RBI Prescribes Technology for COMPLIANCE MONITORING

www.teamleaseregtech.com

Table of Contents

RBI Pushes for Adopting Technology in Compliance Monitoring

RBI issued a circular, RBI/2023-24/117, DoS.CO.CSITEG.SEC.No.9/31-01-015/ 2023-24, dated 31.01.2024 on streamlining the internal compliance monitoring processes and functions of its regulated entities (REs). These REs include:

- Scheduled Commercial Banks (excluding Regional Rural Banks);
- Small Finance Banks; Payments Banks;
- Primary (Urban) Co-operative Banks (Tier III and IV);
- Upper- and Middle-Layer Non-Banking Financial Companies
- (including Housing Finance Companies);
- Credit Information Companies
- All India Financial Institutions (EXIM Bank, NABARD, NaBFID, NHB and SIDBI)

The advisory was prompted based on an assessment of select supervised entities (SEs) employing the prevailing system for internal monitoring of compliance with regulatory obligations. The assessment also looked into the extent of usage of technological solutions to support this monitoring function. The Reserve Bank found that these SEs had adopted and implemented varying levels of automation, ranging from macro-enabled spreadsheets to workflow-based software solutions.

RBI concluded that there is a need to implement comprehensive, integrated, enterprise-wide and workflow-based solutions/ tools to enhance the effectiveness of the compliance monitoring function. The aim is to reduce manual intervention and automate the compliance monitoring function.

Consequently, RBI has advised all REs to comprehensively review the existing internal compliance tracking and monitoring processes. The REs must then institute necessary changes to their existing internal systems or implement new ones by 30.06.2024.

The central bank has also put forth certain requirements for compliance monitoring solutions. These include:

- Providing a platform for effective communication and collaboration among all the stakeholders (business, compliance and IT teams, Senior Management, etc.)
- The solution must be able to identify, assess, monitor and manage compliance requirements
- Escalate issues of non-compliance
- Require recorded approval from a competent authority for any deviations/ delays in compliance submissions/ filings
- Provide a unified dashboard view to Senior Management on the compliance position of the RE as a whole

The circular marks another step towards India’s digital transformation. Businesses have, over the years, digitalised numerous business processes and functions, such as payroll management, security, access control, workflow and inventory management, to name a few. Requiring REs to strengthen internal compliance monitoring systems will significantly boost the efficiency, efficacy, transparency, and accountability around compliance functions. Such a system will allow the RE to pinpoint deficiencies in their existing processes and take steps to mitigate them.

The Regulatory Framework for RBI Regulated Entities in India

Financial Regulator

All financial institutions that qualify as a 'regulated entity' under RBI are required to adhere to and follow all instructions, directions, and circulars brought by the Reserve Bank. RBI is the principal regulator of financial institutions and keeps a strict eye on banks with regard to their regulatory obligations and compliance status. A typical mid-sized financial institution deals with 621[1] unique compliance obligations. In addition, RBI has been empowered to assess the financial position of a bank and issue directions/instructions under various legislation, such as:

- The Banking Regulation Act, 1949
- The Reserve Bank of India Act, 1934
- The Credit Information Companies (Regulation) Act, 2005
- Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002
- Factoring Regulation Act, 2011, etc.

At the end of every financial year, the central bank conducts routine inspections of banks, such as the Statutory Inspection for Supervisory Evaluation (ISE) and Annual Financial Inspection (AFI). In addition, the RBI also maintains off-site surveillance to monitor the financial health of banks between two on-site inspections and identify banks which show signs of financial deterioration. RBI has mechanisms in place to conduct quarterly monitoring visits to banks displaying financial and systemic weaknesses, appoint monitoring officers and directly monitor certain problem areas.

