

# FINTECH FLYER

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## AI AND FIN-TECH INTERSECTION

In the recent past, the Reserve Bank of India (RBI) has taken well-timed and forward-thinking initiatives in the booming artificial intelligence (AI) and digital fintech landscape. These include *inter alia*:

1. constitution of a committee for development of FREE-AI (*defined hereinafter*), as more specifically detailed in this Flyer;
2. launch of the RBIDATA mobile application of RBI, that offers macroeconomic and financial statistics relating to the Indian economy in a user-friendly and visually engaging format; and
3. MuleHunter.AI initiative, a cutting-edge AI / machine learning (ML) model that helps identify mule bank accounts, thereby harnessing AI to tackle fraud prevention.

These initiatives align with the recent challenges associated with AI, as well as national and global efforts to establish a regulatory framework or guiding principles for AI governance, such as the ‘Organization for Economic Co-operation and Development’ AI principles and the recent ‘Report on AI Governance Guidelines Development’ dated 06 January 2024 (**Report**) issued by the Ministry of Electronics and Information Technology. The Report, which advocates a ‘whole-of-government approach’, urges collaboration and coordination among various regulators and government departments, and these initiatives by RBI appear to be in consonance with such recommendations of the Report.

While adopting such advanced technologies, it also becomes pertinent that the interests of the customers are adequately protected, including raising customer awareness. In this regard too, RBI has been proactive in implementing measures and guidelines to ensure customers are warned against, and exercise caution in relation to digital / financial fraud.

## **AI – FINTECH INTERSECTION**

### **COLLABORATION**

### **NATIONAL AND GLOBAL EFFORTS**

# RBI STRENGTHENS PENALTY NORMS BY AMENDING THE FRAMEWORK FOR IMPOSITION OF PENALTIES AND COMPOUNDING OF OFFENCES UNDER THE PSSA

On 30 January 2025, RBI amended the 'Framework for imposing monetary penalty on authorised payment system operators / banks under the Payment and Settlement Systems Act, 2007' (PSSA) with the aim to rationalize and consolidate enforcement action by RBI.

Some key provisions of the amendments are summarized below:

1. Illustrative list of violations: Regulated Entities (REs) may be examined for enforcement actions on the violation of the following – (a) non-compliance with RBI authorization terms; (b) making false statements or omissions to RBI; (c) failure to provide required information or documents to RBI; (d) unauthorized disclosure of information; (e) inadequate storage of payment system data in India; and (f) contravention of PSSA provisions or regulations.
2. Increase in Penalty Amount: Now the RBI is empowered to impose a penalty upto INR 10,00,000 (which was previously INR 5,00,000) in cases of contravention or default by the payment systems. If the contravention or default continues, an additional penalty of up to INR 25,000 can be imposed for each day it persists beyond the first day.

3. No further proceedings after compounding: Once a contravention is compounded by RBI, no further proceedings will be initiated or continued against the person for that contravention.
4. Non-payment of Compounding Amount: In case of failure to pay the compounding amount within 30 days, the contravention will not be considered compounded, and the applicant may face criminal proceedings or other actions.
5. Disclosure: After imposition of penalty and completion of compounding action, necessary disclosures of the penalties may be made in the annual financial statements. A press release shall also be published on the RBI website.

## LEX TAKEAWAY

The updated framework by RBI for imposing monetary penalties and compounding offenses is designed to enhance enforcement measures, ensuring a more structured and transparent approach to addressing regulatory violations. Payment system operators and banks are required to adhere to the regulations with the utmost diligence, as non-compliance can lead to increased financial penalties upto INR 10 Lakhs.

## PAYMENT SYSTEMS

### PENALTY AND COMPOUNDING OF OFFENCES – TIGHTER NORMS

# RBI CONSTITUTES A COMMITTEE FOR DEVELOPING AN ETHICAL AI FRAMEWORK IN THE FINANCIAL SECTOR

As part of RBI's 'Statement on Developmental and Regulatory Policies' released on 06 December 2024, RBI constituted a committee (**Committee**) to develop a 'Framework for Responsible and Ethical Enablement of AI' (**FREE-AI**) in the financial sector.

