great Britain Pound ("GBP") to rise,[9] that President of the United States of America has been tested positive for Covid-19 led Japanese Yen to rise against USD[10] or that the Reserve Bank of India's postponement of the week's interest rate announcement had a direct impact on USD/INR (Indian Rupee) exchange rate.[11]

Derivatives help in hedging such risk of unpredictability in the FX market. A Derivative is a financial product which derives from an underlying market. Section 45U(a) of the Reserve Bank of India Act, 1934 defines derivative as "*an instrument, to be settled at a future date, whose value is derived from change in interest rate, foreign exchange rate, credit rating or credit index, price of securities (also called "underlying"), or a combination of more than one of them...*"

Derivatives provide a means for shifting risk from one to another that is more willing or better placed to assume that risk.[12] Firms looking to transfer risk generally do not have the immediate need or ability to transact in an underlying

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[8] *Supra* note 6.
[9] Olga Cotaga, *Sterling opens higher as UK, EU continue Brexit talks*, REUTERS (October 2, 2020), https://in.reuters.com/article/britain-sterling-open/sterling-opens-higher-as-uk-eu-continue-brexit-talks-idINL8N2GT1IK.
[10] Gertrude Chavez-Dreyfuss, *Dollar, yen gain as Trump's positive COVID test sparks haven buying*, REUTERS (October 2, 2020), https://in.reuters.com/article/us-global-forex/us-dollar-yen-rise-after-trumps-positive-covid-test idINKBN26N01P.
[11] Daniel Debrovsky, *Indian Rupee, Niftty 50 at Risk to a US Stimulus Setback after RBI Delay*, DAILY FX (October 2, 2020), https://www.dailyfx.com/forex/market_alert/2020/10/02/Indian-Rupee-Nifty-50-at-Risk-to-a-US-Stimulus-Setback-After-RBI-Delay.html
[12] ALAN N. RECHTSCAFEN, CAPITAL MARKETS, DERIVATIVES AND THE LAW: POSITIVITY AND PREPARATION, 158 (OUP USA 2019).

asset but it contemplates a future need. Considering the volatility involved, firms will be interested in locking the price as of the day, to avoid a costlier transaction in the future (hedging the risk).[13] As set out in the *Commissioner Of Income Tax* v *Bharat R. Ruia*,[14] firms which are exposed to changes in market prices can enter into derivatives contracts and transfer the risk to a large financial institution which can withstand more risk than a small corporate, for a reasonable compensation.

Therefore, as explained in *Rajshree Sugars & Chemicals* v *Axis Bank Limited,*[15] derivatives can be used as insurance cover against fluctuations in the rate of foreign exchange, rate of interest on borrowings, and value of specified assets. Based on how they are traded, they can be classified as Over-The-Counter (OTC) derivatives or Exchange-traded derivatives. OTCs are transacted bilaterally, while exchange traded, as the name suggests, are traded on an organised platform.[16]

In *Sportking India Limited* v. *H.D.F.C. Bank Limited,*[17] the court defined FX derivative contract to derive its value from the price movement of one or more underlying assets and includes a transaction which involves at least one foreign currency; or at least one interest rate applicable to a foreign currency or a forward contract. Derivatives are valuable because they provide efficient ways to manage and transfer risk.

[13] *Id,* at 158.
[14] (2011) 337 ITR 452 (Bom).
[15] (2008) 8 MLJ 261.
[16] DAVID MURPHY, OTC DERIVATIVES: BILATERAL TRADING & CENTRAL CLEARING, 09 (2013).
[17] Sportking India Limited v. HDFC Bank Limited, Bombay High Court, order dated July 29, 2013, Arbitration Petition No. 1443 of 2010.

There are four main types of OTC FX derivative: Spot, forwards, swaps and options.

- **FX Spot:** They are the simplest form of FX derivatives, whereby one party purchases an agreed amount of one currency in exchange for an agreed amount of another currency.[18] The Settlement is within two Business Days (T+2).[19] Most commonly, one part of this transaction would be in need of currency for a specific purpose (such as to make payment in foreign currency for importing goods) and the other will be a broker which will earn the difference between the rate at which it exchanges the currency with the importer and the rate at which it purchased the currency from market. This difference or spread is the profit earned by a broker.[20] Therefore, currency exchanges for international payment for goods and services are considered as "spot" as they are not intended to earn a profit or hedge against FX risk.[21]
- **FX Forward:** FX Forward is a contract to lock in the exchange rate between two currencies for the purchase and sale on a future date. A forward contract is a contract agreed upon at the date to purchase or sell the security at a future date for a price that is specified at trade date.[22]
- **FX Swaps:** A foreign currency swap is an agreement to swap principal and interest payments denominated in one foreign currency loan made in one currency to another foreign currency. In other words, a party borrows foreign currency from another party and simultaneously lends it to such a party in another foreign currency.
- **FX Options:** In FX Option contract, one party holds contractual right to buy/sell currency at a fixed rate on a future date. Such right comes with a fee

[18] EDMUND PARKER, *supra* note 01, at 539.
[19] Exception to this rule is for USD/CAD, with a settlement date of T+1.
[20] EDMUND PARKER, *supra* note 01, at 539.
[21] Min-woo Kang, *Rethinking spot FX regulation*, 13(4) LAW AND FINANCIAL MARKETS REVIEW, 234–243 (2019).
[22] Martin Haugh, *Forwards, Swaps, Futures and Options IN IEOR E4706: Foundations of Financial Engineering,* Columbia Edu (Feb 8, 2021), http://www.columbia.edu/~mh2078/FoundationsFE/for_swap_fut-options.pdf.

in the form of a premium. The buyer has no obligation to buy but the seller has a definitive obligation to sell if the buyer wishes.

FX REGULATION: INDIAN LANDSCAPE

The scarcity of FX reserves in India brought about the need for a regulatory framework. The Foreign Exchange Regulation Act, 1973 (the "FERA")[23] was enacted with a view to regulate this scarcity and hence, the Government of India *de jure* was the legal owner of all foreign currencies within India. The exchange rate of the INR was fixed by the Reserve Bank of India (the "RBI") until the early 1990s and only a narrow range of deviation was allowed.[24]

Even though banks were permitted to participate in intra-trading of FX since 1978,[25] it was only during the early 1990s that the Indian FX Market underwent a complete overhaul. The economic reforms of 1991 initiated the liberalisation of the Indian FX market and a market determined exchange rate system was subsequently adopted. This changed the landscape necessitated a complete overhaul of the prevailing regulatory framework to complement liberalization.

In light of the same, the Foreign Exchange Management Act, 1999 (the "FEMA")[26] was enacted, overruling FERA, to provide a comprehensive regulatory framework for the liberalised FX Market and designating RBI as the regulatory authority.

With the advent of FEMA, the regulatory approach towards FX changed from that of 'conservation' to 'management' in order to build a vibrant FX Market. The RBI issued the Foreign Exchange Management (Foreign exchange

[23] The Foreign Exchange Regulation Act, 1973.
[24] K.J. Udeshi, Keynote Address of Deputy Governor, Reserve Bank of India at 15th Forex Assembly organised by Forex Association: Development of Forex Markets in India: Review and Prospects (September 2004) of India in Colombo, Sri Lanka (August 20, 2004).
[25] K.J. Udeshi, *Supra* note 2, 1.
[26] The Foreign Exchange Management Act, 1999.

derivatives contracts) Regulations, 2000[27] in order to provide a regulatory framework for the safe usage of OTC derivatives. Under it, a "Foreign exchange derivative contract" was defined as a "*financial transaction or anarrangement in whatever form and by whatever name called, whose value is derived from price movement in one or more underlying assets, and includes,*

(a) a transaction which involves at least one foreign currency other than currency of Nepal or Bhutan, or

(b) a transaction which involves at least one interest rate applicable to a foreign currency not being a currency of Nepal or Bhutan , or

(c) a forward contract,

But does not include foreign exchange transaction for Cash or Tom or Spot deliveries;"[28]

A general prohibition was placed on the entry into FX derivative contracts except for the ones permitted by RBI.[29]

Users in the FX derivatives market were classified into two types: (i) person resident in India, and (ii) person resident outside India.[30] Persons resident in India included retail as well as non-retail users and this user classification framework indicates that the Indian FX derivatives market was not yet mature enough as to merit a distinction between retail and corporate users.[31] Persons resident outside India included foreign institutional investors and non-resident Indians who were only allowed to enter into forward contracts as opposed to

[27] The Foreign Exchange Management (Foreign exchange derivatives contracts) Regulations, 2000.
[28] Foreign Exchange Management (Foreign exchange derivative contracts) Regulations, 2000, Reg. 2(v).
[29] Foreign Exchange Management (Foreign exchange derivative contracts) Regulations, 2000, Reg. 3.
[30] Foreign Exchange Management (Foreign exchange derivative contracts) Regulations, 2000, Reg. 4 & 5.
[31] Foreign Exchange Management (Foreign exchange derivative contracts) Regulations, 2000, Reg. 4.

persons resident in India.[32] Only banks and other financial institutions authorised by RBI were permitted to enter into FX derivatives contracts with users in the FX Market.[33] It is imperative to note that these regulations only permitted derivatives to be used to hedge an existing underlying exposure and hence, the notional principal amount of the derivative could not exceed total amount of underlying exposure.[34] The scope of derivative contracts allowed were mostly restricted to forward contracts with certain exceptions for persons resident in India for contracts not involving the INR.[35] Further restrictions were placed on the cancelling and re-booking of contracts.[36]

As in many other countries, the FX Market of India is also divided into two types: (i) Spot Market[37] (ii) Derivatives Market. A further classification of the Derivatives Market can be done into: (i) Exchanged-Traded (ii) Over the Counter (OTC). The FX Market in India is predominantly an OTC market with banks, corporates and brokers being the dominant players,[38] Exchange-traded FX currency derivatives were introduced by National Stock Exchange of India (NSE) in 2008 with the launch of the Currency Derivatives segment.[39] The principal instrument for regulation of exchanged-traded derivatives is Securities

[32] Foreign Exchange Management (Foreign exchange derivative contracts) Regulations, 2000, Reg. 5.
[33] The Foreign Exchange Management Act, 1999, Sec 10(1).
[34] Foreign Exchange Management (Foreign exchange derivative contracts) Regulations, 2000, Reg. 4 & 5.
[35] Foreign Exchange Management (Foreign exchange derivative contracts) Regulations, 2000, Schedule I & II.
[36] Foreign Exchange Management (Foreign exchange derivative contracts) Regulations, 2000, Schedule I.
[37] In the 'Spot Market', currencies are traded at the prevailing spot rate and the settlement date is not more than 2 business days.
[38] *Report of the Internal Working Group on Comprehensive Review of Market Timings*, RESERVE BANK OF INDIA (July 10, 2019), https://www.rbi.org.in/scripts/PublicationReportDetails.aspx?ID=935 (last visited October 4, 2020).
[39] National Stock Exchange of India Ltd., https://www1.nseindia.com/products/content/derivatives/curr_der/about_currency_der.htm (last visited Feb 8, 2021).

Contracts (Regulation) Act, 1956 (SCRA).[40] But there were still certain doubts lingering with respect to the legality of OTC derivatives caused in part due to the Securities Laws (Amendment) Act, 1999[41] which inserted Section 18A of SCRA which stated that only derivatives traded on recognised stock exchanges and settled on a clearing house shall be considered legal.[42] This led market participants to believe that OTC derivatives contracts are legally invalid and could further be considered as wagering contracts according to Section 30 of the Indian Contract Act, 1972.[43] To allay these concerns, Reserve Bank of India (Amendment) Act, 2006 inserted Section 45V of RBI act, 1934[44] which clarified that derivative transactions will be valid if either of the parties is either a bank or a regulated entity under Banking Regulation Act, 1949 or FEMA.

The above section made it clear that OTC derivatives would still be considered legal as long as one of the parties is a regulated party and hence, the RBI Amendment Act, 2006 was a monumental change in laying out a regulatory framework for the regulation of OTC derivatives including FX derivatives.

Subsequent to the enactment of FEMA in 1999, the Indian FX Market has expanded rapidly in the years leading to the Great Financial Crisis. According to RBI FX Turnover Data, the Total Annual Turnover of Indian FX Market has more than quadrupled from $1,306 billion in 1997-1998 to $5,734 billion in 2006-2007.[45] FX derivatives comprised of nearly 50% of the FX Turnover during 1997-2006. The volume of FX derivatives further rapidly expanded in 2007 as the INR was appreciating against the USD due to Great Financial Crisis. This also led to complex derivative products being sold to exporters who

[40] Securities Contracts (Regulation) Act, 1956.
[41] Securities Laws (Amendment) Act, 1999.
[42] Securities Contracts (Regulation) act, 1956, S. 18A.
[43] Indian Contract Act, 1972, S. 30.
[44] Reserve Bank of India Act, 1934, S. 45V.
[45] RBI DOCS, https://rbidocs.rbi.org.in/rdocs/publicationreport/pdfs/77577.pdf (last visited Feb 8, 2021).

did not exactly comprehend the mechanics of these products.[46] The subsequent volatility in currency markets in 2008 led to substantial INR depreciation and as a result, many small and medium exports suffered huge losses. Several exporters moved courts in different parts of the country to contest the legality of these contracts.[47] RBI found that banks who were authorised dealers side stepped the existing regulations intended to prevent leverage or let the value of hedge exceed the amount of underlying exposure.[48]

In light of the FX derivatives mis-selling in 2007-08, there was a need for a comprehensive framework detailing operational and products guidelines for OTC FX derivatives in India. RBI released Comprehensive Guidelines on Over the Counter (OTC) FX Derivatives and Overseas Hedging of Commodity Price and Freight Risks in December 28, 2010.[49] These detailed guidelines built upon on and expanded the existing regulatory framework under Foreign Exchange Management (Foreign Exchange Derivative Contracts) Regulations, 2000. For persons resident in India, a new category of products were permitted on the basis of probable future exposures[50] whereas under FEMA (Foreign Exchange Derivative Contracts) Regulations, 2000 no such anticipated exposures were permitted to be hedged except for probable exposure related to submission of a tender in foreign currency.[51] Further, Small and Medium Enterprises (SMEs) were permitted under special dispensation to enter into forward contracts

[46] Oommen A. Ninan, *Mis-selling of derivative products: RBI acts*, THE HINDU (May 2, 2011), https://www.thehindu.com/business/Economy/misselling-of-derivative-products-rbi-acts/article1983530.ece (last visited October 4, 2020).
[47] OUTLOOK INDIA, *Exporters cry foul over banks 'mis-selling' forex derivatives'* (September 04, 2008), https://www.outlookindia.com/newswire/story/exporters-cry-foul-over-banks-mis-selling-forex-derivatives/9889 (last visited October 4, 2020).
[48] Oommen A. Ninan, *supra* note 45.
[49] Reserve Bank of India, Comprehensive Guidelines on Over the Counter (OTC) Foreign Exchange Derivatives and Overseas Hedging of Commodity Price and Freight Risks, RBI/2010-11/338, (Notified on Dec 28, 2010), https://www.rbi.org.in/scripts/NotificationUser.aspx?Id=6175&Mode=0.
[50] *Id,* at 2.
[51] Explanation, Foreign Exchange Management (Foreign exchange derivative contracts) Regulations, 2000, Schedule 1.

without having to produce supporting documents for hedging their FX exposure.[52] The scope of derivative products available to both persons resident in India and outside India had been further expanded.[53] A reporting requirement was introduced for Authorised Dealers Category I[54] with respect to all the FX derivative products used by them.[55] In compliance with the G-20 Commitment on Reporting of OTC Derivative Trades to Trade Repository, the RBI further mandated in January 15, 2014 that all interbank FX derivatives along with selective trades between banks and their client shall be reported to the reporting platform of Clearing Corporation of India Limited (CCIL).[56]

The daily average turnover of OTC FX instruments in India on a net-gross basis peaked at 38 billion USD in 2007 right before the sub-prime mortgage crisis and thereafter stumbled down to 27 billion USD by 2010.[57] With the introduction of RBI's comprehensive guidelines on OTC FX derivatives in 2011 and with the regulatory framework becoming more certain, the daily average turnover of OTC FX instruments began to gradually increase to 34 billion USD in 2016 and to 40 billion USD in 2019.[58] The daily average OTC FX turnover in INR on net-net basis has also increased from 38 billion USD in 2010 to 114 billion USD in 2019 and simultaneously the share of INR in the total OTC FX turnover in the world was less than 1% in the early 2000s and has since increased to 2% in 2019 which is still considerably less.[59]

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[52] *Supra* 49.
[53] *Supra* 49, 2-3.
[54] The Foreign Exchange Management Act, 1999, Sec. 10(1).
[55] *Supra* 49, 33.
[56] Reserve Bank of India, RBI's Compliance with the G-20 Commitment on Reporting of OTC Derivative Trades to Trade Repository**,** (Issued on Jan 15, 2014), https://rbidocs.rbi.org.in/rdocs/PressRelease/PDFs/IEPR1424OTC0114.pdf.
[57] BANK FOR INTERNATIONAL SETTLEMENTS, *Triennial Central Bank Survey: Global foreign exchange market turnover in 2019*, 66 (December 8, 2019), https://www.bis.org/statistics/rpfx19_fx_annex.pdf (last visited October 10, 2020).
[58] *Id.*
[59] *Id,* at 72-73.