Regulatory Ecosystem for Financial Institutions

All financial institutions, including banks, NBFCs, and HFCs, must adhere to predetermined compliance guidelines safeguarding customer interests by promoting transparency and accountability. These include:

- Reserve Bank of India (Know Your Customer (KYC) Directions, 2016
- Reserve Bank of India (Interest Rate on Deposits) Directions, 2016
- Reserve Bank of India (Interest Rate on Advances) Directions, 2016
- RBI directions on 'Loans and Advances – Statutory and Other Restrictions'
- RBI directions on 'Customer Service in Banks'
- RBI directions on 'Financial Services provided by the Banks'
- RBI directions on 'Frauds classification and reporting by commercial banks and select FIs'
- Master Circular – Basel III Capital Regulations
- Master Circular - Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances
- Master Circular - Guarantees and Co-acceptances
- Master Direction - Classification, Valuation and Operation of Investment Portfolio of Commercial Banks (Directions), 2023
- Master Direction - Minimum Capital Requirements for Operational Risk
- Master Direction - Outsourcing of Information Technology Services
- Master Direction - Credit Card and Debit Card – Issuance and Conduct Directions, 2022

1 Data for a single-entity NBFC operating in a single state

- Master Direction - Classification, Valuation and Operation of Investment
- Portfolio of Commercial Banks (Directions), 2021
- Master Direction - Digital Payment Security Controls

In the digital era, innovation in digital technology has prompted technology companies to establish digital platforms that provide lending services comparable to those offered by RBI-regulated financial institutions. In response, the Reserve Bank of India (RBI) implemented digital lending regulations that hold REs liable for digital lending services.

These guidelines require loan disbursals and repayment transactions to take place between the borrower's bank accounts and regulated entities. Pass-through pool accounts have been prohibited for LSPs and third parties. Automatic credit limit increases without borrower consent have also been made illegal. In addition, REs are required to pay LSPs directly, provide a standardised KFS (Key Fact Statement) to borrowers, and provide a cooling-off period for borrowers to exit digital loans without penalty.

Furthermore, REs are required to adhere to numerous Master Directions and Master Circulars as well as directions and circulars issued by RBI under the Reserve Bank of India Act, 1934. NBFCs, for instance, must adhere to*:

- Master Direction – Information Technology Framework for the NBFC Sector, 2017
- Master Direction – Know Your Customer (KYC) Direction, 2016
- Master Circular – Non-Banking Financial Company – Micro Finance Institutions, 2015
- Master Circular - Fair Practices Code, 2015

Table 1. Categorisation of compliances *

Sl. No.	Category	Number of Compliances
1	Finance & Taxation	41
2	Commercial	26
3	Secretarial	45
4	Industry Specific	216
5	EHS	35
6	Labour	240
7	General	18

