

RBI issues Master Direction on “fit and proper” criteria for sponsors of Asset Reconstruction Companies

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In brief

The Reserve Bank of India (RBI) has issued Master Directions¹ dated 25 October 2018 to provide for various determinants and data points that RBI evaluates before considering a sponsor of asset reconstruction companies (ARCs) as “fit and proper”. The ARCs are now required to obtain this information and undertake reporting with the RBI. This should assist the RBI in expediting the approval process and also monitoring “fit and proper” criteria of the sponsors of ARCs on an ongoing basis.

In detail

The key highlights of the Master Directions are outlined below:

Applicability

- The Master Directions apply to the existing and proposed sponsors of ARCs registered under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.
- The Master Directions are effective immediately.

Eligibility criteria and determinants of “fit and proper” status for sponsors of ARCs

- Master Directions state that in order to determine whether the sponsor is “fit and proper”, the RBI will consider all relevant factors, as appropriate including,

but not limited to the following:

- (i) The sponsor’s integrity, reputation, track record and compliance with applicable laws and regulations;
- (ii) The sponsor’s track record and reputation for operating business in a manner that is consistent with the standards of good corporate governance and integrity, in addition to the similar assessment of individuals and other entities associated with the sponsor;
- (iii) The business record and experience of the sponsor;
- (iv) Sources and stability of funds for acquisition and the ability to access financial markets;
- (v) Shareholding agreements and their impact on control

and management of the ARC.

- The Master Directions also provide that the RBI could, *inter-alia*, seek feedback from domestic and foreign regulators and enforcement and investigative agencies as the RBI deems appropriate, in order to make an assessment about whether a sponsor being “fit and proper”.

Reporting requirements – existing sponsors of ARC

- The ARCs are required to obtain declaration from its existing sponsors in Form I (except Part E) within one month from the close of the financial year (i.e., by 30 April).
- Further, the ARCs are required to obtain information in Form III from its existing sponsors

¹ RBI/DNBR/2018-19/66 Master Direction DNBR. PD (ARC) CC. No. 06/26.03.001/2018-19

and submit the same to RBI by 31 May every year.

Reporting requirements - proposed sponsors of ARC

The ARCs are now required to submit information as per Form II and Form I (Part A to D to be obtained from the proposed sponsor and Part E to be provided by the ARC) along with application to RBI seeking approval for change in shareholding.

- As per the extant RBI guidelines, a prior RBI approval is required with respect to change of shareholding that results in following:
 - (i) any transfer of shares of the ARC by which the transferee becomes a sponsor; or
 - (ii) any transfer of shares by which the transferor ceases to be a sponsor; or
 - (iii) an aggregate transfer of 10% or more of the total paid-up share capital of the ARC by a sponsor during the period of five years commencing from the date of certificate of registration (in the case of new ARCs).

Key disclosures in the forms

Form I (Part A to D) – to be furnished to ARCs by the sponsors

- Shareholding pattern of the sponsor.
- Details of the regulator of the sponsor entity, if any (in India or abroad).
- Details of capital raised by the sponsor during the past three years.
- Detailed corporate structure of the Group, if the sponsor belongs to a Group.

- Whether the sponsor entity is a foreign owned and controlled entity or an Indian owned and controlled entity as per the regulations framed under Foreign Exchange Management Act, 2002 -
- Profitability and average income for the last three years and net worth (certified by statutory auditors).
- Sources of fund for acquisition of securities in ARC (certified by statutory auditors).
- Audited financial statements and income-tax returns for the last three years.
- Details of directorship/ shareholding/ voting rights/ securities of the sponsor in banks and other institutions in the financial sector.
- Whether any other person has beneficial interest in the proposed acquisition.
- Background, experience, expertise and track record of the business of the sponsor.
- List of relatives, persons acting in concert, associated enterprises and related parties of the sponsor (as defined in the Master Directions).
- Entities which hold 10% or more of the paid-up share capital in the sponsor.
- Entities in which the sponsor is holding 10% or more of the paid-up share capital.
- Entities in which the sponsor is considered as being interested under

section 184 of the Companies Act, 2013.

- Entities where there are common shareholders of the sponsor who collectively hold 20% or more of the paid-up equity share capital of the sponsor and those entities.
- The sponsors are also required to furnish details and particulars (for itself and the above entities) of bankruptcy/ insolvency, disciplinary action, criminal prosecution, violation of rules/ legislative requirements by customs/ direct and indirect tax/ other revenue authorities, wilful defaulter declaration.

Form I (Part E) – to be furnished by the ARC

Following key details are included in Part E of Form I:

- Explanation/ information in regard to items considered relevant for judging “fit and proper” status of the sponsor.
- Brief details of shareholder agreements.

Form II – to be furnished by the ARC along with the application to seek RBI’s approval for change in shareholding

Following key details are included in Form II:

- Proposed sponsor’s track record on integrity and reputation.
- Report of the ARC on the acquisition (based on the review of the board of the ARC).
- Whether the sponsor or any of the entities mentioned in Form I have been subject to any

proceedings of serious disciplinary or criminal nature.

Form III – to be furnished by the ARC to RBI

Following key details are included in Form III:

- Details of regulatory actions against the sponsors and the other entities and persons mentioned in Form I by regulators in India or abroad, during the last five years.
- Details of civil and criminal proceedings against the sponsors and

persons mentioned in Part B of Form I during the last five years.

- Change in ownership of the sponsor in the last five years.

Apart from the above, there are certain factual information that are to be provided in the above Forms (refer Form I, II and III for more details).

The takeaways

The issue of above Master Directions is a welcome move by the RBI, as it has now shared the indicative list of factors that it considers for determining “fit

and proper” criteria for sponsors of ARC. This provides transparency and clarity for the existing as well as the proposed sponsors investing in the ARC.

While the Master Directions are silent as regards the applicability to sponsors of a new ARC, given the wider framework under which the Master Directions are issued, these directions may still be relevant for sponsors of new ARCs.

Let’s talk

For a deeper discussion of how this issue might affect your business, please contact your local PwC advisor

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