To keep up pace with the expanding OTC FX market and to further increase a negligible 2% share of Indian Rupee ("INR") in the total OTC FX turnover, RBI undertook a review of the existing regulatory framework for OTC FX derivatives in 2019.[60] Subsequent to this review, the current hedging facilities for residents and non-residents were revised under FEMA and a circular to this effect was issued on April 7, 2020.[61] The user classification framework was revamped and now the users have been divided into: (i) retail users (ii) non-retail users. Non-retail users entail regulated financial institutions and companies with a minimum net worth of Rs 500 crores.[62] Access to complex OTC FX derivatives was again restored specifically to non-retail users after having banned them in 2008 due to excessive mis-selling by banks. For non-retail users, the permitted products included any derivative contracts including covered options[63] and these products can be independently priced and valued by authorised dealers provided that they get it approved by their governing board.[64] While expanding the scope of products available for non-retail users, RBI re-emphasised that the objective of these transactions must be for genuine hedging which has been defined as "*the activity of undertaking a derivative contract to offset the impact of an anticipated or a contracted exposure*".[65] All users who are not non-retail users can be classified as retail users. The product scope for retail users was restricted to forwards, call/put European options, call/put spreads and

[60] *See* Press Release, RBI, Press Release: Statement on Developmental and Regulatory Policies (February 7, 2019), https://www.rbi.org.in/scripts/BS_PressReleaseDisplay.aspx?prid=46237 (last visited October 10, 2020).
[61] Reserve Bank of India, RBI/2019-20/210 A.P.(DIR Series) Circular No. 29, (Notified on April 7, 2020).
[62] Reserve Bank of India, Annex II, RBI/2019-20/210 A.P.(DIR Series) Circular No. 29, (Issued on April 7, 2020).
[63] 'Covered Option' is a financial transaction under which the investor writing the call/put option also owns the underlying asset.
[64] Reserve Bank of India, Annex II, RBI/2019-20/210 A.P.(DIR Series) Circular No. 29, (Issued on April 7, 2020).
[65] Foreign Exchange Management (Foreign Exchange Derivative Contracts) (First Amendment) Regulations, 2020, Regulation 2(i)(xv).

swaps.[66] Authorised dealer shall permit users to free cancellation and rebooking of derivative contracts. Further, all derivatives contracts were made subject tothe Suitability and Appropriateness policy provided under Comprehensive guidelines on derivatives published by RBI on April 20, 2007.[67]

With respect to the regulatory framework of the on-shore market, there existed a huge void in the absence of bilateral netting for OTC derivatives.[68] This void was not only present in the OTC FX derivatives regulation but was pervasive throughout the whole of OTC derivatives regulatory framework in India. The absence of bilateral netting locks up capital for market participants and compels them to manage credit risk on a gross basis thereby damaging credit capacity and liquidity. Banks acting as authorised dealers in the FX market are required to calculate their credit exposure to counterparties and regulatory capital requirements with respect to OTC derivative transactions on a gross basis. Due to this, market participants are required to post increased margins to secure any outstanding exposure. Netting in OTC FX derivatives would enable banks to consolidate the vast number of frequent trades and group them under a single netting agreement leading to streamlining and increased efficiencies of processes. As stated by Scott O'Malia on the significance of netting, Chief Executive of International Swaps and Derivatives Association (ISDA), "*This is the single most effective tool for reducing credit risk between counterparties, and is critical to establish certainty and encourage participation in local markets*".[69] It is estimated that around 2.14 lakh crore INRs have been locked up with banks during the

[66] Reserve Bank of India, Annex II, RBI/2019-20/210 A.P.(DIR Series) Circular No. 29, (Issued on April 7, 2020).
[67] Reserve Bank of India, Circular no.DBOD.No.BP.BC.86/21.04.157/2006-07 (Issued on April 20, 2007.
[68] Bilateral netting refers to the offsetting of all claims relating to transactions entered into by two parties so that a single amount can be determined for payment.
[69] Scott O'Malia, ISDA Chief Executive, Opening remarks at ISDA AGM Hong Kong 2019 (April 10, 2019).

financial year period of 2017-2020 due to the lack of a bilateral netting law.[70] Fortunately, India took the leap of introducing bilateral netting into the country on 23 September 2020 with the passing of The Bilateral Netting of Qualified Financial Contracts Act, 2020[71] (the "Netting Act") by the parliament.[72] The Netting Act is based largely on the Model Netting Act by ISDA to assist jurisdictions to bring in their own netting laws.[73] One of the most striking features of the Act is that it ensures the enforcement of bilateral netting[74] against insolvent parties by limiting the powers of administration practitioner in blocking any payments in connection with bilateral netting.[75] Furthermore, the applicability of netting under this Act overrides any conflicting laws such as the Insolvency and Bankruptcy Code, 2016, FEMA and other laws stated in the second schedule of the Act to the extent they are in conflict with the Netting Act.[76] This would reassure on-shore markets players of their counterpart's payment obligations (however at the detriment of other creditors).

While this Netting Act seems encouraging in terms of freeing up capital and improving process efficiencies in the derivatives market, what remains to be seen is its implementation and effectiveness once various authorities under the Act identify Qualified Financial Contracts.

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[70] FE Bureau, *'Netting law to help banks unlock capital and spur lending, says FM Nirmala Sitharaman'*, FINANCIAL EXPRESS (September 24, 2020), https://www.financialexpress.com/industry/banking-finance/netting-law-to-help-banks-unlock-capital-spur-lending-says-fm-nirmala-sitharaman/2090384/.

[71] The Bilateral Netting of Qualified Financial Contracts Act, 2020.

[72] Gaurav Noronha & ET Bureau, '*Lok Sabha passes Bilateral Netting of Qualified Financial Contracts Bill, 2020'*, THE ECONOMIC TIMES (September 23, 2020), https://economictimes.indiatimes.com/news/economy/policy/lok-sabha-passes-bilateral-netting-of-qualified-financial-contracts-bill-2020/articleshow/78223431.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst.

[73] ISDA, https://www.isda.org/2018/10/15/2018-model-netting-act-and-guide/(last visited Feb 8, 2021).

[74] It refers to determination of net claim or obligations between parties to a bilateral agreement by way of setting off to result in an aggregate amount.

[75] The Bilateral Netting of Qualified Financial Contracts Act, 2020, Sec 4(3) & Sec 4(4).

[76] The Bilateral Netting of Qualified Financial Contracts Act, 2020, Sec 6(4)

Off-shore INR Markets

Off-shore markets in respect of currencies are normally known as non-deliverable forward (NDF) markets. Off-shore currency markets exist only with respect to non-convertible currencies or currencies with convertibility restrictions. As many emerging market economies (EMEs) have currency convertibility restrictions, these NDF markets exist mostly in respect of EMEs currencies.[77] The reasons behind the advent of NDF markets can be traced to the 1990s when economic liberalisation reforms swept numerous emerging market economies (EMEs) including India. These reforms brought about cross-border trade and foreign capital flows into India. Trade to GDP ratio has risen from around 15% in 1990 to 43% in 2018.[78] With increased participation of non-resident investors in the domestic economy of India, there arose currency risk too with the potential of damaging returns on investments of non-resident investors. India did have a nascent domestic FX market developing in the 1990s but this market restricted the participation of non-resident investors to a large extent. There were widespread concerns that easy access to on-shore FX market would eventually lead to speculative activity which would further result in increased exchange rate volatility.[79] This led the development of an off-shore rupee NDF market to meet the hedging and also speculative needs of international participants.

NDFs are OTC FX derivative contracts which trade in restricted or non-convertible currencies at major off-shore financial centres like London, Hong Kong and Singapore thereby circumventing the jurisdiction of respective country's regulatory authorities. NDF is basically a forward contract but the

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[77] Nikhil Patel & Dora Xia, *Offshore markets drive trading of emerging market currencies,* BIS QUARTERLY REVIEW (December 8, 2019), https://www.bis.org/publ/qtrpdf/r_qt1912h.htm (last visited October 10, 2020).

[78] RBI, REPORT OF THE TASK FORCE ON OFFSHORE RUPEE MARKETS, 14 (8 August, 2020), https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/REPORTFB5DEA33A7254948AA1D5B09657152A1.PDF. (last visited Feb 8, 2021).

[79] *Id,* at 22

settlement is not done in the underlying currency but rather in a freely convertible currency like the USD. On the maturity date, the settlement done is the difference between a previously agreed exchange rate and the prevailing spot rate in a popular international currency mostly the USD.

The main cause of concern for India, as to the rise of off-shore INR markets, is that they are completely out of the regulatory purview of national authorities. This concern has only aggravated over the years with the exponential rise in the NDF INR market. In 2013 Triennial Central Bank Survey by Bank for International Settlements (BIS), the average daily volume of INR OTC derivatives trading in off-shore markets was measured to be 17.2 billion USD as against 20.9 billion USD in the on-shore market.[80] In the 2016 triennial BIS survey, the average daily volume of INR OTC derivatives trading in off-shore markets was 16.4 billion USD as compared to 24.6 billion USD in the market.[81] But especially in the recent years between 2016 and 2019, the FX turnover of EME currencies grew by a substantial 60% while the global turnover grew by 33%. Another interesting statistic to note is the rise in share of trading firms, hedge funds and other financial clients in EME currency trading.[82] Low interest or almost zero interest rates in developed economies has led international investors to go seek out more risky assets in pursuit of higher returns and EME assets was their answer. This along with increased electrification of NDF trading[83] led to a rise in off-shore trading as more and more investors are seeking to hedge the currency risk in their underlying EME investments. Hence

[80] *Triennial Central Bank Survey: Global foreign exchange market turnover in 2013,* BANK FOR INTERNATIONAL SETTLEMENTS (February 2014), https://www.bis.org/publ/rpfxf13fxt.pdf (last visited October 10, 2020).
[81] *Triennial Central Bank Survey: Global foreign exchange market turnover in 2016,* BANK FOR INTERNATIONAL SETTLEMENTS (December 11, 2016), https://www.bis.org/publ/rpfxf16fxt.pdf (last visited October 10, 2020).
[82] Nikhil Patel & Dora Xia, *Supra* note 44.
[83] Philip Wooldridge, *FX and OTC derivatives markets through the lens of the Triennial Survey* – BIS QUARTERLY REVIEW (December 8, 2019), https://www.bis.org/publ/qtrpdf/r_qt1912e.htm (last visited October 10, 2020).

in the 2019 triennial BIS survey, the average daily volume of INR OTC derivatives trading in off-shore markets surged to 50 billion USD overshadowing the average daily volume billion in the on-shore market which was a distant 28.7 billion USD.[84]

The recent surge in NDF INR trading must be examined in the context of the relationship between the NDF and on-shore prices. In a 2006 study, it was found that on-shore prices had a directional influence over NDF prices even though volatility spill-overs in the latters would sometimes seep into the on-shore market.[85] In a subsequent study done examining the linkage between NDF and on-shore prices during 2000-2009, it was found that there was change in dynamics with increased volatility spill-over from NDF to on-shore prices rather than the vice versa.[86] The task force constituted by RBI in 2019 conducted a comprehensive study on the price linkage between NDF and on-shore prices[87] and their findings confirmed the change in dynamics found in earlier studies.[88] The study found a bidirectional relationship between off-shore and NDF prices. Both the prices share a robust long-term relationship and during bouts of increased volatility, this relationship breaks into disequilibrium. Then on-shore and NDF prices gradually converge towards each other. This indicates that both prices directionally impact each other although at varying levels. The market which has the bulk of volumes drives price discovery which tend to oscillate substantially mostly during periods of stress. During the 2013

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[84] *Triennial Central Bank Survey: Global foreign exchange market turnover in 2019*, BANK FOR INTERNATIONAL SETTLEMENTS (December 8, 2019), https://www.bis.org/statistics/rpfx19_fx_annex.pdf (last visited 10 October 2020).

[85] Sangita Misra and Harendra Behera, *Non Deliverable Foreign Exchange Forward Market: An Overview*, 27(3) RESERVE BANK OF INDIA OCCASIONAL PAPERS 26, 37-38 (2006).

[86] Harendra Kumra Behera, *On-shore and offshore market for Indian rupee: recent evidence on volatility and shock spillover,* 4(1) MACROECONOMICS AND FINANCE IN EMERGING MARKET ECONOMIES 43, 54 (2011).

[87] RBI, REPORT OF THE TASK FORCE ON OFFSHORE RUPEE MARKETS (July 30, 2019), https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/REPORTFB5DEA33A7254948AA1D5B09657152A1.PDF (last visited10 October 2020).

[88] Sangita Misra and Harendra Behera, *Supra* note 52 & Harendra Kumra Behera, *Supra* note 53.

taper tantrum and 2018 emerging market crisis, the relationship became one-sided with the NDF market driving price discovery in on-shore markets and the market being thrown in disequilibrium. The extent of volatility spill-over also rises during periods of stress from NDF to on-shore markets. An interesting asymmetry was observed as the volatility spill-over would increase from NDF to on-shore markets during periods of INR depreciation and the volatility spill-over would increase from on-shore to NDF markets during episodes of INR appreciation.[89] Therefore, it was clear that the increased NDF volumes would be the predominant driver of price discovery in on-shore markets.

In order to re-direct some of the volumes from the off-shore market to on-shore, RBI introduced a regulatory scheme for banking units[90] to be set-up in the International Financial Services Centre (IFSC)[91] and further, in March 2020 during the beginning of the Covid-19 pandemic, permitted them to participate in the NDF market by allowing them to offer NDF INR contracts to persons not resident in India.[92] Earlier in the year in January 2020, RBI also decided to allow trading of INR derivatives with settlement in foreign currency in IFSC.[93] With Covid-19 pandemic causing increased volatility and disrupting financial markets, RBI's decision to allow trading of INR derivatives was timely to counter the influence of NDF markets on on-shore prices. But only exchange traded currency futures[94] and currency options[95] were allowed to be traded.

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[89] Report of the Task Force on Offshore Rupee Markets, *Supra* note 54.
[90] Foreign Exchange Management (International Financial Services Centre) Regulations, 2015.
[91] International Financial Services Centre is a Special Economic Zone (SEZ) jurisdiction in India which provides financial services to investors outside the jurisdiction of India. The first IFSC set up in India is Gujarat International Finance Tec-city.
[92] Reserve Bank of India, RBI/2019-20/193 A.P. (DIR Series) Circular No.23 (March 27, 2020), https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11843&Mode=0 (last visited October 10, 2020).
[93] Reserve Bank of India, RBI/2019-20/145A.P. (DIR Series) Circular No.17 (January 20, 2020), https://rbidocs.rbi.org.in/rdocs/notification/PDFs/APDIR17BEBA86C0E89041BBAA3425106742E6D1.PDF (last visited October 10, 2020).
[94] Currency Futures in International Financial Services Centre (Reserve Bank) Directions, 2020.

National Stock Exchange (NSE) and Bombay Stock Exchange (BSE) introduced INR/USD derivatives in IFSC at Gujarat International Finance Tec-city (GIFT).[96] Securities and Exchange Board of India (SEBI) allowed institutional investors to take fixed positions up to 1 billion USD whereas other investors could take up positions up to 100 million USD.[97] Stock exchanges in GIFT have been allowed to be open for 22 hours a day thereby making it easier for foreign investors to hedge their NDF requirements.[98] But the migration of NDF trades to stock exchanges in IFSC is unlikely to happen soon unless these exchanges markets develop enough liquidity and efficient price discovery and space for OTC derivatives is also created.