The Committee has been entrusted with the following:

1. Assessing the level of AI adoption in financial services, both globally and in India;
2. Reviewing regulatory and supervisory approaches on AI, with a focus on the financial sector globally;
3. Identifying potential risks associated with AI, if any, and recommending an evaluation, mitigation, and monitoring framework, along with compliance requirements for financial institutions;
4. Recommending governance structures that ensure AI adoption is both responsible and ethical; and
5. Addressing any other matters related to AI in the Indian financial sector.

## LEX TAKEAWAY

By addressing AI's potential risks, ensuring ethical adoption, and establishing regulatory clarity, the Committee can help India become a global leader in responsibly integrating AI into the financial sector. This initiative has the potential to drive both innovation and trust, enabling AI to enhance the efficiency and inclusivity of India's financial ecosystem while safeguarding public interest. It will be interesting to see the final recommendations from the Committee, as these will likely set the foundation for how AI evolves in the Indian financial space.

### ARTIFICIAL INTELLIGENCE

#### AI RISKS

#### RESPONSIBLE AND ETHICAL AI

#### AI IN FINANCIAL SECTOR

## RBI EXPANDS UPI ACCESSIBILITY FOR PPIs THROUGH THIRD-PARTY APPLICATIONS

On 27 December 2024, RBI amended the 'Master Directions on Prepaid Payment Instruments' (**PPIs**) (**PPI Amendment**) to enable PPI holders to make Unified Payment Interface (**UPI**) payments via third-party UPI applications.

Key features of the PPI Amendment are as follows:

1. UPI integration: PPI issuers can now enable their full-KYC PPI holders to make UPI payments by linking their PPIs to the PPI issuer's UPI handle, accessible via the issuer's mobile application.
2. Authentication: UPI transactions initiated through the PPI issuer's application will be authenticated using the PPI holder's existing credentials, ensuring that the transaction is pre-approved before entering the UPI system.
3. Discovery and linking: PPI issuers may also facilitate the discovery of their full-KYC PPIs on third-party UPI mobile applications, which in turn, shall enable the linking of these full-KYC PPIs to UPI.
4. Onboarding limitations: PPI issuers, acting as payment service providers, are prohibited from onboarding customers of other issuers or banks.

Position prior to the PPI Amendment: UPI payments involving PPIs could only be conducted through the application of the PPI issuer and not through any third-party applications.

## LEX TAKEAWAY

While the restrictions on onboarding customers from other issuers or banks may limit the competitive scope of PPIs, the shift towards greater convenience and flexibility for consumers is likely to drive significant growth in the adoption of digital payment tools in India.

### **FULL-KYC PPI HOLDERS**

### **INTEROPERABILITY BETWEEN UPI AND PPI**

### **FLEXIBILITY**

### **IMPROVED USER EXPERIENCE**

### **USER CONVENIENCE**

## RBI GUIDELINES TO PREVENT FINANCIAL FRAUDS

Due to the increase in digital transactions and the increasing risks associated with financial frauds, particularly those involving voice calls and SMS, RBI has issued guidelines aimed at mitigating such risks. These measures target fraudulent activities that misuse mobile numbers, which are often used for OTPs and sensitive payment alerts.

The key directives to be followed by REs include:

1. 'Mobile Number Revocation List utilization' to clean up customer databases and identify potentially compromised mobile numbers.
2. Developing a Standard Operating Procedure (SOP) to update registered mobile numbers after due verification, monitor accounts linked to revoked numbers, and prevent their misuse for money mules or cyber frauds.
3. Enhancing call and SMS guidelines for commercial voice calls and SMS, including the use of designated number series and protocols outlined by the Telecom Regulatory Authority of India (TRAI) to ensure transparency.
4. Creating awareness and educating customers about blocking unwanted communications, especially fraud-related messages. They are also required to report suspected fraudulent communications on appropriate platforms.
5. Safeguarding customer data and ensuring that any misuse or leakage is swiftly addressed, with reports submitted to law enforcement agencies.

