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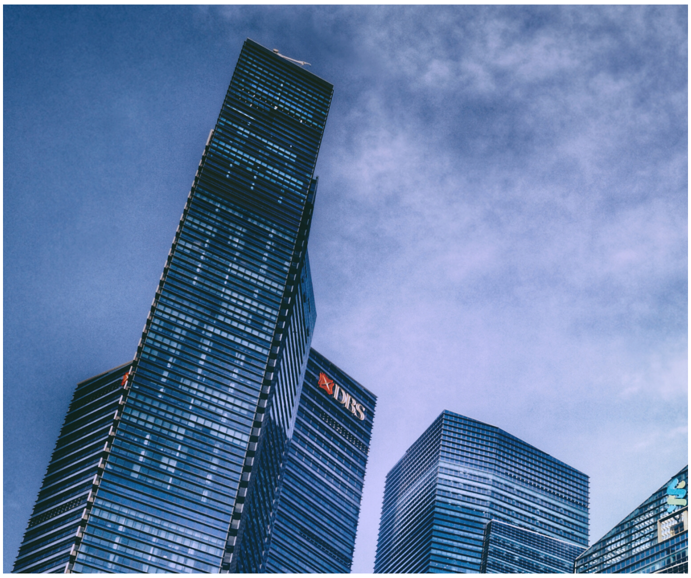
INSIDE THIS ISSUE:

A Robust Shadow Banking System For the Indian Micro Borrower

Customers for micro-entrepreneurs have dwindled. This significant loss of demand coupled with the supply side shock most cannot ply their trades with any significant level of certainty and consistency. With overburdened banks and a substantial non-performing asset portfolio, the shadow financing industry's inclination is to percolate downwards leading to a wider reach among the economically weaker sections of the society across India. In addition to this, the limited prudential regulation pertaining to NBFCs further attracted a high quantum of micro borrowers in India looking to pave their way out of the pandemonic situation.



In the past, interests of micro-borrowers were compromised in the single-minded pursuit of increased profits by lenders with a scarce focus on the well-being of borrowers. To address this problem the Reserve Bank of India (RBI), in 2011, introduced comprehensive regulations on micro-credit with “master directions" for NBFC-Micro Finance Institutions, which covered products, leverage limits, market segments, pricing and the interface with customers. However, the potential effect of similar such comprehensive regulations were wiped off with the onset of the pandemic hurling a substantial population of micro-borrowers in a fathomless abyss of debt and penal interests. In addition to this, the recent government-led relaxations have induced a lopsided effect of pushing the demand side upward while the industry continues to be plagued with disrupted supply chains and unavailability of labour force. With the attainment of demand-supply equilibrium appearing as a distant reality, the resilience of the shadow financing industry will be put to a litmus test.

Therefore, safeguarding customer interests is as critical as helping the shadow financing system stay afloat when depressionary forces are mightiest. Adding to the woes of NBFCs is the lack of fund flow and evaporating liquidity which started from the IL&FS fiasco but continues to exacerbate on the pretext of the pandemic. For the lack of government support in this year's Budget, the involvement of NBFCs in sensitive sectors such as real estate and infrastructure has led these shadow banking segments to gorge on public money.

Evidently, the cash influx from the authorities is not sufficient to eliminate concerns among investors about NBFCs and raises concerns of rising bad debts in the coming quarters. The past few years have severely impacted the financial well-being of the shadow financing industry; however they have gained a position of prominence by assuming the role of banks on some occasions. This invariably raises an essential question of whether to bring NBFCs under similar scrutiny levels as banks to as to ensure sustainability of NBFCs. The need for a strongly regulated shadow banking system was urgently felt to be addressed by the RBI to address the systemic risks inherent to NBFC in the country. The proposal to place micro-borrowers in the least stringent regulations is likely to facilitate growth and promote the shadow financing industry which plays an integral role in lending support to micro borrowers in rural and urban areas. However, in doing so, the loss withstanding ability of various classes of NBFCs should be carefully assessed.