Lacunae in Regulation

The most discernable lacuna in the regulation of FX market for India is the lack of regulatory purview over the off-shore INR markets. Especially with the substantial volumes of the NDF market influencing the on-shore prices, the solution lies in bringing the volumes in NDF market on-shore and within the regulatory purview RBI.

One way of bringing the NDF market volumes to India is by making the INR a freely convertible currency but that would be in direct contravention to RBI's policies on managing the "impossible trinity dilemma" – the impossibility of

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[95] Currency Options in International Financial Services Centres (Reserve Bank) Directions, 2020.

[96] *International exchange arms of BSE, NSE launch rupee derivative contracts*, THE ECONOMIC TIMES, May 8, 2020, https://economictimes.indiatimes.com/markets/forex/international-exchange-arms-of-bse-nse-launch-rupee-derivative-contracts/articleshow/75625533.cms (last visited October 10, 2020).

[97] Security and Exchange Board of India, SEBI/HO/MRD2/DCAP/CIR/P/2020/17 (Issues on February 3, 2020), https://www.sebi.gov.in/legal/circulars/feb-2020/currency-future-and-options-contracts-involving-indian-rupee-on-exchanges-in-international-financial-services-centres-ifsc-_45886.html.

[98] Rajesh Bhayani, *Rupee-dollar derivatives set to enter stock exchanges in GIFT City IFSC*, BUSINESS STANDARD, January 21, 2020 https://www.business-standard.com/article/markets/rupee-dollar-derivatives-set-to-enter-stock-exchanges-in-gift-city-ifsc-120012001014_1.html (last visited October 10, 2020).

achieving (i) independent monetary policy, (ii) stable exchange rate, and (iii) free capital flows.[99]

It is only possible to achieve two of these three objectives and RBI's policies have been positioned towards having an independent monetary policy while following a mid-path by partially controlling the exchange rate and capital flows. A freely convertible INR would make the off-shore markets redundant but that would also expose India to macroeconomic instability caused by potential drastic exchange rate volatility.

The solution to bringing NDF markets on-shore lies in the balancing act between maintaining a stable exchange rate and improving the accessibility of on-shore markets to international market participants without compromising on a stable INR exchange rate.

A stable INR exchange rate reinforces the need for capital account restrictions on FX derivatives in the form of position limits, requirement of an underlying exposure for hedging, settlement in INR, restrictions on cancelling and rebooking of contracts etc. These restrictions have already undergone substantial liberalisation over the years and hence the scope for further amendments to the current regulatory framework remains limited. Any further amendments would require India comprising on their objective of a stable INR exchange rate which the authorities are not prepared to do. The on-shore market largely caters to the needs of domestic participants and its regulatory framework is not attractive enough to bring non-resident participants on-shore. But this is needed to be able to bring the whole INR exchange market within the purview of regulatory authorities in India.

An innovative solution would be to create a parallel regulatory framework for NDF INR trades which is competitive in relation to the off-shore markets and

[99] Vijay Joshi, *'India and the Impossible Trinity'*, 26(4) THE WORLD ECONOMY 555, 557 (2003).

can bring in off-shore volumes. India has taken a pivotal step in this right direction by allowing the trading of non-deliverable INR derivatives in IFSC.[100]

IFSC markets operate outside of the purview of FEMA and hence are not bound by the capital account restrictions and also have favourable tax treatment by virtue of being a Special Economic Zone ("SEZ") jurisdiction. These IFSC INR markets, technically speaking, would still be perceived as off-shore especially with their own regulatory agency[101] and with the hands-off approach of RBI. This very perception of an off-shore market although being within the jurisdiction of India is necessary to create in order to inspire market confidence and bring in NDF market participants. However, these markets would still be subject to regulation by Indian authorities and are also required to report all OTC FX derivative transactions to CCIL[102] thereby providing the necessary oversight to the regulatory authorities. Hence, this parallel regulatory framework in IFSC is ideal as it has the right optics of being an off-shore market but is still within the oversight of regulatory authorities. The lack of capital account restrictions in this parallel framework seems like a necessary compromise to gain the benefit of regulatory oversight over off-shore markets and this parallel framework might in fact be the answer to bringing the NDF markets on-shore without compromising on the objective of a stable INR exchange rate.

CONCLUSION

The significance of FX and the regulatory framework surrounding it grew exponentially in India since the economic liberalisation reforms of 1991. With increased cross-border transactions, foreign direct investment and increased

[100] Reserve Bank of India, RBI/2019-20/145A.P. (DIR Series) Circular No.17 (Issued on January 20, 2020), https://rbidocs.rbi.org.in/rdocs/notification/PDFs/APDIR17BEBA86C0E89041BBAA3425106742E6D1.PDF (last visited October 10, 2020).

[101] International Financial Services Centres Authority of India (IFSCA) is the regulatory authority for all financial services in IFSCs in India.

[102] Reserve Bank of India, RBI/2019-20/233 FMRD.FMID.26/02.05.002/2019-20 (Issued on May 18, 2020), https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11889&Mode=0.

capital inflows - FX needs of market participants grew sophisticated; resultingin increased use of derivatives as a risk management tool. However, the regulations failed to maintain pace.

The spotlight on FX derivatives and the regulation landscape came about during 2007 due to the mis-selling of complex derivatives to unsophisticated user by banks.[103] As highlighted previously, the most significant drawback of theregulatory framework was lack of regulatory oversight over the off-shore INRmarket. It is only recently, numerous significant steps have been taken, with the introduction of a liberalised parallel regulatory framework for FX derivatives in GIFT; India's first IFSC.

India has balanced the rather conflicting objectives of increased regulatory oversight and attracting off-shore INR markets on-shore by allowing trading ofnon-deliverable INR derivative contracts in IFSC. Further, the introduction ofthe Bilateral Netting of Qualified Financial Contracts Act, 2020 has further pushed off-shore INR market participants to satisfy their INR FX requirementson-shore.

As the global economy is experiencing tremendous changes, the need for business community will also evolve. The regulatory authorities will be required to keep pace with developments to ensure robust regulatory framework surrounding FX derivatives.

[103] *Exporters cry foul over banks 'mis-selling' forex derivatives*, OUTLOOK INDIA (September 04, 2008),https://www.outlookindia.com/newswire/story/exporters-cry-foul-over-banks-mis-selling- forex-derivatives/9889.

Yamika Khanna, *Decoding the quandary of bank guarantee amidst the outbreak of COVID- 19,* 9(1) SCHOLASTICUS, 49 (2022)

DECODING THE QUANDARY OF BANK GUARANTEE AMIDSTTHE OUTBREAK OF COVID-19

Yamika Khanna[⊥]

ABSTRACT

The gravity of Covid-19 pandemic and its debilitating effect on world economy and commercial supply chain are ubiquitous and unpredictable. The drastic measures in the form of imposition of lockdown to curb the impact and spread of COVID-19 has disrupted the supply chain and caused a global shortage of labour force leading to pernicious ramifications for business entities across the globe. Due to increase in breach of contract and non-performance of contractual obligations, involvement of bank guarantee and disputes regarding its invocation are inevitable.

In this article, the author evaluates the judicial approach adopted with regard to invocation and restraint on bank guarantees with special emphasis on recognition of 'Special Equities' as an independent exception for such restrain and its impact on commercial contracts. Moreover, we assess the impact of force majeure clause on invocation of bank guarantees. We argue that courts must be vigilant and cautious while granting injunctive reliefs with regard to invocation of bank guarantees and uphold the fidelity of commercial contracts, as unwarranted judicial interference may produce adverse economic impact in the long term. Furthermore, we analyse the emerging judicial trends concerned with bank guarantee and comparatively analyse them with the global developments.

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INTRODUCTION

The evolving global scenario led to a surge in globalisation and cross country commercial contracts. This development marked the establishment of financial instruments of autonomous nature, ensuring financial security to the contracting parties. Section 126 of the Indian Contract Act, 1872[1] defines a 'contract of guarantee' as a "contract to perform the promise, or discharge the liability, of a third person in case of his default.[2]" Under this provision, the contract of bank guarantee has been developed to secure a payment obligation under a commercial contract by a third party, namely the bank.

A bank guarantee thus, is an agreement for the due performance of a pre-stated promise or the discharge of a liability of a third person in case a default is committed.[3] The most distinctive feature of a contract of bank guarantee is that it is a separate and autonomous contract and is thus, independent of any dispute between the principal debtor and the beneficiary. The rationale behindthis was laid down in *Hamzeh Melas & Sons v. British Imex Industries Ltd.*[4] wherethe court held that the commercial trading involving bank guarantee or a letterof credit must go on, irrespective of a dispute between the contracting parties.[5]

But over a period of time, the court recognized three exceptions that could lead to a restraint against the invocation and encashment of bank guarantee.[6] These are as follows:

- Fraud in connection with the bank guarantee;[7]

[1] Indian Contract Act, 1872, Section 126.
[2] *Id.*
[3] Rashi Suri and Pradyun, *Invoking Performance Bank Guarantees Due To Covid-19 Related Non-performance* LAWYERED (7 May 2020),https://www.lawyered.in/legal-disrupt/articles/invoking-performance-bank-guarantees-due-covid-19-related-non-performance-by-advocate-rashi-suri/. (accessed on May 12, 2020).
[4] Hamzeh Melas & Sons v. British Imex Industries Ltd., (1958) 2 QB 127.
[5] *Id.*
[6] U.P Coop. Federation Ltd. v. Singh Consultants & Engineers (P) Ltd., 1988 SCC (4) 274.
[7] *Id.*

- Irretrievable harm or injustice - the party seeking relief would necessarily have to show exceptional circumstances which would make it impossible for the guarantor to reimburse himself in the event of succeeding in the main dispute;[8]
- *Special Equities.*

The outbreak of the virus and the subsequent imposition of lockdown across the globe has resulted in disruption of commercial activities. This has resulted in breach of contracts or non-discharge of contractual obligations, further resulting in the contracting parties resorting to invocation of the line of credit secured through bank guarantee. Countering the same, parties subjected to invocation of bank guarantee have argued COVD-19 and lockdown to be *force majeure* events, justifying the injunction of bank guarantees as a condition of "*Special Equities"* exists.

The development of '*Special Equities*' as an exception can be perceived as a threat as well as a tool for rendering justice with regard to contractual obligations. In *Svenska Handelsbanken v. Indian Charge Chrom*e[9], '*Special Equities*' were recognised as a part of irretrievable harm and injustice. The court held that "in order to restrain the operation either of irrevocable letter of credit or confirmed letter of credit or bank guarantee, there should be serious dispute and there should be good prima facie case of fraud and *special equities* in the form of preventing irretrievable injustice between the parties."[10]

But the Hon'ble Supreme Court in *Standard Chartered Bank Ltd v. Heavy Engineering Corporation Ltd,*[11] recognized irretrievable injustice and "Special Equities" as distinct circumstances and held that the existence of either one of

[8] U.P. State Sugar Corporation v. Sumac International, (1997) 1 SCC 568.
[9] Svenska Handelsbanken v. Indian Charge Chrome, (1994) 1 SCC 502.
[10] *Id.*
[11] Standard Chartered Bank Ltd v. Heavy Engineering Corporation Ltd., (2019) SCC Online SC 1638.

them shall lead to an order of injunction. The court further concluded that in cases where ”Special Equities” are recognised to duly exist, the court on the basis of facts and circumstances of the case is empowered to restrain the invocation or encashment of a bank guarantee.[12] Therefore, with the development of '*Special Equities*' as an independent exception for restraint on invocation of bank guarantees in the time of COVID-19, the judicial scope for granting such relief, expands. It is thus essential to trace the intersection of invocation of bank guarantees with the outbreak of COVID-19.

PRIMA FACIE CATEGORISATION OF COVID-19 AS AN EVENT OF *FORCE MAJEURE*

The High Court of Delhi in the interim order passed in *Halliburton v. Vedanta*[13] held that "Lockdown prima facie in the nature of *force majeure*."[14] This assumption led the court to pass an injunction restraining the invocation of bank guarantee by Vedanta without dwelling into the facts of the case and recognising the link between the *force majeure* event and the non-performance of contractual obligations. To understand the impact of *force majeure* on the contracts of Bank Guarantee, it is essential to understand the functionality of such clause.

The *force majeure* clause is defined as "the happening of an act or circumstance that impedes or disrupts a party from performing its contractual obligations under the existing contract, if and to the extent that the party affected by the hindrance or obstruction."[15] Therefore, the essentials for establishing *force majeure* are as follows:

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[12] *Id.*

[13] Halliburton Offshore Services Inc. v. Vedanta Limited, (O.M.P. (I) (COMM) & I.A. 3697/2020).

[14] *Id.*

[15] International Chamber of Commerce, *ICC Force Majeure And Hardship Clauses,* http://iccwbo.org/, https://iccwbo.org/content/uploads/sites/3/2020/03/icc-forcemajeure-hardship-clauses-march2020.pdf (accessed on June 12, 2020).

- Externality- the cause is not created by the fault of the defaulting party;
- Unpredictability- The unexpected event must be inevitable and unforeseeable;
- Irresistibility- The cause must make execution of the contract, wholly impossible to invoke the contractual clause.[16]

The Supreme Court in *Energy Watchdog v. Central Electricity Regulatory Commission & Ors,*[17] held that if a *force majeure* event correlates with an express or implied clause in the contract, it will be governed by Section 32 of the Indian Contract Act[18] and by Section 56 of the Indian Contract Act,[19] if the event falls outside the ambit of the contract.[20]

Furthermore, to seek relief on account of a *force majeure* event, the non-performance of the party must result directly from the event of *force majeure*.[21] Moreover, the party seeking relief under *Force majeure* clause bears the duty to mitigate and/or explore alternate means of performance of the contractual obligation.[22]

The Bombay High Court in *Standard Retail Pvt. Ltd. v. M/s G. S. Global Corp & Ors*[23] held that the absence of a direct causal link between Covid-19 pandemic and the non-performance, was one of the grounds on which the Court refused

[16] Sumeet Lall, Sidhant Kapoor and Devyani Sharma, *COVID-19 India: A curious case of Force Majeure,* CLYDE & CO (May 13, 2020), https://www.clydeco.com/insight/article/covid-19-india-a-curious-case-of-force-majeure (accessed on May 18 2020).
[17] Energy Watchdog v. Central Electricity Regulatory Commission & Ors. (2017) 14 SCC 80.
[18] India Contract Act, Section 32.
[19] India Contract Act, Section 56.
[20] Abhiraj Singh Shekhawat, *COVID-19: The Inflection Point of Force Majeure Clauses*, THE ICLRAP BLOG (May 20, 2020), http://iclrap.in/covid-19-the-inflection-point-of-force-majeure-clauses/ (accessed on Jan 31, 2021).
[21] Adarsh Saxena, Aditya Sikka and Drishti Das, *Force Majeure In The Times Of COVID -19*, INDIAN CORPORATE LAW- A CYRIL AMARCHAND MANGALDAS (April 30, 2020) https://corporate.cyrilamarchandblogs.com/2020/04/force-majeure-in-the-times-of-covid-19/#_ftn21 (accessed on May 17, 2020).
[22] *Id.*
[23] Commercial Arbitration Petition (L) No. 404-408 of 2020, Order dated April 8, 2020.

to grant an injunction.[24] The Court observed that distribution of steel was an essential service and since there were no restrictions on its movement, performance of the contract was not affected.[25] Thus, as there was no link between the *force majeure* event and the performance of contractual obligations, due to it being a part of essential services, the *force majeure* clause wasn't allowed to be invoked.

Furthermore, *force majeure* when applied to contracts, can be categorised as either '*Preventive Force Majeure Delay*' or '*Unavoidable Force Majeure Delay*'.[26]

- *Unavoidable Force Majeure Delay* is when the *force majeure* event occurs during the original period of the contract.
- While *Preventive Force Majeure Delay* is when the *force majeure* event occurs after the completion of the contract period.[27]

The same approach was adopted by the court in *Indrajth Power Private Limited v. UOI & Ors*[28], where the court observed that "despite the extension of 12 months, the petitioner could not fulfil their obligation under the Contract and thus, refused to grant relief to the Petitioner."[29] The Court further held that the Petitioner's position under the contract was unaffected by the imposition of the lockdown and thus, the respondent was in his right to invoke the bank guarantee.