## COMBATTING FINANCIAL FRAUDS

### MISUSING MOBILE NUMBERS

Further, RBI, in its statement on development and regulatory policies dated 07 February 2025 expressed its initiatives to implement the 'bank.in' exclusive Internet domain for Indian banks, which registration shall commence from April 2025, which shall also be followed by the 'fin.in' domain for the financial sector.

## LEX TAKEAWAY

RBI's latest guidelines are a critical step in combating the rising tide of financial frauds. By enforcing stricter measures and tightening rules around SMS and call practices, RBI is enhancing safeguards for consumers. By implementing measures in relation to the domain names, RBI seeks to reduce cyber security threats and malicious activities like phishing; and streamline secure financial services, thereby enhancing trust in digital banking and payment services and create awareness among the customers in relation to authenticity of the banking and financial entities.

Entities that engage telemarketers for various activities such as lead generation activities, may also be required to be vigilant and ensure that they and their empaneled telemarketers comply with these guidelines while reaching out to various clients / prospective clients to telemarket various facilities / products offered by these fintech entities.

## CAUTION

### CUSTOMER AWARENESS

### SAFEGUARD CUSTOMER DATA

## RBI PROPOSES TO STOP CERTAIN REs FROM LEVYING FORECLOSURE CHARGES / PRE-PAYMENT PENALTIES ON FLOATING TERM LOANS

As part of RBI's Statement on Developmental and Regulatory Policies issued on dated 09 October 2024, RBI on 21 February 2025 released a draft circular on 'Responsible Lending Conduct – Levy of Foreclosure Charges / Pre-payment Penalties on Loans' (**Draft Circular**). The Draft Circular aims to address the divergent practices among certain REs regarding the levy of foreclosure charges and pre-payment penalties on loans sanctioned to individuals for business purposes and Micro and Small Enterprises (**MSEs**), which have led to customer grievances and disputes in the past.

The Draft Circular can be briefly summarized as follows:

- i. REs shall permit foreclosure / pre-payment of all floating rate loans to individuals (for purposes other than business) without levying any charges / penalties, expanding the scope from only floating rate term loans as earlier;
- ii. REs, except Tier 1 and Tier 2 Primary (Urban) Co-operative Banks and Base Layer Non-Banking Financial Companies (**NBFCs**), shall be prohibited from levying any charges or penalties on floating rate loans granted to individuals and MSE borrowers for business purposes, where the aggregate sanctioned limit is up to INR 7.50 crore per MSE borrower;

- iii. REs cannot levy any change / penalty that were previously waived or undisclosed, or where foreclosure / pre-payment is initiated at the instance of the RE;
- iv. The levy of foreclosure charges or pre-payment penalties by REs shall be based on the Board-approved policy of the REs and shall depend on the outstanding amount in the case of term loans and the sanctioned limit in the case of cash credit / overdraft facilities;
- v. The applicability or otherwise of foreclosure charges / pre-payment penalties must be clearly mentioned in the key fact statement for applicable loans and advances; and
- vi. REs must permit foreclosure / pre-payment of loans without any minimum lock-in period.

These instructions apply irrespective of the source of funds used for foreclosure / pre-payment of loans. In the case of a combination of fixed and floating rate loans, the applicability of charges will depend on whether the loan is on a fixed or floating rate at the time of foreclosure / pre-payment.

## LEX TAKEAWAY

The RBI's Draft Circular aims to promote responsible lending practices with a view to safeguarding customers' interest through better transparency, fairness and customer centricity by lenders. The Draft Circular broadens the scope of such regulations to cover loans extended to MSEs by REs, providing protection to borrowers, especially MSEs, from unfair practices. By eliminating the foreclosure charges / pre-payment penalties in certain areas, the RBI seeks to make lending more borrower friendly. The Draft Circular also seeks to promote healthy competition among lenders and provides better freedom to the borrowers to choose their financial options.