Since NBFCs attract a high quantum of borrowers, a robust system would enable the NBFCs to assign credit scores to individuals. Thus, propelling the existing framework towards a fool-proof one would mitigate default risks which caused the collapse of the sector in the past. As NBFCs operate more like banks and provide similar banking services at present, the current practice demands a stricter regulation on the NBFCs wherein checks and balances at regular intervals would ensure the overall financial health while securing the interests of micro-borrowers at large.

Killer Acquisitions in Indian Pharmaceutical Industry: Emerging Trends

The launch of Covaxin in India amidst the outbreak of COVID-19 has attracted enormous investments from the government as well as private investors in the pharmaceutical sector. The pandemic has played a significant role in the expansion of the Indian pharmaceutical sector and simultaneously recovered the global supply chain which has portrayed India as not only a reliable nation, but also as a partner during such unprecedented times. Thereby, it is evident that the competition in the pharmaceutical industry is cutthroat.

To eliminate competition, killer acquisition is a peculiar practice in the pharmaceutical sector, therefore, in most such cases, the mergers/acquisitions take place abroad where the drug is launched as it does not in any manner affect the competition in India. Moreover, Killer Acquisitions in the pharmaceutical industry is further complicated because when the drug is at a nascent stage, it is difficult to decide whether the drug would enter the market. More importantly, it is often noticed that drug development is an uncertain process as most of the drugs fail in the early trial stage while some are scrapped even at later stages. Such a practice encourages companies to constantly watch-out for new development and innovate which augments competition.

But unfortunately, it has also paved the way for big companies to acquire small companies, thereby gave rise to the practice of Killer Acquisition and impede the growth and welfare of the pharmaceutical industry at large. Currently, the merger agreements which involves Killer Acquisitions in the pharmaceutical market have not been scrutinized under the competition law of India. It was also observed in the *Arun Maira Committee*, in 2011, that the Competition Act was not equipped towards the regulation of mergers in the pharmaceutical sector owing to the acquisitions taking place outside India.

Interestingly, though the CCI has the power to make structural changes to the merger/acquisition for a merger/acquisition opted abroad which is likely to cause an appreciable adverse effect on competition, the CCI has never taken cognisance of such an offence yet as it could dissuade companies from investing in India. On the brighter side, there is a probability that the CCI would actively take cognizance of the pharmaceutical sector in the near future as previously the CCI did examine the merger of Sun Pharma and Ranbaxy wherein the CCI had imposed pre-conditions towards the merger and one such precondition was to divest seven drugs from the portfolio of each party.

Also, the recent 2020 Competition Amendment Bill addressed the vulnerability of Digital market to Killer Acquisitions, wherein it shed light upon innovation and advancement being the primary reason for increasing acquisitions which could often act as a threat for small and new companies. Similarly, the same rationale could be applied to Killer Acquisitions in Pharmaceutical market as innovation in the said industry. Besides, considering how big a role the pharmaceutical sector has been playing during this Covid-19 pandemic, these practices should be challenged under Section 3, 4 of Competition Act for having an adverse effect on the competition and causing dominance and monopoly.

Moreover, section 5 of the Act could be used for curbing Killer Acquisition by revising the threshold limit of notifying acquisition to include the transactional value and the intent of such an acquisition. Alternatively, it could also consider investigating a merger done in-lieu of maintaining dominance in a sector or protection of an existing drug under Section 4 of Competition Act. Mergers that do not meet the merger thresholds under Section 5 of the Competition Act or are eligible for the de minimis exemption may be indirectly examined under Section 4 of the Competition Act for abuse of dominance.

Further, as far as the problem of new drugs are concerned, CCI could adopt European Commission's procedure to consider a drug undergoing Phase III trial as a promising competitor to those existing players in the market.

In conclusion, mergers in the pharmaceutical sector can be regulated by creating a vigilance committee that would look after the mergers and acquisitions taking place in the pharmaceutical industry, empowering CCI to create guidelines, penalties, rules and regulations towards the pharmaceutical industry and lastly, establishing a system wherein inspections are done in a time-bound fashion.

Also, providing tax incentives towards research and development for the Indian pharmaceutical companies would go a long way in maintaining a healthy competition. Evidently, the implementation of these rules are dependent upon several political, legal and economic factors, but if applied stringently it would ensure that Killer Acquisitions are nipped in the bud.