[24] *Supra* note 13.
[25] Sumeet Lall, Sidhant Kapoor and Devyani Sharma, *COVID-19 India: A curious case of Force Majeure,* CLYDE & CO (May 13, 2020), https://www.clydeco.com/insight/article/covid-19-india-a-curious-case-of-force-majeure.
[26] Anoushka Ishwar and Palak Kumar, *Covid19-XVII: Invocation Of Bank Guarantees In The Times Of Covid-19* LAW SCHOOL POLICY REVIEW (May 19. 2020), https://lawschoolpolicyreview.com/2020/05/19/covid19-xvii-invocation-of-bank-guarantees-in-the-times-of-covid-19/.
[27] *Id.*
[28] Indrajth Power Private Limited v. UOI & Ors. Crl. M.A.10268-69/2020.
[29] *Id.*

The judicial stance on the application of outbreak of COVID-19 and the subsequent lockdown as an event of *Force Majeure*, on contracts, especially those governing restraint on invocation of bank guarantee, was made clear in the final order passed in *Halliburton v. Vedanta*[30]. The final order was in accordance with the principles asserted in *Sri Ananda Chandra Behera v. Chairman, Orissa State Electricity Board*[31] with reference to the relationship between the *force majeure* clause and the subsequent situation impacting the contractual obligation between the contracting parties.

The High Court of Delhi, while reaffirming COVID-19 as a *force majeure* event, held that it can't be used as an excuse for breach of deadlines and contractual obligations, prior to its outbreak in the country. Further, it was noted by the court that for invoking the *force majeure* clause, certain criteria have to be fulfilled to justify that the non-performance of contractual obligations or breach of contract was due to the pandemic.[32] These conditions are as follows:

- Conduct of parties prior to the event - This can be noted by reviewing whether the contracting parties were fulfilling their obligations prior to the *force majeure* event.
- Imposition of deadlines in contract – whether the contracting parties were fulfilling the deadlines mentioned in the contract prior to such event.
- Measures that were to be taken and whether attempts were made by the parties to fulfil the obligations via an alternative method.

[30] Halliburton Offshore Services Inc. v. Vedanta Limited O.M.P (I) (COMM.) No. 88/2020 & I.As. 3696-3697/2020.
[31] Sri Ananda Chandra Behera v. Chairman, Orissa State Electricity Board (1998) 85 CLT 79.
[32] Karan Tripathi, *COVID-19 A Force Majeure Event; But Not An Excuse For Breach Of Deadlines Before Pandemic Outbreak : Delhi HC*, LIVE LAW (29 May 2020), https://www.livelaw.in/top-stories/covid-19-a-force-majeure-event-but-not-an-excuse-for-breach-of-deadlines-before-pandemic-outbreak-delhi-hc-157557?infinitescroll=1.

- Various compliances that were required to be fulfilled-[33] whether the parties were in compliance with the obligations and terms of the contract.

The court further observed that the *force majeure* clause is to be interpreted narrowly and not broadly and excusing non-performance of contractual obligations would be an exceptional situation.[34] Moreover, the irrevocable and unconditional nature of bank guarantees was further reaffirmed by the court.[35] Furthermore, the court relied on *Global Steel Philippines v. STC of India Ltd., ILR 2009 VI Delhi 1 and Global Steel Philippines v. STC of India Ltd*[36] to make it clear that in contracts having an arbitration clause, the question whether the non-performance of contractual obligations would be justified by *force majeure* clause, would have to be determined in arbitral proceedings.

Therefore, even though the outbreak of COVID-19 has been recognised as a *force majeure* event, the justification of non-performance of contractual obligations due to the same, would largely depend upon the link between the event and the non-performance and would vary from case to case based on the facts of each case.

RECOGNITION OF '*SPECIAL EQUITIES*' AS AN INDEPENDENT EXCEPTION

The unpredictable conditions faced by the commercial sector in the time of COVID-19 led to an increase in contractual disputes, due to non-performance of contractual obligations. The prevailing circumstances made it nearly impossible for contracting parties to fulfil their obligations and often posed the threat of invocation of bank guarantee. The court in lieu of such circumstances recognized '*Special Equities*' as an autonomous ground, to restrain the invocation

[33] *Id.*
[34] *Supra* note 28.
[35] *Supra* note 22.
[36] Global Steel Philippines v. STC of India Ltd., ILR 2009 VI Delhi 1; Global Steel Philippines v. STC of India Ltd, FAO (OS) No. 186/2009, decided on May 12, 2009.

of bank guarantee. The term '*Special Equities*' was coined in *Texmaco Ltd. v. State Bank of India*. The concept is vague and its categorisation largely depends on the discretion of the court.[37]

In *Vinitec Electronics Pvt. Limited v. HCL Infosystems Limited,*[38] the court asserted that irretrievable injury and injustice was connected to *Special Equities*. The Supreme Court reemphasized on the rationale applied in *Itek Corporation v. The First National Bank of Boston,*[39] in *Svenska Handelsbanken v. M/s. Indian Charge Chrome,*[40] where it was held that there should be a prima facie case of fraud and of *special equities*, in the form of irretrievable injustice and injury between the parties.

The nature of irretrievable injury was elaborated in *United States District Court, Massachusetts in Itek Corporation v. The First National Bank of Boston.*[41] In this particular case, the corporation was a company, based in United States which entered into a contract with a party based in Iran. Soon after, hostilities broke between both the countries and US issued a travel advisory against Iran. In such a situation, if invocation of bank guarantee would have been allowed, such decree could not have been enforced in Iran due to the conflict. Thus, the court held that such a situation would lead to emergence of '*Special Equities*' that resulted in restrain against the invocation of bank guarantee.[42]

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[37] Ankoosh Mehta, Aviral Sahai & Ria Lulla, *Injunction against encashment/invocation of Bank Guarantees: evolution of Fraud and Special Equities,* INDIA CORPORATE LAW - A CYRIL AMARCHAND MANGALDAS BLOG (May 13, 2020) , https://corporate.cyrilamarchandblogs.com/2020/05/injunction-against-encashment-invocation-of-bank-guarantees-evolution-of-fraud-and-special-equities/#more-3648.

[38] Vinitec Electronics Pvt. Limited v. HCL Infosystems Limited, (2008)1 SCC 544.

[39] Itek Corporation v. The First National Bank of Boston, 566 F Supp. 1210.

[40] Svenska Handelsbanken v. M/s. Indian Charge Chrome (1994) 1 SCC 502.

[41] United States District Court, Massachusetts in Itek Corporation v. The First National Bank of Boston, 566 F Supp. 1210.

[42] *Supra* note 19.

Furthermore, the *Supreme Court in Standard Chartered Bank v. HEC*[43] recognized special equity as an independent exception, forming an exception with reference to the invocation of bank guarantee, along with egregious fraud and irretrievable harm and injury. The High Court of Delhi in the ad- interim in *Halliburton v. Vedanta*[44], recognised the bank guarantee as special equity, in light of the COVID-19 situation and granted an injunction against invocation by Vedanta.

The categorization of a bank guarantee as Special Equity, has been recognised as an autonomous exception to restrain the invocation of bank guarantee. This, thus leads to instability with regard to the security provided by Bank Guarantee as an autonomous line of credit. The court in *U. P. State Sugar Corporation v. Sumac International Ltd.*[45] held that "The bank giving such a guarantee is bound to honour it as per its terms, irrespective of any dispute raised by its customer. The very purpose of giving such a bank guarantee would otherwise be defeated. The Courts should, therefore, be slow in granting an injunction to restrain the realization of such a bank guarantee."[46]

Furthermore, it is essential to note that for classification as '*Special Equities*', Supreme Court relied on the rationale of US court in the case of Itek Corp,[47]. The Court in the Itek Corp case laid down the test for irretrievable harm and injustice as, "in commercial litigation, where the question whether the plaintiff is likely to suffer irreparable injury would determine whether the plaintiff has available a legal remedy adequate to compensate it for its injuries."[48] Therefore, '*Special Equities*' are inferred to exist, only when a party is left with no legal

[43] Standard Chartered Bank v. HEC, Civil Appeal No. 9288 of 2019, decided on 18th December 2019.
[44] *Supra* note 11.
[45] U. P. State Sugar Corporation v. Sumac International Ltd., (1997) 1 SCC 568.
[46] *Id.*
[47] *Supra* note 40.
[48] *Supra* note 40.

recourse or adequate legal remedy, to receive damages for the irreparable injury caused due to wrongful invocation and encashment of bank guarantee.

It is essential to note in cases pertaining to injunction of invocation of bank guarantee, solely due to the existence of '*Special Equities*', especially with reference to the ad-interim order passed in *Halliburton v. Vedanta*[49], that no rationale was provided to elaborate on the reasoning for the existence of '*Special Equities*' and the court order failed to pass the test established in the case of *Itek Corp*,[50] as the presence of alternative legal remedies in form of Arbitration was ignored.

While '*special equities*' as an independent exception, will lead to a greater scope for judiciary to intervene in cases pertaining to bank guarantee, the undefined scope of this ground poses a threat to the general principle of bank guarantee, which is undeniably integral for providing security to the contracting commercial parties.

Halliburton Offshore Services Inc. v. Vedanta Limited [51]

Halliburton v. Vedanta[52] emerged as a landmark case with respect to invocation of bank guarantee in lieu of COVID-19, especially due to the recognition of '*Special Equities*' as an independent ground to grant injunction. Here, both the parties had entered into a contract on April 25, 2018, for integrated development of three blocks of oil wells. The petitioner furnished various bank guarantees in the said contract and eight of such bank guarantees were subject matter of the dispute in the present case. Under the contract, Halliburton had an obligation to complete the development of the wells by 16 January, 2019, 16 March, 2019 and 16 June, 2019 respectively. Further, Halliburton contended

[49] *Supra* note 11.
[50] *Supra* note 40.
[51] *Supra* note 28.
[52] *Supra* note 28.

that an extension of time was granted till 31 March, 2020. Halliburton contended that the work didn't get complete on time due to the prevalence of COVID-19 and the subsequent lockdown.

The court in its ad-interim order, held that in the interest of justice there shall be a stay on invocation and encashment of the eight Bank Guarantees. *Justice C Hari Shankar* primarily based his opinion on the fact that since the *"*imposition of the lockdown was by way of a sudden and emergent measure, of which no advance knowledge could be credited to the petitioner – or, indeed, to anyone else… the petitioner's activities had to suddenly discontinue on 22nd March, 2020, and have not been able to resume ever since."[53] Justice C Hari Shankar further held that there was prima facie presence of *Special Equities*, resulting in the injunction.

The court overruled the order of injunction in its final order, where it held, while recognising the COVID-19 outbreak and subsequent lockdown as a situation of *force majeure*, that this cannot be used as an excuse for non-performance of a contract, for which the deadlines were much before the outbreak itself. Thus, the court asserted that whether the pandemic justifies non- performance of contractual obligations, should be decided on the basis of the facts and circumstances of the case. [54]

The ad-interim order passed didn't take into account that time was the essence of the contract between the parties and default in fulfilling the contractual deadline was done by Halliburton, prior to the outbreak of COVID-19 and the subsequent lockdown imposed. Furthermore, the court failed to recognize the presence of alternative legal remedy, in the form of Arbitration, which could have provided damages if the invocation of the bank guarantees led to legal injury.

[53] *Supra* note 11.
[54] *Supra* note 28.

EMERGING TRENDS WITH REGARD TO BANK GUARANTEE IN LIEU OF COVID-19

The COVID-19 crisis led to an international standstill impacting, businesses and industries to their core, due to the precautionary measures adopted and imposed by the government in form of lockdown, as well as due to a major disruption encountered by the supply chain. This unprecedented change in circumstances led to a spike in cases concerned with invocation and encashment of Bank Guarantee. The judicial view in *Halliburton v. Vedanta*[55] can be compared to the orders passed in three major cases dealing with similar question of law, namely, *Standard Retail Pvt. Ltd. v. M/s G. S. Global Corp & Ors*[56], *Indrajth Power Private Limited v. UOI & Ors*[57] and *Ashwini Mehra vs IOCL & Ors*.[58]

In *Standard Retail Pvt. Ltd. v. M/s G. S. Global Corp & Ors*[59], the petitioner approached the court to restrain the bank from invoking the line of credit as the contract had become "unenforceable" under section 56 of the Indian Contract Act, dealing with "frustration, impossibility and impracticality"[60]. The contract was between a South Korean company, who exported steel to an Indian entity. The Petitioners (buyers) failed to take delivery and pay for the goods supplied to them by the sellers. The petitioners pleaded that due to the outbreak of COVID-19 and the consequent lockdown, they were not able to take delivery for onward movement of the steel and make the payment.[61] The court applied general principle and held that the line of credit is autonomous from disputes arising in contract between the parties and thus held that the

[55] *Supra* note 28.
[56] *Supra* note 9.
[57] *Supra* note 26.
[58] Ashwini Mehra vs IOCL & Ors., W.P.(C) 2966/2020 & CM APPLs. 10297-99/2020.
[59] *Supra* note 9.
[60] *Supra* note 17.
[61] Lakshmikumaran & Sridharan, *Performance Securities - Legal Principles and early decisions on enforcement during COVID-19*, LEXOLOGY (May. 8, 2020) https://www.lexology.com/library/detail.aspx?g=c4385127-573c-4e28-b167-a9e3df9bdab9> (accessed on May 12, 2020).

inability in performing contractual obligations by the buyer cannot be a ground for restraining the respondent from invoking the line of credit.[62]

In *Indrajth Power Private Limited v. UOI & Ors,*[63] the court recognised that COVID-19 cannot be constituted as a ground for injunction for invocation of bank guarantee, if a contractual default was made prior to the imposition of lockdown or any substantial change in the circumstances. The court adjudged that 'despite the extension of 12 months, the petitioner could not fulfil its obligation under the contract, and thus refused to grant relief to the petitioner'.[64] The Court further held that petitioner's position under the contract was unaffected by the imposition of the lockdown and thus, the respondent was in his right to invoke the bank guarantee. The rationale of the court in this particular case was subsequently affirmed in the final order in *Halliburton v. Vedanta*.[65]

Furthermore, the approach adopted by the court in the ad-interim order in *Halliburton v. Vedanta,*[66] was further embraced in *Ashwini Mehra vs IOCL & Ors,*[67] where the petitioner approached the court with an objective of seeking directions to restraint the respondent from invoking the bank guarantee, with regard to the contract dealing with Haldia Refinery Project. The petitioner approached the High Court under Article 226,[68] only because of certain unavoidable circumstances, owing to the COVID-19 pandemic and intended to approach NCLT. The court ordered injunction with reference to the invocation

[62] *Supra* note 9.
[63] *Supra* note 26.
[64] *Supra* note 26.
[65] *Supra* note 28.
[66] *Supra* note 11.
[67] *Supra* note 26.
[68] INDIA CONST. art. 226.

of bank guarantee, till the expiry of one week, from the lifting of the lockdown imposed by the central government.[69]

The interim order in Halliburton was subsequently overruled by the Delhi High Court in its final order. But the rationale laid down in the interim order and its adoption by various courts such as, in the case of *Ashwini Mehra*, highlights the perplexity surrounding the exception of "*Special Equities*" as an independent exception for restraining the invocation of bank guarantees. Therefore, the court should be cautious while determining whether the disputed bank guarantee qualifies as "*Special Equities*" on the basis of the principle laid down by the courts as well as the facts and circumstances of the case in question.

Expiration of validity of performance bonds - The judicial oversight

The relief of injunction, against the invocation of bank guarantee, due to the categorisation of COVID-19 as an event of *Force Majeure* led to the emergence of a challenging issue, pertaining to the future possibility of extension of lockdown period and the injunction along with its impact on the validation of the bonds.

Generally, the expiry of bond is extended by an offer made by the party procuring the bond to extend the validity of the bond. But this would be extremely difficult in cases of dispute between the contractual parties. The relief of injunction by the court could lead to termination of contract by the opposing party. This led to the termination of the contractor's contract and creates a slippery slope for extension of validity of bonds.