### **FORECLOSURE CHARGES**

### **PRE-PAYMENT PENALTIES**

### **MICRO AND SMALL ENTERPRISES**

### **LOANS**

### **TRANSPARENCY**

## REGULATORY ACTIONS TAKEN BY RBI

In the months of December 2024 – February 2025, RBI has issued orders for: (i) cancellation of the licenses / certificate of registration of entities; (ii) imposition of monetary penalties; and (iii) removal of supervisory restrictions on certain entities, as summarized as under:

### 1. *Cancellation of licenses / certificate of registration:*

Name of entity	Penalty Amount (in INR)
<b>Bank</b>	
<b>Vaishali Shahari Vikas Co-operative Bank Limited</b>	The bank did not have adequate capital and earning prospects, failed to comply with the licensing conditions set out under the Banking Regulation Act, 1949 ( <b>BR Act</b> ), and lacked the financial capacity to fully repay its present depositors. This led to cancellation of its banking license.
<b>NBFC</b>	
<b>Zavron Finance Private Limited</b>	The following actions by Zavron were questioned by the RBI, leading to cancellation of its certificate of registration: <ul style="list-style-type: none"> <li>(a) outsourcing its core decision-making functions, including credit appraisal, loan disbursement, fixing of interest rate, and the ‘know your customer’ (<b>KYC</b>) verification process.</li> <li>(b) failure to conduct due diligence on lending service providers (<b>LSPs</b>).</li> <li>(c) failure to conduct periodic review of security practices and control processes deployed by LSPs.</li> <li>(d) violation of the ‘fair practices code’ by not providing customers with a copy of the loan agreement and sanction letter in vernacular language.</li> </ul>
<b>X10 Financial Services Limited</b>	Violation of RBI outsourcing guidelines by X10, by outsourcing its core decision-making functions, including credit appraisal, fixing of rate of interest, and KYC verification, to its service providers ( <b>SPs</b> ), and failure to conduct due diligence on the SPs, led to cancellation of its certificate of registration.

Cancellation of certificate of registration of Zavron and X10 Financial Services due to irregular lending practices is consistent with RBI's approach in the past, in the case of Star Finserv and Polytex India, in July 2024.

## 2. Significant Monetary Penalties:

Name of entity	Penalty Amount (in INR)	Reason
<b>Bank</b>		
<b>IndusInd Bank Ltd</b>	INR 27,30,000	The bank opened certain savings deposit accounts in the name of ineligible entities, violating the provisions of the RBI (Interest Rate on Deposits) Directions, 2016.
<b>Jammu and Kashmir Bank Limited</b>	INR 3,31,80,000	The bank was penalized for multiple regulatory non-compliances, including: (a) allowing 'Basic Savings Bank Deposit Account' (BSBDA) holders to open savings bank deposit accounts; (b) failing to identify beneficial owners for certain legal persons; (c) permitting non-compliant small account operations; and (d) sanctioning a loan against government subsidies, thereby violating RBI's directions on 'Financial Inclusion', 'KYC', and 'Loans and Advances'.
<b>Bank of India</b>	INR 1,00,00,000	Failure to transfer eligible amounts to the 'Depositor Education and Awareness Fund' within the prescribed timeline, violating Section 26A of the BR Act, and the Depositor Education and Awareness Fund Scheme, 2014.
<b>Canara Bank</b>	INR 1,63,60,000	Non-compliance with RBI directions on 'Priority Sector Lending', 'Interest Rates on Deposits', and 'Financial Inclusion'. The violations included: (a) collecting loan-related charges on certain priority sector loans up to INR 25,000; (b) failure to pay interest on some savings bank deposit accounts; and (c) maintaining both savings bank deposit accounts and BSBDA for the same customers.
<b>Janata Sahakari Bank Limited</b>	INR 17,50,000	Failure to classify the loan accounts of certain borrowers as non-performing assets (NPAs), and imposition of penal charges on savings bank accounts for non-maintenance of minimum balance on a flat-rate basis, instead of levying charges in proportion to the extent of shortfall.