RBI's Revised Regulatory Framework for (NBFCs): Industry Framework

NBFCs emerged as a better alternative with the banking sector regulations being tightened and due to the differences in legislative frameworks and licensing frameworks of banks and NBFCs as all NBFCs are subjected to the same regulations irrespective of the risk complexity, perception, and size of the borrower. On the contrary, such regulations also mean that NBFCs can assume such a scale that can potentially impact the systemic stability.

The drastic collapse of a major NBFC did cause a systemic risk in the NBFC sector and the tremors of the collapse were experienced by all the other participants. One of the reasons for the crisis was that the company borrowed short term instruments from the financial institutions and lent loans to the long-term project developers. Thus, with the increasing interlink between the NBFCs and financial systems, the need for reviewing the regulatory framework and plugging the loopholes has become the need of the hour.

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In the light of the same, there were discussions on the systemic risks of NBFC in the country and in January 2021, the RBI came up with the *"Discussion Paper on Revised Regulatory Framework for NBFCs - A Scale Based Approach" ("Discussion Paper").* The discussion paper proposed that the regulatory and supervisory resources have to be more focused on entities because of their systemic interconnectedness with different financial market participants. Therefore, they have been classified on the basis of the nature of activity, risk perception and size of operations.

Further, they have also been layered into four categories viz, base layer, medium layer, upper layer and top layer. Considering that each NBFC has a different impact on the financial stability of the industry, the layering of NBFCs and imposing different regulations on each of the layer is a positive change instead of a uniform rule which has caused irrevocable damages.

The base layer is aimed to have the least stringent regulations which shall include Type-I NBFCs, Peer to Peer Lending Platforms, Non-Operative Financial Holding Company and Account Aggregators. Such lenient regulations would facilitate growth and promote the shadow financing industry which plays an integral role in lending support to micro borrowers in rural and urban areas. Further, the medium layer is proposed to include all the non-deposits taking the NBFCs which are classified as systematically important and all deposits taking NBFCs which doesn't meet the parameters of regulations specified in the NBFC-UL.

As this layer would include Infrastructure Debt Funds, Standalone Primary Dealers, IFC, Housing Finance Companies etc the said regulations are stricter as compared to the NBFC-BL to eliminate any probable risk spill-overs. Thereon, the upper layer is to comprise of NBFCs identified as systematically significant which would treat NBFCs as banks and impose stringent rules on lending capital to sectors such as capital markets and real estate as they are unpredictable. The regulation under this equates to the controlling effect that banking regulations have on institutions as well as borrowers to ensure that systemic risks are mitigated.

In other words, it would ensure better risk management of asset quality and reduce borrower defaults which would further ensure a better financial health of the NBFC and shadow financing industry at large.

Lastly, the top layer is proposed to remain empty and if there is any unsustainable systematic risk is perceived from NBFC-UL, then it might be shifted to this layer. Therefore, it can be observed that the proposed regulatory framework seems promising with regards to maintaining stability in the NBFC sector by the way of imposing lenient regulations on small NBFCs to augment their growth and reach and simultaneously ensuring strict vigilance on the big players.

Having said that, if these regulatory framework are implemented, only 76 companies would be sliding down from the Systematically Important status to the Non Systematically Important status. Also, the Middle Layer and Upper Layer would require several revisions in their compliance and governance framework which would affect more than 500 NBFCs. Nevertheless, these drawbacks can be met efficiently by empowering the RBI to change the management of NBFCs and make amendments in the bank's guidelines to encourage Public Sector Banks and financial institutions to buy the high rated assets. Also, implementation of a systematic filing system of individual firms to keep a track on NBFCs would go a long way.

In conclusion, considering the potential contribution of NBFCs with regards to future investments, it is imperative for the government to ensure that the NBFC sector is protected from systemic failures and is focused on minimising bad debts.

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Office Nos. 2075/2089, Spaces, Adani Western Heights, Nr DN Nagar Metro Stn., Andheri West, Mumbai - 400053.
info@kslegal.co.in | +91-8169409649
Offices at: Mumbai | Pune | Delhi | Bangalore | Chennai | Ahmedabad