A similar situation was encountered in an English case, *Liberty Mercian Ltd v Cuddy Civil Engineering Ltd and another*[70] where due to the termination of the

[69]Aditi Singh, *[COVID-19] Delhi HC restrains IOCL from invoking/encashing bank guarantees furnished by Punj Lloyd Limited*, BAR AND BENCH (April 24, 2020) https://www.barandbench.com/news/litigation/delhi-hc-restrains-iocl-from-invoking-encashing-bank-guarantees-furnished-by-punj-lloyd-limited (accessed on June 12, 2020).

underlying contract, there was an inability in obtaining performance bonds. Hence, the court had to order the contractor in lieu of the performance bond to pay money to the court.[71]

The issue of expiration of performance bonds was dealt effectively with regard to the prevailing COVID-19 crisis by a legislation passed by Singapore. Section 6 of Singapore's COVID-19 (Temporary Measures) Act 2020[72] mandates that the period of validity of any bond that would expire during the period that the act prohibits a call from being made, will be automatically extended upon application by the procurer to a period ending seven days after the prohibition is lifted.[73] This measure leads to minimization of discretion of the bank and establishment of uniform procedure throughout the country with regard to the issue of expiration of validity of bonds.

Furthermore, for the speedy disposal of construction disputes that arose amidst the global crisis of COVID-19, Hong Kong framed the Department of Justice's ODR Scheme. The scheme aims at disposing speedy and cost effective resolution of disputes concerning micro, small and medium-sized enterprises (MSMEs). The prominent feature of the scheme is that it governs disputes arising out of the COVID-19 crisis and aims to facilitate a settlement via negotiation and mediation.[74] This can prove to be extremely critical in determining the time frame of legal proceedings and can have a significant impact on the validity of the bonds.

With reference to the Indian scenario, the court can order the bank to honour the bonds but hold the funds with itself until the final resolution of the dispute.

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[70] Liberty Mercian Ltd v Cuddy Civil Engineering Ltd and another (2014) EWHC 3584 (TCC).
[71] *Id.*
[72] Singapore's COVID-19 (Temporary Measures) Act 2020, Section 6.
[73] *Id.*
[74] Christopher Short & Vivian Wong, *Covid-19 Hong Kong: Online Scheme - Way forward for small and medium-sized construction disputes?,* CLYDE & CO, (May 20, 2020) https://www.clydeco.com/insight/article/covid-hk-online-scheme-way-forward-construction-disputes (accessed on June 10, 2020).

But that sort of order would probably only be made if there was a risk that the beneficiary would not be good for the money if it were required to repay in due course.[75]

CONCLUSION

Several parties are bound to approach the court amidst the outbreak ofCOVID-19, due to the deterioration of financial health in commercial sector, as well as, disruption in supply lines and lack of labour force due to the imposition of lockdown.[76] The courts must act with caution in cases pertaining to bank guarantees and restraining its invocation. It is of utmost importance, to apply the *force majeure* clause as a justification of breach of contract only after conclusion establishment of link between the event and the breach of contract.

force majeure should thus, be interpreted in light of the dicta of the Supreme Court in Energy Watchdog, where the court affirmed that it was not the domain of the courts to absolve the parties from performing their part in the contract while deciding the cases pertaining to invocation of bank guarantee.

Moreover, recognition of establishment of '*Special Equities*' as an independent exception, for restraining the invocation of bank guarantee, widens the scope of judicial intervention in matters pertaining to invocation of bank guarantee. The recognition of establishment of '*Special Equities*' by the judiciary should be done with immense caution to maintain the sanctity of and fidelity of such financial instruments, essential for facilitation of global commercial and trading relations and undisrupted flow of cash.

Therefore, a nuanced approach in concord with the settled legal principles is the need of the hour to establish a fine intersection of the interests of the procurer and beneficiary of bank guarantees, while maintaining the sanctity of

[75] Sourav Lahiri, *Halliburton v Vedanta: Performance bonds and COVID-19*, ATKIN CHAMBERS (April 24, 2020) https://www.atkinchambers.com/halliburton-v-vedanta-performance-bonds- and-covid-19/ accessed on 10 June 2020.
[76] *Supra* note 35.

bank guarantees. It is extremely imperative for the courts to adopt a uniform approach in case of "*Special Equities*" based on the basic fundamentals of bank guarantee while determining the invocation of the same.

Furthermore, the court shall limit its intervention while granting interim relief in arbitral matters pertaining to invocation of bank guarantee, as the same is based on autonomous and independent contract aimed at providing assistance and aidin facilitation of commercial transactions and business activities.

Ananya Singh & Mohammed Ahzam Mujtaba**,** *Digital lending as a means to provide for hassle-free credit access to new credit customers*, 9(1) SCHOLASTICUS, 68 (2022)

DIGITAL LENDING AS A MEANS TO PROVIDE FOR HASSLE-FREE CREDIT ACCESS TO NEW CREDIT CUSTOMERS

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ABSTRACT

The article aims to explore the impact of Financial Technology (FinTech) lending on the availability of unsecured consumer credit. Given the low penetration of credit in India, lending is an attractive business opportunity. Several non-financial services companies have entered the lending space over the last few years. The non-traditional companies that have a strong brand, large consumer base as well as a strong distribution network will attack the lending market through innovative digital models. These innovative models are not only being used by the FinTech companies but also by the banks and NBFCs by way of partnership. The complexities and inefficiencies built by the traditional channels of lending have left out the micro-borrowers and underserved population of the society.

The article also highlights how the financial data of a prospective or 'New to Credit' customer is evaluated by way of digital lending and explore the role of financial regulators like the RBI. The authors have discussed how the digital technology drives the micro-borrowers to make need based informed decisions and enable the generation of alternative credit scores based on non- traditional data thereby improving their financial inclusion in the money lending market.

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INTRODUCTION

I. Financial Inclusion

It was famously propounded by Charles Darwin that "*If the misery of the poor be caused not by the laws of nature, but by our institutions, great is our sin.*".[1] Inclusion by way of literacy is the key to ensure access to appropriate products and services needed by vulnerable groups. The institutions providing financial services have to ensure that that weaker sections and low-income groups of our society are provided with an easy access to timely and adequate credit at affordable costs.[2] In brief, financial inclusion is a means to promoting affordable and accessible financial services to all the citizens in a transparent and safe manner in order to support the inclusive and resilient multi-stakeholder led growth. However, in order to cut costs and improve service delivery of formal financial services and products, greater reliance on technology needs to be facilitated.[3]

II. Micro-borrowers unlikely to receive credit in the form of loans from formal lending channels

People who could not borrow funds from the traditional credit lending sources previously have benefited from the implementation of the peer-to-peer (P2P) economy. It is a model for transferring credit risk from banks and financial institutions and dispersing it among individual lenders, who are typically individuals and households seeking better returns on their surplus savings.[4] There is a need for better policies to create conducive environment for the

[1] M. Sreeramulu, *Financial Inclusion in India – An Assessment*, RESERVE BANK OF INDIA, https://rbidocs.rbi.org.in/rdocs/Speeches/PDFs/MFI101213FS.pdf.
[2] Rangarajan C., *Committee on Financial Inclusion*, RESERVE BANK OF INDIA (2008), http://slbckarnataka.com/UserFiles/slbc/Full%20Report.pdf.
[3] Mohanty D., *Committee on Medium-Term Path to Financial Inclusion*, RBI (2015), https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/FFIRA27F4530706A41A0BC394D01CB4892CC.PDF.
[4] *FinTech in India- Ready for Breakout*, DELOITTE- IAMAI, (July 2017), at 17, https://www2.deloitte.com/content/dam/Deloitte/in/Documents/financial-services/in-fs-FinTech-india-ready-for-breakout-noexp.pdf.

overall development of borrowers, lenders and the industry. Still, the sector poses a unique challenge to the principles of customer well-being and needs to transform the borrower's journey from that of a job seeker to a job creator. [5] The regulatory framework of NBFC-MFIs only defines micro-credit-specific rules from the perspective of customer well-being and not how micro-credit is offered by banks and NBFCs. Lenders do not operate under any one set of rules while dealing with the same set of customers, which in turn undermine the well-being of the customers, risking the industry. In the wake of these circumstances, the micro-credit industry has voluntarily adopted Code of Responsible Lending ("**CRL**"), which includes five globally accepted customer protected principles- fair interaction, suitability, transparency, privacy and grievance redressal.[6]

These principles are for the delivery of financial services to the base of the income pyramid- women, rural population and MSMEs, in order to enhance their livelihoods and meet social and emergency needs. In India, microfinance is mostly identified with micro-credit, which refers to unsecured small-ticket loans to low-income customers.[7]

It is necessary for us to analyse the deliberation process that takes place in the minds of these individuals before borrowing the money. The first and foremost decision they take is based on their financial need, the need which is recognised by way of their life which is a mixture of consumption, emergencies and opportunities. Further, to address these needs, the individuals need to

[5] *Vision of Microfinance in India*, PWC-SIDBI (Nov., 2019), at 11, https://www.pwc.in/assets/pdfs/consulting/financial-services/vision-of-microfinance-in-india.pdf.

[6] Clause 1.1, *Code of Conduct*, CENTRUM MICROCREDIT LIMITED (Feb 2019), https://www.centrum.co.in/sites/default/files/Policies/cmpl-code-of-conduct-final-docx.pdf. [7] Sugandh Saxena, *What micro lenders must do to safeguard their customers*, LIVEMINT (Oct 24, 2019), https://www.livemint.com/opinion/online-views/what-micro-lenders-must-do-to-safeguard-their-customers-11571935624945.html.

simultaneously choose from three credit lending channels primarily - formal, semiformal and informal, which involves screening certain information about borrowing options, their evaluation, and selection. This decision is also driven by external factors which involve sociological, economical and behavioural circumstances. The screening and finality of the institution leads the micro-borrowers to opt for the informal institutions based on the transaction costs, likelihood of credit access in the future and other flexible benefits.[8] In most cases, borrowers are also successful in establishing good social relationships with their lenders from informal institutions. Borrowing from an informal institution thereby, is often accompanied with the element of trust.

But this is not a one way choice left up to the borrowers. Their decision of opting for informal institutions over formal ones is also affected by the unlikeliness of the formal financial institutions to grant them credit in the form of loans. Non-ownership of non-liquid and immovable assets which can be used as collateral in banks can hinder access to formal markets as lower-income households may be prone to idiosyncratic shocks, therefore demanding more informal credit.[9]

This entire cycle of borrowing mainly depends upon the existing information asymmetries between borrowers and lenders. Borrowers are aware of their repayment abilities and creditworthiness, whereas lenders in order to avoid financial risk and moral hazard avoid granting them access to credit. But these

[8] Guirkinger C., *Understanding the Coexistence of Formal and Informal Credit Markets in Piura*, 36(8), PERU. WORLD DEVELOPMENT, 1436–1452 (2008), https://imas2008.files.wordpress.com/2008/08/guirkinger-2008.pdf.

[9] Olga Kondratjeva, *Exploring the Connection of Formal and Informal Borrowing and Household Well-Being: The Case of Nepal*, THE OHIO STATE UNIVERSITY 19 (2017), https://etd.ohiolink.edu/apexprod/rws_etd/send_file/send?accession=osu150054952679372&disposition=inline.

institutions can make headway by way of intensive ex-ante screening of loan applicants.[10]

Lenders facing information asymmetry problems could devote more resources into mitigating the problem or commercial lending can be developed by way of innovative technologies and concepts. However, the micro-borrowers get attracted to the alternative informal channel because of the social ties, lower costs using collateral substitutes and localisation. In comparison, the entire lending and borrowing process through formal channels is often construed to be extremely complicated by virtue of the high documentation load accompanying it and increased logistical costs. It is necessary, thereby, to provide for an easy and hassle free process of securing loan by using modern innovations and technology.

USING TECHNOLOGY TO FACILITATE ALTERNATIVE LENDING TO NEW TO CREDIT CUSTOMERS

I. 'New to Credit' Customers

New to Credit (NTC) customers comprise of a segment which has not previously borrowed from the traditional credit lending institutions. These customers either have low income, reside in rural areas where financial goods and services have limited ground presence, or are first time borrowers and are disqualified from obtaining a bank loan from the formal financial institutions owing to their credit history.

The advent of digitization however, has played a pivotal role in remedying the aforementioned situation. FinTech companies assess credit risks by utilizing the database containing prospective money borrower's experience in a hassle-free way. Amongst the credit-eligible customers in India, only a few are credit-active and remaining act as a the potential attraction for the financial institutions. This

[10] *Id* at 22.

untapped borrower market can lead to a prudent growth for lenders who are willing to meet the needs of the non-active credit population of the nation.[11]

II. How do NTC customers secure loans without resorting to technology?

In the absence of digital banking, there are mainly three alternatives available with the NTC customers. These can be classified into informal, semi-formal and formal borrowing channels (*Table I*). It is difficult for micro-borrowers to resort to formal lending channel in order to adequately meet their high credit requirements. By providing access to liquidity for improvement of livelihoods of low-income individuals, financial inclusion is preferred.[12] But it is not always that these micro-borrowers can borrow from the formal channels.

Informal financial arrangements	Semi- formal financial institutions	Formal financial institutions
Relatives, co-workers, neighbours, friends, employers, landlords, merchants, shopkeepers, moneylenders, self-help groups and non-financial group members (associations of producers and	Unregulated NGOs, unregulated microfinance institutions, unregulated savings and credit cooperatives, or village banks.	Commercial banks, and other types of banks (state, development, governmental, microfinance, Grameen), regulated NGOs, finance companies, regulated savings and credit cooperatives.[14]

[11] FE Online, *Economic boom in India coming soon? Massive number of consumers eligible for credit; here's what it means*, FINANCIAL EXPRESS (May 21, 2018), https://www.financialexpress.com/economy/economic-boom-in-india-coming-soon-massive-number-of-consumers-eligible-for-credit-heres-what-it-means/1175548/.

[12] Madhusudan Ekambaram, *COVID-19 lockdown: How digital lenders can contribute to financial inclusion*, FINANCIAL EXPRESS (Aug 18, 2020), https://www.financialexpress.com/money/covid-19-lockdown-how-digital-lenders-can-contribute-to-financial-inclusion/2058684/.

consumers, women's associations, farmers' associations)[13]		

(*Table I*)

Both formal and informal credit is considered by the customers due to different credit arrangements and levels of accessibility based on their economic well-being. A report by the World Bank describes that the most cited reasons for not enrolling in a bank account is the lack of money (30%), ownership of an account by another family member (25%) high costs of opening a bank account (23%), and physical distance (20%).[15]

The social environment and social ties tend to play a crucial role in influencing borrowers' selection of a particular lender, specifically from the informal financial institutions (friends, relatives, neighbours and private lenders).[16] Economic considerations of low borrowing costs, convenient loan terms or lenders' availability of capital are also factors influencing decision making. In some cases, loan is secured by way of advice or assistance of friends and neighbours who provide information about available borrowing channels, assist with loan applications, or encourage joining particular financial institutions.

The terms and costs of loan or lack of appropriate collateral can influence how borrowers make trade-offs between different credit options, be it banks or informal institutions. But instead of hopping from one institution to other,

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[14] Vikas Batra & Sumanjeet, *The State of Microfinance in India: Emergence, Delivery Models and Issues*, AIUB (2011), https://core.ac.uk/download/pdf/6234654.pdf.
[13] HELEN TODD, WOMEN AT THE CENTER: GRAMEEN BANK BORROWERS AFTER ONE DECADE (Boulder Co: Westview Press, 1996).
[15] *Global Financial Development Report 2014: Financial Inclusion,* WORLD BANK, (2014) http://documents1.worldbank.org/curated/en/225251468330270218/pdf/Global-financial-development-report-2014-financial-inclusion.pdf.
[16] Supra 9, at 139.

some customers prefer being "locked-in" as they might be unwilling to search for better alternatives, simply because it is easier and more convenient to stay with the old financial institution.[17] Participation in the same institution is more suitable instead of re-evaluating expenses during each borrowing cycle. The decision whether to borrow or not to borrow from a financial institution is thus a combination of exogenous constraints and endogenous processes.