Name of entity	Penalty Amount (in INR)	Reason
<b>Bank</b>		
<b>Citibank N.A.</b>	INR 39,00,000	Non-compliance of directions issued by RBI on 'Large Exposures Framework' and 'Furnishing of Credit Information to credit information companies (CICs)' by: (i) reporting certain breaches in large exposures limits with delay; and (ii) not uploading the rectified data pertaining to certain segment, within 7 days of receipt of the rejection reports from CICs.
<b>Hongkong and Shanghai Banking Corporation Limited</b>	INR 66,00,000	Non-compliance of directions issued by RBI on 'KYC', 'Reporting of Information on Unhedged Foreign Currency Exposures of the Borrowers to CICs' and 'Interest Rates on Deposits' by: (i) outsourcing the disposal / closure of AML alerts to a group company; (ii) not reporting unhedged foreign currency exposures of certain borrowers to CICs; and (iii) opening savings deposit accounts in the name of certain ineligible entities.
<b>NBFC</b>		
<b>Shriram Finance Limited</b>	INR 5,80,000	Non-compliance with RBI (KYC) Directions, 2016 (KYC MD), 'NBFC - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016' and directions on 'Data Format for Furnishing of Credit Information to CICs' by: (i) failing to put in place a system of periodic review of risk categorisation of accounts; (ii) failing to ensure that its agreements with certain direct sales agents had a clause regarding RBI's right to inspect books and accounts of service providers; and (iii) failing to share information about the relationship segment of the corporates to the CICs, during the financial year 2022-23.
<b>Manappuram Finance Limited</b>	INR 20,00,000	Non-compliance with KYC MD, by failing to verify the PAN using the verification facility of the issuing authority at the time of customer acceptance. Additionally, allocating multiple identification codes to certain customers instead of assigning a unique customer identification code to each customer.

Name of entity	Penalty Amount (in INR)	Reason
<b>NBFC</b>		
<b>Asirvad Micro Finance Limited</b>	INR 6,20,000	Non-compliance of the 'Master Direction - RBI (Regulatory Framework for Microfinance Loans) Directions, 2022', and 'Appointment of Internal Ombudsman by Non-Banking Financial Companies' by: (i) failing to report the household income of certain borrowers to CICs; (ii) failing to provide factsheets to certain gold loan customers; and (iii) failing to establish a system of auto-escalation of all complaints that were partly or wholly rejected by its internal grievance redress mechanism to the internal ombudsman for a final decision.
<b>IIFL Samasta Finance Limited</b>	INR 33,10,000	Non-compliance of the 'NBFC - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016' and 'MYC-MD by: (i) charging interest on loans for a period prior to the date of actual disbursement of loan / issuance of cheque to certain borrowers in contravention of RBI directions on 'fair practices code; (ii) failing to classify certain loan accounts with overdue of 90 days or more as NPAs; (iii) classifying certain loan accounts which were NPA as 'standard asset' without realisation of entire arrears of interest and principal amount due; and (iv) allotting multiple customer identification codes to certain individual customers instead of a Unique Customer Identification Code (UCIC) to each individual customer.