Table 2. Number of compliances across government levels*

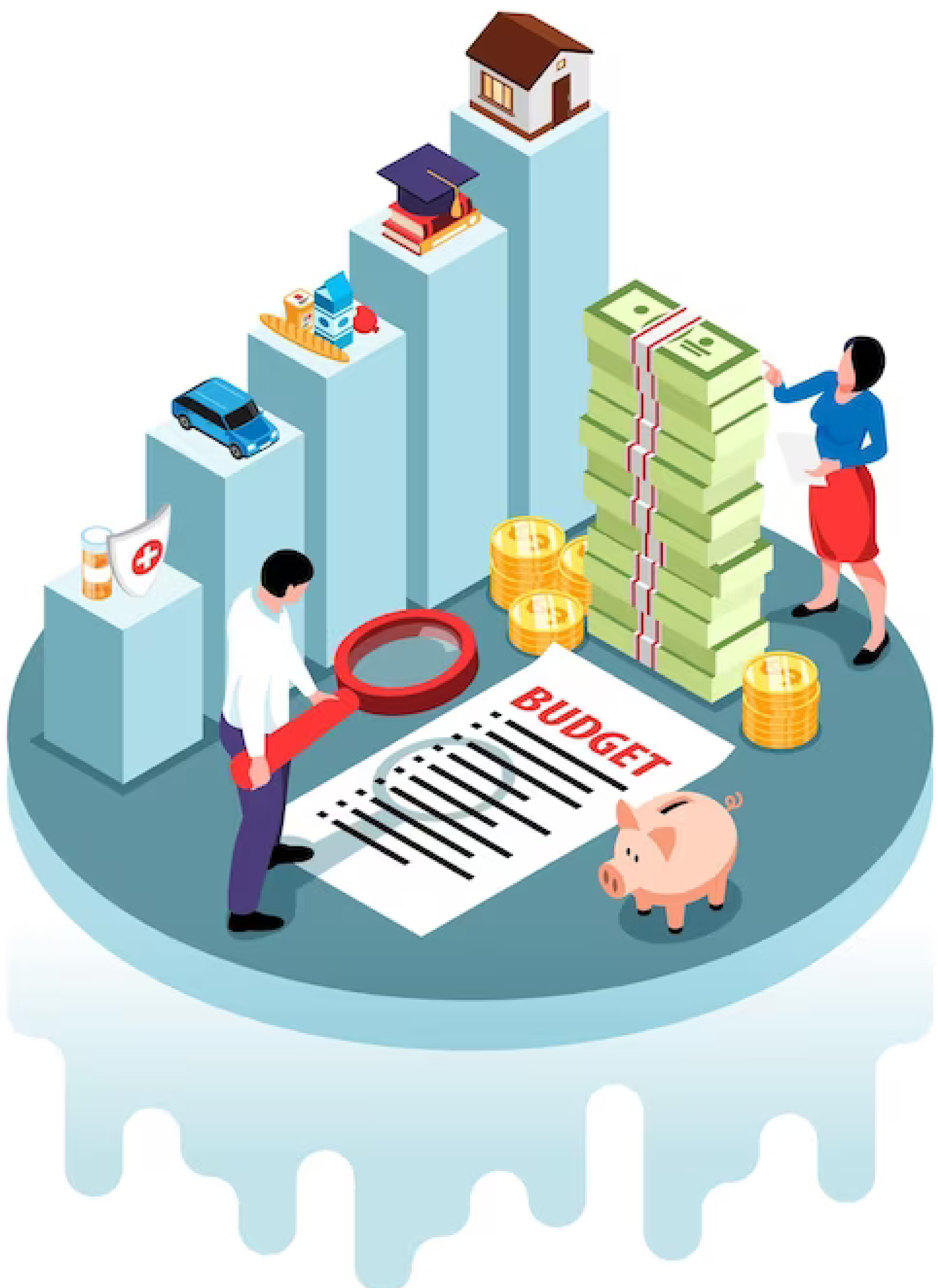
Sl. No.	Level	Number of Compliances
1	Central	434
2	State	177
3	Municipal	10

*For a Single Entity NBFC Operating in a Single State

They must also publish the fair practices code on their website. In addition, the borrowers must be informed in vernacular language about the terms and conditions of their loans. The staff must be trained to refrain from coercive actions during loan recovery. The corporations are required to appoint an internal ombudsman, with quarterly and annual submissions of the complaints received and the decisions made. In addition, all NBFCs must comply with the various V-CIP (Video Customer Identification Process) compliance requirements.

NBFCs are further required to maintain records and file returns under the Prevention of Money Laundering Act, 2002 and Prevention of Money Laundering (Maintenance of Records) Rules, 2005. Similar requirements are there under the RBI Guidelines on Fair Practices Code and some other significant regulations. The sector is highly regulated, and the companies must comply with RBI regulations and follow the Ministry of Corporate Affairs regulations. Each regulation comes with its own set of procedures, documentation, filings and penalties.

Failure to comply with the extant regulations has a significant impact, with RBI levying monetary penalties that cause loss of reputation and trust in the shareholders and customers. In extreme cases with serious long-term violations, RBI can also impose suspensions of key banking activities, initiate legal action against the defaulters and suspend/ cancel banking licenses. Such punitive measures can completely upheave the business, affecting share prices, and action against board members, and might even result in the foreclosure of business.