III. Digital Lending as a means to ensure Financial Inclusion

The future is digital and to bring the excluded population into the mainstream, we need to leverage the power of finance plus technology, and eye on the milestone of digital transformation. FinTech, with its cutting edge technology and digital expertise, offers new financial products and services to new market segments in an economically viable manner.[18]

The goal of financial services made available via digital platforms is to contribute to poverty reduction and to financial inclusion objectives of developing economies.[19] Ease of access to financial services via digital platforms through the use of smart electronic devices like mobile phones and personal computers, is known to have led to greater financial inclusion. This has been achieved by providing NTC customers from tier two and tier three cities and villages with personal credit services, which can be accessed easily through these electronic devices. According to estimates made by the World Bank, nearly 50% of the people in the developing world are already in possession of, or have

[17] *Supra* note 9, at 143.
[18] *Supra* note 4, at 7.
[19] U.N. DIGITAL FINANCIAL INCLUSION – INTERNATIONAL TELECOMMUNICATION UNION (ITU), Issue Brief Series, Inter-agency Task Force on Financing for Development, (July 2016), https://www.un.org/esa/ffd/wp-content/uploads/2016/01/Digital-Financial-Inclusion_ITU_IATF-Issue-Brief.pdf.

access to mobile phones and smart electronic devices.[20] Despite the aforementioned position, digital finance and financial inclusion have failed to adequately permeate to the relatively underprivileged sections of our society. This disparity is also observable in the FinTech lending sector. FinTech lenders however, are continually ramping up their efforts to make sure that their "easy credit - facilitating technology" truly reaches those in need.

IV. FinTech and FinTech Providers

Over the last few decades, FinTech and FinTech providers have certainly gained more popularity in the financial sector as discussed above. They fall under the group of "alternative lending" through the use of new technologies like machine learning algorithms and big data analytics.[21]

THE RISE OF NEW TO CREDIT CUSTOMERS IN INDIA

I. The impact of alternative lending channels on the growth of the Indian economy

With digital transformation taking place in India, the traditional form of borrowing from family, friends, and unorganized money lenders has been levelled up in a way to meet the demand and supply.

The most deprived section of our society are the 83 million people living in rural India, which has been underserved when it comes to access to financial products and financial literacy. The potential customers are facing financial

[20] *Digital Finance- Empowering the Poor via New Technologies*, WORLD BANK (April, 2014), https://www.worldbank.org/en/news/feature/2014/04/10/digital-finance-empowering-poor-new-technologies.

[21] Variyar, M., *FinTech cos like CapitalFloat, LoanTap are using bots to decide if you're eligible for a loan*, ECONOMIC TIMES (Nov 09, 2016), http://tech.economictimes.indiatimes.com/news/startups/FinTech-cos-like-capitalfloat-loantap-are-using-bots-todecide-if-youre-eligible-for-a-loan/55325018.

literacy as the biggest roadblock.[22] But the government, RBI and FinTech-focused government bodies are tackling it by way of various initiatives. For example, the Financial Literacy Week initiative by the RBI aims to promote awareness on key topics every year through a focused campaign. This year, the focus was on the financial literacy of farmers. By investing in such manner, we can build better businesses and better lives and bridge the financial services gap in rural India and bring financial inclusion to more people.[23] In India, FinTech has grown from urban to urban-rural and then rural markets and low-income base population, focusing on financial inclusion possibilities in the underserved population of India. Acting as the best alternative for lending built around technology, the operating cost is more efficient, servicing activities are within a flexible regulatory environment as compared to the traditional banking model. They must not prioritize quantity over quality of loans. This will ensure success of this model.[24]

Formal institutions can benefit from the digital lending segment through constant innovations and collaborations. From the data available, there is lack of capital for micro borrowers' sustenance because of insufficient business data and financial reports. In order to revolutionize the way of lending, digital lending addresses such credit gap and financial exclusion. Alternative lending or digital lending refers to credit disbursal services offered by digital platforms through the distribution of easy to obtain low-cost loans to the largely untapped market in the form of Micro Small and Medium Enterprises (MSMEs) loans, consumer loans, working capital loans and payday loans, among others.[25] The

[22] Dr. Deepali Pant Joshi, *Financial Inclusion & Financial Literacy, Bi Oecd Seminar – Roundtable On The Updates On Financial Education And Inclusion Programmes In India*, at 11, OECD (June 28, 2011), https://www.oecd.org/finance/financial-education/48303408.pdf.
[23] Mona Kapoor, *Banking goes digital to reach rural entrepreneurs*, ACCION (Sept 02, 2020), https://www.accion.org/banking-goes-digital-to-reach-rural-entrepreneurs.
[24] *Supra* note 4, at 17.
[25] Ravikumar Thangaraj, *Digital Lending: Is it an Alternative Lending Revolution?* 8 INTERNATIONAL JOURNAL OF SCIENTIFIC & TECHNOLOGY RESEARCH 599-601 (2019).

non-formal sector prefers these loans over the more traditionally offered loan schemes owing to their categorization as a relatively less volatile asset class.[26] Added benefit of these loans is that they are often disbursed faster and have a short term repayment period. Granted, that alternative credit lending services like these cannot completely replace the traditional form of money lending in developing countries like India anytime soon, but they are likely to contribute significantly to the growth of the economy of as a whole in the long run. The Boston Consultancy Group, for instance, estimates that the digitally distributed retail loans in India are likely to reach the figure of $1 trillion by the end of 2023.[27]

The information asymmetry has evolved with time and has revolutionised the institutions by using AI techniques to check the creditworthiness of especially those individuals who may not have formal credit repayment history.[28] Such technique could provide plethora of data on the digital transactions, financial obligations, credit score and their ability to repay it. Be it digital lenders, NBFCs, banks or any financial institutions, FinTech in India is accelerating the credit economy by leveraging artificial intelligence based credit assessment. Even if a prospective customer has never borrowed money from a traditional money lending institution before, his money spending patterns are analysed so as to determine whether he can repay his short-term loan within the stipulated period of time.[29] Big data is likely to lead a digital lending boom in India with lenders analysing the cost of consumer acquisition, underwriting models and early warning systems. For instance, Jan Dhan, the financial inclusion scheme to

[26] *Id*.
[27] Alpesh Shah et al., *Digital Lending*, at 15, THE BOSTON CONSULTING GROUP (2018), https://image-src.bcg.com/Images/BCG-Digital-Lending-Report_tcm9-197622.pdf.
[28] Daniel Bjor□kegren and Darrell Grissen, *Behavior Revealed in Mobile Phone Usage Predicts Credit Repayment*, at 34, THE WORLD BANK ECONOMIC REVIEW 618–634 (2020), https://academic.oup.com/wber/article-abstract/34/3/618/5622690.
[29] Barras R., *Interactive innovation in financial and business services: The vanguard of the service revolution* 19(3) RESEARCH POLICY 215–237 (1990).

ensure access to financial services in an affordable manner has opened more than 550 million banking accounts in the last two years, with over 90% of Indian households accessing to banking services. With their enrolment into the Aadhaar scheme in early 2018, brings nearly 1.2 billion people into its fold and making Aadhar the world's largest biometric database.[30]

Such technology advancements are contributing towards India's credit bureau infrastructure being the best in the world and bringing more NTC consumers into the fold of formal finance. FinTech players are trying to connect the unbanked and underbanked population to the mainstream financial system of India. Such financial revamp is probably going to take the Indian economy on a positive development trajectory through the incorporation of NTC customers, in accordance with the nation's digitalization desire. More or less, FinTech has wiped out hindrances that were made before in the payment techniques, bringing about more noteworthy financial movement and creation of wealth. Nearly 150 million consumers who were not 'credit dynamic' are probably now qualified to be retail credit borrowers. Tapping into this untapped and undiscovered potential borrower market could give remarkable break for retail lenders and boost the Indian economy.[31]

II. The future of India's digital ecosystem

Adopting technological innovations across value chains will aid optimisation of resources and processes reduces the turnaround time and drive maximum possible growth. Through these mechanisms thereby, prospective borrowers

[30] *Supra* note 27.

[31] *FinTech Lending- Unlocking Untapped Potential*, NASSCOM (2019), https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=&ved=2ahUKEwjdrIq8qdTsAhUbOisKHUczCOMQFjAGegQIChAC&url=https%3A%2F%2Fcommunity.nasscom.in%2Fdownload.php%3Ffile%3Dwp-content%2Fuploads%2Fattachment%2F18283-FinTech-lending---unlocking-untapped potential.pdf&usg=AOvVaw2_QxDtHiaF2OS365hx1LQ.

can avail hassle free loans in a matter of minutes without having to worry about them having a good credit score. Along with the analysis of customer behaviour patterns to facilitate easy lending, India's digital ecosystem has been further bolstered by development of new technologies like Aadhar, Unified Payment Interface (UPI), Bharat Bill Payment System, cashless economy pushes and Goods and Service Tax (GST).[32]

III. Moving towards a new alternative credit lending regime

The modelling of banking and financial landscape has majorly been fulfilled by FinTech. Technology can allow both banks and FinTech lenders to serve small businesses and consumers without brick and mortar investments.[33] The innovative and unique landscape of AI introduced by registered FinTech is improving the penetration of financial services in India by developing credit score and history, authenticating identity, leveraging data and most importantly serving the borrowers underserved by banks and NBFCs.

With time these FinTech companies have established their goodwill, which have received authentication and recognition from regulating authorities, banks and NBFCs and is gradually expanding its operation by means of non-financial players as well which are either partnering with NBFCs or spawning their own NBFCs to captive consumer base (*Table II*).[34]

Cars24	Automotive sector is seeing traction with OEMs as well as digital attackers and planning to launch new age digital NBFCs.

[32] *Supra* note 25.
[33] Anjan Thakor, *FinTech and Banking*, JOURNAL OF FINANCIAL INTERMEDIATION (July 30, 2019), https://apps.olin.wustl.edu/faculty/Thakor/Website%20Papers/FinTechandBanking%20JFI%202019.pdf.
[34] *Supra* note 27, at 20.

Xiaomi	The mobile handset manufacturer has launched a credit program for its consumers in India in partnership with KreditBee.
Samsung	It is exploring 'value +' models to potentially underwrite a large base of consumers on the back of handset linked data.
Flipkart	It has recently applied for an NBFC license to offer credit to shoppers as well as sellers.
Uber and Ola	Partnering with banks like SBI to introduce financing solutions to their drivers.
Future Retail	Planning for setting up a lending business.
Airtel	It is actively getting into financial services business and is likely to tie-up with NBFCs to distribute loans to their large consumer base.
Aditya Birla Group	It is to combine notable capital with digital models in a bid to win
Paytm and MobiKwik	They are on the back of a large base of acquired and engaged consumers.

(*Table II*)

The antique culture of traditional lenders is changing its approach with time and digital intervention as the banks and NBFCs are supporting such lending companies and enabling them to operate in a truly digital fashion. The working of these institutions can be interdependent in a way that when the borrower apply for loan, the data by way of consent can be extracted from different sources like credit agencies, tax authorities, marketplaces, e-commerce companies etc. The credit score so generated is made available to the banks, NBFCs and lending FinTech, thereby disposing duplication of efforts by each

entity.[35] This data is then handled by the respective proprietary risk model and through this, partnership banks and NBFCs can acquire the capabilities required to offer an end-to-end digital experience to their borrowers for equitable growth.[36]

Alternative lending channels can remedy this through their partnership with FinTech, given the pace of change and customer expectations. Some NBFCs are moving forward with testing and deploying solutions in collaboration with FinTech software as a service (SaaS), to automate back-end and middleware software applications, which shall make the origination and underwriting process swift, structured and transparent.[37]

But RBI has raised its concern to a point where FinTech entity is the sourcing partner, NBFC is the funding partner and as a result, the FinTech companies have access to the credit information bureau's database by getting into partnership with the banks and NBFCs, thereby breaching customer confidentiality.[38] FinTech get their data through their apps as customers consent to it but misusing the same and intimidating or harassing the customers is problematic and therefore, RBI insists on robustness of internal controls, audit, compliance and grievances redressal. There is a dire need to educate the NTC customers about their credit behaviour, credit score, etc and empower their participation from every social stratum.

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[35] *The Future of Financial Services: How disruptive innovations are reshaping the way financial services are structured, provisioned and consumed*, WORLD ECONOMIC FORUM (2015), http://www3.weforum.org/docs/WEF_The_future of_financial_services.pdf.

[36] *Supra* 27, at 37.

[37] Avneesh Singh Narang & Raghav Aggarwal, *Breaking new ground: How emerging technologies are helping NBFCs evolve*, PwC, https://www.pwc.in/consulting/financial-services/FinTech/FinTech-insights/breaking-new-ground.html.

[38] Pratik Bhakta & Ashwin Manikandan, *RBI restricts access to credit data of consumers*, THE ECONOMIC TIMES (September 19, 2019), https://economictimes.indiatimes.com/small-biz/startups/newsbuzz/apex-bank-restricts-access-to-credit-data-of-consumers/articleshow/71194383.cms?from=mdr.

CONCLUSION

Digital lending is gaining widespread acceptance in developing economies throughout the world including India. It would not be incorrect to suggest that India probably has the largest untapped informal market when it comes to digital lending and if digital lending were to be implemented more efficaciously here, it would provide a huge impetus to the working of our economy. There is limited academic literature pertaining to the use of digital lending for the benefit of NTC customers and the poor sections of the society. Scholars have still not been able to comprehensively define 'FinTech' and determine its implications on the working of the world economy. FinTech's adoption patterns, its key characteristics and external factors affecting its implementation are yet to be studied fully but positive steps are certainly being taken to analyse, observe and explore the existing academic literature pertaining to it.

Further challenges to understanding FinTech however, still remain. There are pending questions for instance, regarding the applicability of technologies like blockchain, cryptocurrency, crowd-funding, big data analytics, and near field communication, among others to digital lending. It is necessary thereby, to apply an all-inclusive approach in understanding what FinTech and digital lending actually entails. To top it all, RBI has excluded innovations pertaining to credit information and credit registry, which will foreclose innovation. Instead of financial inclusion, a path of financial exclusion has been taken, as the regulatory authority need to encourage lending products and services vis-à-vis technology.

Due to Covid-19, the necessity of an inclusive financial infrastructure has never been more apparent. Rural populations and low-income individuals currently suffer from a lack of financial literacy and poor availability of services. The increasing collaboration among FinTech companies, banks and NBFCs, calls for more focus on data analytics and portability of trusted data between service

providers under data empowerment and protection architecture. The dire situation of rural populations and low-income individuals has been exacerbated by the pandemic. These are players that can no longer be left out of the financial system. When we empower participation from every social stratum, we drive socio-economic growth. Therefore, it is crucial for us to extend lendingservices by digitally empowering this underserved population in order to createa thriving economy for the benefit of everyone.

Shubham Jain & Sadhvi Chhabra, *Financing the Indian Real Estate and Infrastructure Sector Through REITs and InvITs*, 9(1) SCHOLASTICUS 86 (2022)

FINANCING THE INDIAN REAL ESTATE AND INFRASTRUCTURE SECTOR THROUGH REITS AND INVITS

Shubham Jain[⊥] *& Sadhvi Chhabra*[*]

ABSTRACT

The Indian real estate and infrastructure sector required a push to achieve the growth it was expected to achieve for the coming years. To achieve the full potential of the said sectors, provision of REITs and InvITs were introduced; it was also expected to ease the problem of delays and financial constraints. In India these vehicles have received good response from the investors.

With this article, the authors aim to provide a holistic understanding of REITs and InvITs as implemented in India and the phases of development it has already undergone under the vigil of the careful regulators in the market. The authors have also encompassed the developments in these vehicles during COVID- 19 and the revival strategy post the dip in economic growth in 2020.

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INTRODUCTION

The real estate and infrastructure sector in India is expected to grow exponentially in the coming decade. It is estimated that India will require investments worth INR 50 trillion across infrastructure by 2022 to have a sustainable development in the country.[1] Pursuant to the requirements of the sector, the Government of India has allocated INR 111 trillion under National Infrastructure Pipeline for INR 2019-25 in sectors such as energy, urban railways, and roads.[2] Furthermore, the real estate sector is projected to reach a market size of USD 1 trillion by 2030, with a significant growth from the market size of USD 120 billion in 2017.[3] The regulators are constantly making provisions in order to supplement the growth of the sector. Real Estate Investment Trusts (**"REITs"**) and Infrastructure Investment Trusts ("**InvITs"**) are two such initiatives which are expected to propel the growth of the new-age India.

Real Estate Investment Trusts

REITs are expected to provide an opportunity of over USD 19.2 billion in the coming years.[4] First proposed in 2007, REIT is a method to finance the infrastructure projects. After numerous amendments in the governing regulations, India witnessed its first REIT initial public offering (**"IPO"**) in

[1] INDIAN BRAND EQUITY FOUNDATION, *Infrastructure Sector in India*, https://www.ibef.org/industry/infrastructure-sector-india.aspx#:~:text=The%20infrastructure%20sector%20has%20become,sustainable%20development%20of%20the%20country.&text=5%2C000%2C000%20crore%20(US%24%20750%20billion,railways%20infrastructure%20from%202018%2D30 (last visited Feb 6, 2021).