## CANCELLATION OF LICENSE

## MONETARY PENALTIES

## REMOVAL OF RESTRICTIONS

### **3. Removal of supervisory restrictions:**

Upon being satisfied with the remedial actions taken by the entities, RBI, removed the supervisory restrictions, imposed on the following entities:

<b>Name of the entity</b>	<b>Restrictions imposed by the cease-and-desist orders</b>
<b>Kotak Mahindra Bank Limited</b>	(i) onboarding of new customers through its online and mobile banking channels; and (ii) issuing fresh credit cards.
<b>ECL Finance Limited</b>	Engaging in structured transactions concerning its wholesale exposure, other than those related to the regular repayment or closure of accounts.
<b>Edelweiss Asset Reconstruction Company Limited</b>	Acquiring financial assets, including security receipts (SRs), and reorganizing existing SRs into senior and subordinate tranches.
<b>Asirvad Micro Finance Limited</b>	Sanctioning and disbursal of loans.
<b>DMI Finance Private Limited</b>	Sanctioning and disbursal of loans.
<b>Arohan Financial Services Limited</b>	Sanctioning and disbursal of loans.

## **REMEDIAL ACTIONS**

### **IRREGULAR LENDING PRACTICES**

### **CONSISTENT APPROACH**

# SEBI UPDATE

## SEBI ISSUES NEW GUIDELINES FOR RAs & IAs

On 08 January 2025, Securities and Exchange Board of India (SEBI) issued the 'Guidelines for Research Analysts' (RA Guidelines) and 'Guidelines for Investment Advisers' (IA Guidelines) (collectively referred to as Guidelines), establishing a regulatory framework aimed at enhancing investor protection and transparency for research analysts (RAs) and investment advisers (IAs). The Guidelines cover various aspects, including qualification standards, fee structures, deposit requirements, and client segregation protocols, among other things.

Key provisions include:

### 1. Deposit Requirements:

(a) SEBI has introduced a tiered deposit structure for IAs and RAs based on the maximum number of clients served on any given day during the previous financial year:

- (i) Up to 150 clients: INR 1 lakh;
- (ii) 151 to 300 clients: INR 2 lakhs;
- (iii) 301 to 1,000 clients: INR 5 lakhs;
- (iv) 1,001 and above clients: INR 10 lakhs.

(b) Existing IAs are required to comply with these provisions by 30 June 2025, while RAs must comply by 30 April 2025. For new applicants, the deposit requirement will take effect immediately upon registration.

## 2. Dual Registrations:

- (a) Entities can hold dual registrations as RAs and IAs, provided that advisory and research services are distinctly segregated, with separate compliance frameworks for each function.
- (b) To maintain independence, such entities must ensure clear segregation between their advisory and research functions, with a commitment to upholding an arm's length relationship between the two.
- (c) This change also extends to part-time IAs and RAs, who may now engage in unrelated business activities or employment, provided these activities do not involve managing client funds or providing investment advice. The eligibility of such part-time IAs and RAs will be determined based on their compliance with the qualification and certification requirements for full-time IAs or RAs.

## 3. AI Usage:

Entities using AI in their services must disclose the extent of AI usage, ensure data security, and comply with the applicable rules prescribed in this regard.

**SEBI**

**RESEARCH ANALYSTS**

#### 4. Disclosure Requirements:

RAs and IAs must provide detailed disclosures, including terms and conditions of services, fee structures, and conflict-of-interest declarations.

#### 5. Compliance Audits:

(a) RAs and IAs must undergo annual compliance audits and submit reports to their respective supervisory bodies: the Research Analyst Administration and Supervisory Board (**RAASB**) and Investment Adviser Administration and Supervisory Board (**IAASB**). Any adverse findings must be published on their websites, along with corrective actions.

(b) SEBI has mandated that RAs and research entities enhance their KYC procedures and maintain detailed records of all client interactions. These records should include written and signed documents, telephone recordings, emails, SMSs, and any other legally verifiable communication. All records must be retained for a minimum of 5 years or until the resolution of any disputes, whichever is longer. RAs must ensure full compliance with these record-keeping requirements by 30 June 2025.

(c) RAs must maintain a functional website with mandatory disclosures and ensure KYC compliance for all clients.