[2] MORDOR INTELLIGENCE, *Infrastructure Sector in India – Growth, Trends, Covid-19 impact, and Forecasts (2021 - 2026)*, https://www.mordorintelligence.com/industry-reports/infrastructure-sector-in-india (last visited Feb 6, 2021).

[3] INDIAN BRAND EQUITY FOUNDATION, *Indian Real Estate Industry Report*, https://www.ibef.org/industry/real-estate-india.aspx (last visited Feb 6, 2021).

[4] *Id.*

March, 2019 by Embassy Office Parks, a Bangalore based real estate developer.[5] The said IPO raised INR 4,750 Cr. and showed substantial returns and growth as compared to the BSE Realty Index between April 2019 and July 2020.[6] India saw an investment of Rs. 3972 Crores in 2020 itself through mutual funds.[7] The Embassy Office Park REIT was soon followed by Mindspace Business Parks REIT, which managed to raised INR 4500 Cr., with the IPO being over-subscribed to the tune of 13 times.[8] Overall, the projected rate of interest for REIT projects is estimated to be approximately 12% to 14% in the long term.[9] Investor's belief in REITs is providing a promising vision for the future of the commercial real estate sector in India. The infrastructure development has also seen considerable optimism.

REITs have changed the traditional mindset of personal ownership attached to the real estate sector in India by creating a setup similar to that of mutual funds being traded in the market. Through these vehicles, investments are primarily made in a pool of income generating asset, and thus it doesn't focus on increase in the value of the investment. Although, the investment is undertaken over a stock exchange and remains an investment in units of the commercial real

[5] Ashwini Kumar Sharma, *India's first REIT is finally here. Should you invest?*, LIVEMINT (March 18, 2019, 12:00 PM),https://www.livemint.com/money/personal-finance/india-s-first-reit-is-finally-here-should-you-invest-1552826505402.html.

[6] Anshuman Magazine, *Decoding the future of REITs in India*, FORTUNE INDIA (August 22, 2020), https://www.fortuneindia.com/opinion/decoding-the-future-of-reits-in-india/104683.

[7] *Mutual fund investment in REITs jumps 6-fold to ₹3,972 crore in 2020*, LIVEMINT (January 31, 2021) *at* https://www.livemint.com/mutual-fund/mf-news/mutual-fund-investment-in-reits-jumps- 6-fold-to-3-972-crore-in-2020-11612102121125.html.

[8] Sharad Dubey, *Mindspace Business Park REIT IPO: Here is all you need to know*, BLOOMBER QUINT (July 26, 2020), https://www.bloombergquint.com/markets/mindspace-business-parks-reit-heres-all-you-need-to-know.

[9] India Infoline News Services, *REITs can solve the funding problem of commercial developers*, IIFL SECURITIES (November 23, 2020), https://www.indiainfoline.com/article/news-sector-real-estate/reits-can-solve-the-funding-problem-of-commercial-developers-120112300024_1.html.

estate.[10] Therefore, they are often considered a hybrid of mutual funds and equity share investment.

Infrastructure Investment Trusts

India has seen both public (e.g., IRB InvIT Fund[11] and India Grid Trust[12]) and private (e.g., IndInfravit Trust, India Infrastructure Trust, Oriental Infra Trust) InvITs.[13] Investments by fund houses in InvITs touched INR 948 Cr. in December, 2019 itself.[14] Investors are showing keen interest in investing in InvITs. IRB InvIT fund's IPO saw an oversubscription of over 8.57 times whereas institutional investors' category saw an oversubscription of over 10.81 times and other investors at 5.89 times even though it was India's first InvIT.[15] Looking at the inclination of Indian investors, in 2021, India will see its sixth InvIT as NHAI intends to launch a government sponsored InvIT worth Rs. 5,000 Crore and divided over six projects.[16]

InvITs invest in long-dated assets and liabilities which when combined with stable and diversified returns, suit the investment objectives of various investors

[10] Lisa Pallavi Barbora, *Are REITs, real estate mutual funds or equity shares?*, SCRIPBOX (August 19, 2020 https://scripbox.com/blog/are-r-e-i-ts-real-estate-mutual-funds-or-equity-shares.

[11] Rahul Oberoi, *First ever InvIT listing: IRB InvIT debuts with small premium at Rs 103.25 on BSE*, THE ECONOMIC TIMES, (May 18, 2017) https://economictimes.indiatimes.com/markets/stocks/news/irb-invit-fund-lists-at-rs-103-25-on-bse/articleshow/58728276.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst".

[12] INDIGRID, https://www.indigrid.co.in/aboutus.html. (last visited Feb 6, 2021).

[13] ACUITY LAW, *Reits and InvITs- India update*, https://www.acuitylaw.co.in/publication-and-news/reits-and-invits-india-update (last visited Feb 6, 2021).

[14] RBSA ADVISORS, *InvIT and REIT: A Mirage or Reality?* (April, 2020), https://rbsa.in/archives_of_research_reports/rbsa-invit-and-reit-a-mirage-or-reality.pdf (last visited Feb 6, 2021).

[15] *Supra* note 6.

[16] Nishtha Saluja, *NHAI readies launch of first government-sponsored InvIT* , THE ECONOMIC TIMES (January 07, 2021), https://economictimes.indiatimes.com/news/economy/infrastructure/nhai-readies-launch-of-first-government-sponsored-invit/articleshow/80148468.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst".

and thus are good for long-term investors globally as they prefer investing in operating infrastructure projects earning stable yields.[17] Satisfying interest rates, capital appreciation and dividend income are driving investors to bet on InvITs especially as the listed InvITs are offering upwards of 13 percent yields and thus provides a compelling value proposition on a risk-adjusted basis.[18] InvITs have now made the investors see a new light with the budget introduced this financial year. The government has accorded "tax pass through" status to private unlisted InvITs, which until now, was available only to publicly listed InvITs or those InvITs that were sold to a small group of investors and subsequently listed on exchanges.[19] Ever since its introduction, InvITs have been a better placement privately and thus the recent move by the government has spiked the investors' and sponsors interest multifold.

Business Trusts like REITs and InvITs in India have raised tremendous interest among the investors across the globe, resulting in huge foreign investments in the Indian real estate and infrastructure sector.[20] Through this article, the authors seek to analyze the potential of REITs and InvITs in the Indian economy, and its contribution to the growth of the Indian real estate and the infrastructure market. The second part of the article discusses the basic structure of a REITs and InvITs, and highlights the key features of the regulatory framework governing it. In the third part, the authors have discussed the impact of Covid-19 on the Indian Real Estate and Infrastructure, and the

[17] Harsh Shah, *What infrastructure investment trusts really need to attract more investors*, VC CIRCLE (February 15, 2019), https://www.vccircle.com/what-infrastructure-investment-trusts-really-need-to-attract-more-investors/.

[18] PWC, *India's new real estate and infrastructure trusts: the way forward* (July 2019), https://www.pwc.in/assets/pdfs/financial-service/new-real-estate-and-infrastructure-trusts.pdf (last visited Feb 6, 2021).

[19] Swaraj Singh Dhanjal, *Investment in Infra via InvITs may get a leg up from budget*, LIVEMINT (February 02, 2021), https://www.livemint.com/budget/news/investments-in-infra-via-invits-may-get-a-leg-up-from-budget-11580664194302.html.

[20] LIVEMINT, *Foreign investors keen on REITs, InvITs: SEBI*, (October 18, 2019), https://www.livemint.com/market/stock-market-news/foreign-investors-keen-on-reits-invits-sebi-11570454588371.html (last visited Feb 6, 2021).

regulatory tweaks introduced in 2020 to encourage more REITs and InvITs to come up. To conclude, the article discusses how REITs and InvITs are helping the Indian real estate and infrastructure sector, consequently playing an important role in India's development.

TRANSACTION STRUCTURE AND REGULATORY FRAMEWORK OF REAL ESTATE INVESTMENT TRUSTS, AND INFRASTRUCTURE INVESTMENT TRUSTS

Real Estate Investment Trusts

The real estate sector is bullish for the forthcoming decade due to rapid urbanization, positive demographics, and global sentiments, along with increasing income and spending capability of individuals. REITs provide the developers with alternate sources of real estate funding, as traditional fund-raising channels are increasingly facing challenges.[21] REITs have been quite successful in countries such as USA, UK, Singapore, Australia, etc. The experts believe that they will be equally successful, if not more, in the Indian scenario. Currently, they account for approximately 50% of the market capitalization in Singapore and Japan, and a throbbing 96% in the USA.[22]

The primary stakeholders in a typical REIT transaction are the sponsor, trustee, REIT, manager, and special purpose vehicle ("**SPV"**), etc. Typically in India, REITs follow a 3-tier structure. The sponsor sets up the REIT, managed by a manager which looks after its operations and selects properties for investments. The trustee ensures that the money is managed in the interest of unit-holders.[23]

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[21] BHATIYA AND ASSOCIATES LLP, *Real Estate Investment Trusts in India,* (March 24, 2017), https://www.bathiya.com/wp-content/uploads/2018/10/13.-REIT_Research-Article_Bathiya.pdf (last visited Feb 6, 2021).

[22] Sachin Gupta, et el, *India's REIT Opportunity – Rs 1.5 lakh crore proposition for global private equities as investment horizons and rules align*, CRISIL (October, 2019), https://www.crisil.com/content/dam/crisil/our-analysis/reports/Ratings/documents/2019/october/indias-reit-opportunity.PDF

[23] India Infoline News Service, *Understanding REITs and its Structure*, IIFL SECURITIES (March 14, 2019), https://www.indiainfoline.com/article/general-editors-choice/understanding-reits-and-its-structure-119031400252_1.html.

The sponsors are provided with an agreed upon percentage of the total of the REIT units, subject to the statutory mandates. Remaining units are then issued to the public through REIT-IPO. The real estate generates revenue by way of rent/lease which is then disbursed as dividends to the unitholders (after statutory, and other such payment).[24]

REITs are governed by Security Exchange Board of India (**"SEBI"**) under the SEBI (Real Estate Investment Trusts) Regulations, 2014 (**"REIT Regulations"**) as amended from time to time read with SEBI Circulars. For successful registration of the REIT following conditions must be fulfilled:

- **In relation to the REIT:** REITs in India are set up in the form of a trust under the Indian Trusts Act, 1882 with the primary objective of undertaking the activity of REITs, and registered under the REIT Regulations.[25]
- **In relation to the Sponsor:** [A] Each sponsor shall hold at least five percent of the REIT units post initial offer; [B] Collectively, the sponsors must have a net worth of not less than INR 100 Cr.; and each sponsor must have a net worth of not less than INR 20 Cr.; and [C] The sponsor or its associates must have an experience of not less than five years in real estate development/fund management in real estate industry. If the sponsor is a developer, at least two of its projects must have been completed.[26] Furthermore, the Sponsors shall hold at least 25% of the total unit offered by the REIT during the IPO, with a mandatory lock-in requirement of 3 years.[27]

[24] *Supra* note 22.
[25] Rajesh Begur, *Setting Up Of Real Estate Investment Trusts (REITs) In India: Regulatory And Taxation Aspects*, MONDAQ (May 09, 2016), https://www.mondaq.com/india/fund-management-reits/489236/setting-up-of-real-estate-investment-trusts-reits-in-india-regulatory-and-taxation-aspects.
[26] SEBI (Real Estate Investment Trusts) Regulations, 2014, Regulation 4(2)(d).
[27] SEBI (Real Estate Investment Trusts) Regulations, 2014, Regulation 11(3).

- **In relation to the Manager:** [A] The manager must have a net worth of not less than INR 10Cr.; [B] It must have an experience of not less than five years in fund/property management or advisory services in the real estate industry; with at least two key personnel with the same experience with the same experience; and [C] Not less than half of the governing board or the board of directors (as the case may be) of the manager shall be independent and not a part of the governing board of any other REIT.[28] The manager is also required to make investment/divestment decisions in relation to the underlying assets of the REIT; appoint valuer, auditor, registrar, etc. in consultation with the Trustee; resolve disputes of the unitholders; declare distributions to the unitholders; and undertake other such responsibilities as mentioned in Regulation 10 of the REIT Regulations.[29]
- **In relation to the Trustee:** [A] The Trustee must be registered with the Board under SEBI (Debenture Trustee) Regulations, 1993, and shall not be the associate of the manager or the sponsor;[30] [B] The trustee holds the REIT assets in the trust, and oversee the activities of the manager in the interest of the unit holders;[31] [C] The Trustee is also responsible to make distributions in accordance with the regulations;[32] [D] The Trustees are barred from investing in units of the REIT in which it is designated as the trustee.[33]
- **In relation to the SPV:** [A] The REIT must hold not less than fifty percent of the equity/interest in the SPV; [B] the SPV must hold not less than eighty percent of its assets directly in the properties and does

[28] SEBI (Real Estate Investment Trusts) Regulations, 2014, Regulation 4(2)(e).
[29] SEBI (Real Estate Investment Trusts) Regulations, 2014, Regulation 10.
[30] SEBI (Real Estate Investment Trusts) Regulations, 2014, Regulation 4(2)(f).
[31] SEBI (Real Estate Investment Trusts) Regulations, 2014, Regulation 9(1), and 9(3).
[32] SEBI (Real Estate Investment Trusts) Regulations, 2014, Regulation 9(7).
[33] SEBI (Real Estate Investment Trusts) Regulations, 2014, Regulation 9(15).

not invest in other SPVs; [C] these SPVs must not engage in any activity other than holding and developing property.[34]

- **Other relevant provisions related to the REIT-IPO:** The value of assets being offered must not be less than INR 500 Cr., with aminimum offer size of INR 250 Cr. The number of unit-holders apart from the sponsor and its associates must not be less than 200. Not lessthan 25% of the total outstanding units must be offered through the IPO. The minimum subscription amount in the IPO must not be less than INR 50,000.[35] In order to assure sustained income, REITs are required to invest at least 80% of its assets in completed – rent generating properties.[36] It is important to note that SEBI has mandateddistribution of 90% of the distributable cash flow to the investors on half yearly basis and 90% of the proceeds from sale of assets to unit holders, thereby making it a lucrative investment opportunity.[37] Additionally, not less than 51% of the revenue of the REIT, holding company, and the SPV must be from rent, lease, and incidental revenue.[38]

It is important to note that although it has been explicitly mentioned that the trustees must hold the assets, and undertake actions to the benefit of the unit-holders, there is no such provision for in relation to the manager.[39] The Companies Act, 2013 mandates that the board of directors owe a fiduciary responsibility towards the shareholders of the company.[40] Typically, the

[34] SEBI (Real Estate Investment Trusts) Regulations, 2014, Regulation 2(zs).
[35] SEBI (Real Estate Investment Trusts) Regulations, 2014, Regulation 14.
[36] SEBI (Real Estate Investment Trusts) Regulations, 2014, Regulation 18(4).
[37] SEBI (Real Estate Investment Trusts) Regulations, 2014, Regulation 18(16).
[38] SEBI (Real Estate Investment Trusts) Regulations, 2014, Regulation 18.
[39] Arjun Lall et. Al, *Part I – REIT Management Frameworks – An Exercise in Navigating Split Allegiances*, CAM BLOG (June 03, 2019), https://corporate.cyrilamarchandblogs.com/2019/06/part-i-reit-management-frameworks-exercise-navigating-split-allegiances/.
[40] Companies Act, 2013, § 166(2).

sponsors of the REIT control the trust's manager; however, the unitholders have been authorized to remove the manager for non-performance of its duties. Therefore, in absence of clarity vis-a-vis fiduciary obligation, whenever a conflict of interest arises between the unitholders and the sponsors, decision making of the managers may become cumbersome.[41] Therefore, more clarity is required in this matter.

Infrastructure Investment Trusts

InvITs have been attractive for investors since its introduction as it is a yield generating vehicle, regulated by SEBI and has a compulsory requirement to distribute cash regularly, as and when it is generated.[42] Approximately INR 70,000 Cr. assets under management have been garnered by six InvITs and REIT listings, over a period of the past three financial years, across different infrastructure projects like roads, power transmission, commercial estate and gas pipelines.[43] This is majorly because InvITs offer superior risk-adjusted returns and thus eliminate volatility as there is visibility on the cash flows of the underlying assets.

The major parties involved in the establishment of an InvIT include the Sponsor, the Trustee, the Investment Manager and the Project Manager. An InvIT is a tiered structure in which a trust further invests into eligible infrastructure projects either directly or through SPVs.[44] In order to invest in any infrastructure project, one needs to either invest in a project SPV, either a company or an LLP, wherein the trust can hold or proposes to hold the controlling stake or in case of a PPP project wherein one cannot hold equity

[41] *Supra* note 39.
[42] FICCI, *REITs and InvITs in India*, FINANCIAL FORESIGHTS, http://ficci.in/sector/3/Add_docs/Q4-FY13-14-Digest.pdf.
[43] Harsh Shah, *Should you invest in InvITs*, FORBES BLOG (February 20, 2020), https://www.forbesindia.com/blog/infrastructure/invits-forging-ahead-to-revive-indian-infra/.
[44] *InvITs,* NATIONAL STOCK EXCHANGE (August 18 2020), *https://www.nseindia.com/products-services/infrastructure-investment-trusts-invit.*

ownership and thus would not provide the credence to the concession or any such similar agreement. In these cases, the sponsor will still continue to hold the interest as per the concession or any similar agreement (totaling to minimum 15%) for minimum 3 years.[45]

An InvIT can exercise its discretion to invest in infrastructure projects through a Project SPV, subject to the pre-existing investment restrictions like [A] the partner or shareholder of the Project SPV must not have any rights which can stop the InvIT from compliance with the InvIT Regulations; and [B] the Investment Manager, in consultation with the Trustee, ought to appoint a majority of the board of directors or governing boards of the Project SPVs, as applicable.[46] An InvIT may invest in infrastructure projects through a Holdco subject to [A] the holding interest of the InvIT in the Project SPV(s) should be at least 26%; and [B] the Investment Manager, in consultation with the Trustee, ought to appoint a majority of the board of directors or governing boards of the Project SPVs, as applicable.[47]

Like REITs, InvITs are also governed by SEBI under the SEBI (Infrastructure Investment Trusts) Regulations, 2014 (**"InvIT Regulations"**) as amended from time to time and read with SEBI Circulars. The following play an important role in establishing an InvIT in India.

- **Merchant Bankers**: An investment manager is required to appoint one or more merchant bankers as registered under the Merchant Bankers Regulations and minimum one of them would act as the Merchant Banker on the issue. An InvIT's draft would be considered only when it is made through a merchant banker, who has diligently observed the details and has filed a due diligence certificate with the Draft Offer

[45] SEBI (Infrastructure Investment Trusts) Regulations, 2014, Regulation 12(3).
[46] *Deconstructing InvITs and REITs*, CAM (December 31 2016) https://www.cyrilshroff.com/wp-content/uploads/2017/01/De_construct_ing-InvITs-and-REITs-.pdf, at 7.
[47] *Id.*

Document, the Offer Document, at the time of opening of the Issue and at the time of submission of the final Issue report with SEBI. PostIssue, the merchant banker has filing obligations such as monitoring reports with SEBI, redressal of investor grievances including those inrelation to refund, allotments, dispatches and payment of interest to applicants.[48]

- **Registrar to the Issue**: The registrar to the issue is required to [A] accept application forms from the interested investors to the issue; [B] process such applications and coordinate the allotment and refund of subscription amount in cases where there was no allotment and [C] has to maintain physical and electronic bid data and maintain the application forms so received.[49]
- **Syndicate members or SCSBs etc., Public Issue banks and escrow collection banks**- While the syndicate members or SCSBs etc., undertake the task of accepting applications, verifying them and further maintaining records, the two banks - public issue banks (not applicable in case of private placement) and escrow collection banks, aim at collecting the application money from investors and from non - ASBA investors, respectively.
- **Credit Rating Agency**- Since the role of a Credit Rating Agency is to assign a rating to the InvIT that would be introduced in the market, it has to follow the InvIT regulations and such rating would be considered mandatory in cases where the aggregate consolidated borrowings and deferred payments of the InvIT exceed 25% of the value of the InvIT's assets.[50]

[48] SEBI (Infrastructure Investment Trusts) Regulations, 2014, Regulation 10(f).
[49] SEBI (Infrastructure Investment Trusts) Regulations, 2014, Regulation 10 &14.
[50] SEBI (Infrastructure Investment Trusts) Regulations, 2014, Regulation 20.

The process of formation of an InvIT involves the following processes: 1. Appointment of the trustee by the sponsor; 2. Formation of a trust under the Trusts Act and registering it under the Registration Act; 3. Identification of the Investment Manager and the Project Manager; 4. Submission of the application to SEBI by the Sponsor for registration of the InvIT along with draft of the Trust Deed, the Investment Management Agreement and the Project Implementation and Management Agreement; 5. Review of application by SEBI, addressing queries by SEBI in respect of the application so submitted and marking changes if needed in the documents submitted; 6. Grant of in-principle approval by SEBI for registration of the InvIT; 7. Submission of the executed Trust Deed and Investment Management Agreement to SEBI; and 8. Grant of the final registration certificate as an InvIT by SEBI.[51]

IMPACT OF COVID-19 ON REITS AND INVITS – FUTURE TRENDS AND REGULATORY TWEAKS

The commercial office space in India has been a top choice for the investors, along with warehousing, retail, and co-working segments.[52] However, due to the COVID-19 induced lockdown and adoption of new working policies related to work from home conditions, [53] and foreseeable invocation of *force majeure* clauses to escape payment of rent,[54] experts apprehend a slump in the valuation of rent/lease market for the corporate and commercial real estate. Project delays due to shortage of labour, price reactions and loss of rental

[51] *Supra* note 46, at 11.

[52] *Investment in India's real estate sector to rise 5 pc to $6.5 bn: Report*, THE ECONOMIC TIMES (January 01, 2020), https://economictimes.indiatimes.com/industry/services/property-/-cstruction/investment-in-indias-real-estate-sector-to-rise-5-pc-to-6-5-bn-report/articleshow/73056578.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst.

[53] Rishi Ranjan Kala, *Long-term fears: Commercial real estate at a crossroads as WFH here to stay*, THE FINANCIAL EXPRESS (October 11, 2020), https://www.financialexpress.com/industry/long-term-fears-commercial-real-estate-at-a-crossroads-as-wfh-here-to-stay/2102697/.

[54] Rajeev Nair et. al, *How Coronavirus Outbreak Impacts Real Estate And Infrastructure Investment Trusts*, MONDAQ (June 01, 2020), https://www.mondaq.com/india/operational-impacts-and-strategy/944730/how-coronavirus-outbreak-impacts-real-estate-and-infrastructure-investment-trusts.

income were also noticed in the industry which portrayed a gloomy future for the real estate segment at least in the shorter term.[55] However, since the movement restrictions have been lifted, the developers are showing a positive outlook and high expectations from REITs-IPO.[56] This positive outlook towards REITs, as a result of the successful REIT IPO of the Mindspace Business Parks, has led Brookfield Asset Management to make arrangements for its third REIT IPO seeking to raise INR 4000-4500 Cr.[57]

SEBI relaxed the regulatory norms to ensure that REITs remain a lucrative opportunity for the investors, sponsors, and developers.[58] The Sponsors are now allowed to create encumbrances in the form of lien, pledge, negative lien, etc. during the mandatory holding period for the REIT unit.[59] Thereby, allowing the sponsors to use the said asset as collateral to raise debt upon completion of the following conditions: [A] the person invoking the encumbrances shall get itself/its nominee to become re-designated sponsor in compliance with the concerned REIT Regulations; and [B] the re-designated sponsor shall fulfill the sponsor's obligations as specified in the REIT regulations.[60]

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[55] Ashwini Kumar Sharma, *How covid-19 will impact realty sector*, LIVEMINT, (April 05, 2020), https://www.livemint.com/money/personal-finance/how-covid-19-will-impact-realty-sector-11586103020336.html.

[56] Vandana Ramani*, Despite COVID-19 more developers preparing for a REIT listing*, MONEY CONTROL, (October 02, 2020), https://www.moneycontrol.com/news/business/real-estate/despite-covid-19-more-developers-preparing-for-a-reit-listing-5914561.html.

[57] Ashwin Mohan, *Brookfield Asset Management files documents with SEBI for India's third REIT IPO; looking to raise Rs 4,000-4,500 crore,* MONEY CONTROL (September 30, 2020), https://www.moneycontrol.com/news/business/markets/brookfield-asset-management-files-documents-with-sebi-for-indias-third-reit-ipo-looking-to-raise-between-rs-4000-4500-crore-5902711.html.

[58] *Encumbrance on Units of Real Estate Investment Trusts*, SEBI (March 23, 2020), https://www.sebi.gov.in/legal/circulars/mar-2020/encumbrance-on-units-of-real-estate-investment-trusts_46397.html.

[59] Aashit Shah, *Recent Legal and Regulatory Changes Impacting Debt Transactions*, JSA ADVOCATES & SOLICITORS, (April 06, 2020), https://www.jsalaw.com/covid-19/recent-legal-and-regulatory-changes-impacting-debt-transactions/.

[60] *Id.*

Additionally, SEBI has also allowed the sponsors to declassify themselves as sponsors of the trust after completion of the three year lock-in period provided that: [A] Sponsor or its associates do not hold more than 10% of the outstanding units; [B] Sponsor must not exercise the control over the manager of the trust; [C] Approval by the unitholders in simple majority for the change in Sponsor; and [D] in case the sponsor is a natural person, he/she must not be a fugitive economic offender.[61] Furthermore, earlier each sponsor was required to hold at least 5% of the outstanding units of the REIT, and collectively hold at least 15% of the total outstanding units of the trust. The said requirement has been done away after notification of amendments to the REIT Regulations on June 16, 2020.[62] Earlier, any sale of a unit below the aforementioned threshold required that a re-designated sponsor be appointed. However, the perpetual lock-in requirement is now foregone, and the sponsors can choose to de-classify themselves as the sponsors, thereby absolving them from the responsibilities and liabilities of a sponsor.[63] Therefore, it would allow the sponsors to monetize their unit holdings, and do away with their responsibility towards the trust after an initial lock-in period of 3 years. However, it is important to note that in case of invocation of encumbrances and re-designation of the sponsor, the original sponsor will get an opportunity to do away with the responsibilities and liabilities towards the trust, while still being within the lock-in period.[64] This is not only contrary to the intent of the regulators as evident from the second amendment to the REIT Regulations.

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[61] Subhayu Sen, *REITs And InvITs: SEBI Introduces Norms For De-Classifying Sponsors, Induction Of A Sponsor And Relaxes Sponsor Lock-In Requirements*, MONDAQ (July 1, 2020), https://www.mondaq.com/india/fund-management-reits/960408/reits-and-invits-sebi-introduces-norms-for-de-classifying-sponsors-induction-of-a-sponsor-and-relaxes-sponsor-lock-in-requirements.

[62] SEBI (Real Estate Investment Trusts), Regulations, 2020, Amendment 2.

[63] *Supra* note 61.

[64] Subhayu Sen, *SEBI Permits Encumbrance Over Locked-In REIT Unit – A Boon!,* MONDAQ (April 30, 2020), https://www.mondaq.com/india/fund-management-reits/926094/sebi-permits-encumbrance-over-locked-in-reit-unit-a-boon?type=mondaqai&score=76.

COVID-19's impact on InvITs was majorly seen as long drawn lockdown forced numerous parties to invoke force majeure clauses and the investors received little to no return from the investment made along with the uncertainty of completion of the project.[65] This led to a situation of impairment and madethe investors bear the losses. Furthermore, the situation raised the question of recognition of deferred tax assets as it would take time for the system to restore the normalcy.[66] Another problem for the day-to-day activities for such projects was the deficit in cash and material management as the businesses had to endure long period of overdues and lockdown and as a result of which statutory dues also faced a hit with respect to these individual projects and profiles.[67]

In order to revive the interest of the shareholders and provide a change to the InvITs, SEBI provided the option of creating encumbrance to unit holders as per the InvIT regulations wherein an encumbrance of the nature of pledge, lien, negative lien, non-disposal undertaking etc. or any other covenant, transaction, condition or arrangement can be created during the mandatory holding period provided the conditions of creating such encumbrances are mentioned in the encumbrance agreement executed.[68] Furthermore, the sponsor(s) who create such charge have to provide details of the same to the investment manager of the InvIT within two days from creation of such encumbrance.[69] Once the InvIT is aware of the creation of such encumbrance, it has to pass the information to every stock exchange where units of the InvIT

[65] *Supra* note 54.
[66] *How the tax equation changed for REITs and InvITs*, THE ECONOMIC TIMES (April 02, 2020), https://economictimes.indiatimes.com/markets/stocks/news/how-the-tax-equation-changed-for-reits-and-invits-from-april-1-2020/articleshow/74943558.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst.
[67] *Supra* note 57.
[68] *Encumbrance on units of Infrastructure Investment Trusts*, SEBI (March 23, 2020), https://www.sebi.gov.in/legal/circulars/mar-2020/encumbrance-on-units-of-infrastructure-investment-trusts_46396.html.
[69] *Id.*

are listed.[70] In case of InvITs, this lifetime lock-in requirement as in REITs is not there and hence invocation hasn't been permitted. Since the lock-in in case of InvITs is only for three years, a lender can get an exit after such period is over.[71] SEBI has also given compliance relaxation to both REITs and InvITs considering the delay in projects and performance due to the advent of COVID- 19.[72]

However, in the longer run, InvITs prove to be a lucrative investment for the investors as its major benefit includes the tax exemption on dividend distribution and limited tax liability on the interest income, strong corporate governance, low portfolio risk, and assured returns as 90% of Net Cash Flow is distributed.[73] Thus with restoration of regular activities for these projects and profiles, the long term benefit attracted the investors and thus 2020 witnessed a jump in the investments in these vehicles. This is further substantiated in the budget introduced in the financial year of 2021- 2022, wherein the government has supported the endeavour of investment in these options through exemption from TDS deduction for NRIs on REITs and InvITs dividends, FPI debt financing in REITs and InvITs.[74] Such positive spirited acts by the government prove to act as a motivator for the investors to explore these vehicles and not resort to the traditional methods of investments.

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[70] *Id.*

[71] Payaswini Upadhyay, *SEBI Eases Fund-Raising Rules For REIT*, INVIT, (March 23, 2020), https://www.bloombergquint.com/law-and-policy/sebi-eases-fund-raising-rules-for-reit-invit-sponsors.

[72] *Relaxation from compliance to REITs and InvITs due to the COVID -19 virus pandemic,* SEBI (July 01, 2020), https://www.sebi.gov.in/legal/circulars/jul-2020/relaxation-from-compliance-to-reits-and-invits-due-to-the-covid-19-virus-pandemic-amendment_46985.html.

[73] Dr. Neelam Rani et. Al, *Infrastructure Investment Funds: An attractive enabler for infra sector*, FINANCIAL EXPRESS (January 27, 2021), https://www.financialexpress.com/infrastructure/infrastructure-investment-funds-an-attractive-enabler-for-infra-sector/2179722/.

[74] *Budget 2021-2022*, MINISTRY OF FINANCE (February 01, 2021), https://pib.gov.in/PressReleseDetailm.aspx?PRID=1693882.

Although the Covid-19 pandemic resulted in several blows to the Indian real estate and infrastructure segment, the constant efforts of the regulators to relax the regulatory norms, and increase the easy of business in the tiring times has paid off. We have seen considerable interest by the developers and investors in moving towards REITs and InvITs in order to find liquidity and ease the burden on their books.

CONCLUSION

The real estate and infrastructure sector in India is bound to grow exponentially in the coming years because of the under-utilized potential of the segment. REITs and InvITs can be expected to play a crucial role in enabling these sectors to grow, and increase public ownership of such projects. The regulators are listening to the demands of the market players and tweaking the regulationsto suit the market conditions, as is evident from allowing insurance companiesto invest in REITs and InvITs in 2017, to allowing encumbrances on the assetsheld in such business trusts in 2020. This move towards ease of business is well suited to include increasing number of developers and sponsors within the reach of such business trusts. REITs and InvITs have played a major role in countries such as US, Singapore, UK, and Canada, they are expected to do thesame in India as well.