## 6. Part-Time RAs and IAs:

Professionals such as teachers, architects, lawyers, doctors, or those employed in education or providing statutory services (e.g., members of ICAI, ICSI, ICMAI, or licensed insurance agents under IRDAI) can register as part-time RAs and IAs, provided, they must comply with Regulation 16A of the SEBI (Intermediaries) Regulations, 2008, which prohibits:

- (a) Providing advice or recommendations related to securities without proper SEBI registration.
- (b) Making claims regarding returns or performance on securities without SEBI authorization.

## 7. Model Portfolio Recommendations (RAs):

- (a) The RA Guidelines outline specific provisions regarding the recommendation and management of model portfolio by RAs. RAs providing model portfolio recommendations must submit a detailed model portfolio report, including benchmarking, risk disclosures, and rationale, to ensure that all the relevant facts and information that could impact the investment decisions of potential investors are adequately disclosed.
- (b) RAs engaged in providing model portfolios to their clients must ensure compliance with the model portfolio guidelines latest by 30 June 2025.

## 8. Non-SEBI Regulated Products (IAs):

- (a) IAs are now explicitly restricted from providing investment advice on securities under SEBI's purview. However, they may offer comprehensive financial planning services that include advice on products outside SEBI's jurisdiction. In such cases, IAs must disclose to clients that these services are not regulated by SEBI and that clients have no recourse to SEBI for grievances related to non-SEBI products.
- (b) Additionally, IAs are required to obtain declarations and undertakings from clients regarding these non-SEBI products when onboarding new clients. For existing clients, this provision must be implemented by 30 April 2025.

## 9. Revised fee structure:

- (a) SEBI has allowed IAs greater flexibility in how they charge fees, with the option to change the mode of charging fees, from assets under advice (**AUA**) to a fixed fee and vice versa, at any time, without the previous restriction of a 12-month waiting period. The fee limits for the two modes are:
  - (i) AUA: Capped at 2.5% of AUA per annum, per family across all services.
  - (ii) Fixed: The maximum fee that can be charged is now INR 1,51,000 per annum, per family, up from the previous INR 1,25,000.

(b) RAs can also charge a maximum fee of INR 1,51,000 per annum per family for individuals and Hindu undivided family clients in advance but not exceeding 1 quarter's fees. This fee limit is subject to revision every 3 years based on the 'Cost Inflation Index'.

#### 10. Qualification, certification for RAs:

(a) SEBI has revised the qualification and certification requirements for new applicants. New RAs must hold a relevant professional qualification or a degree in fields such as finance, economics, or business management, along with NISM certification.

(b) SEBI has further clarified in the RA Guidelines that existing individual RAs or employees engaged in providing research services will not be required to meet the new qualifications but must continue to hold NISM certifications.

#### 11. Client-level segregation:

Both RAs and IAs are required to ensure client-level segregation to prevent conflicts of interest. Clients availing advisory services from an entity cannot access distribution services within the same group and vice versa. Furthermore, the Guidelines specifically state that stockbroking is not to be considered a distribution activity for the purposes of such segregation.

## **INVESTMENT ADVISERS**

## LEX TAKEAWAY

The Guidelines have raised significant concerns among IAs and RAs. The enhanced compliance requirements, ranging from maintaining detailed records of client interactions, conducting rigorous compliance audits, and adhering to KYC procedures (for RAs), are seen as burdensome, especially for firms operating with lean structures.

While SEBI has allowed IAs greater flexibility in how they charge fees, one of the most contentious aspects of the RA Guidelines is the restriction on fee payments, which prohibits firms from collecting fees in advance for more than a quarter. For many RAs who typically charge annual fees, this presents a major challenge. The quarterly payment structure forces firms to constantly justify their services based on short-term returns, undermining the long-term investment strategies many offer. This shift toward short-term performance metrics risks compromising the quality of research and advice, potentially prioritizing immediate results over sustained, strategic growth.

## GUIDELINES

## FEE STRUCTURES

## INVESTOR PROTECTION

# FINTECH FLYER

**DECEMBER – FEBRUARY 2025**

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