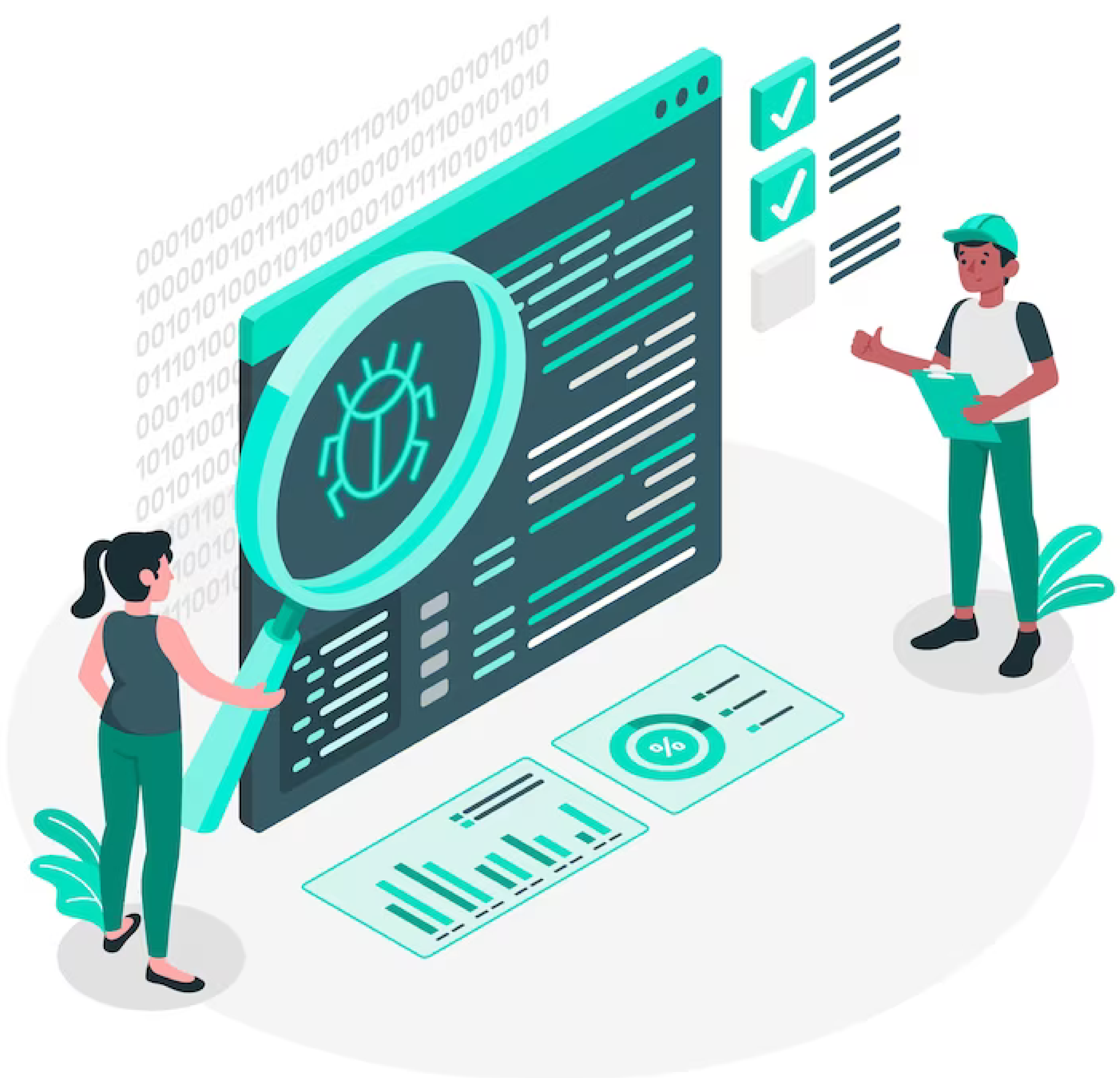


Adopting Technology to Monitor Compliance

Financial institutions are the bedrock of our economic growth in this ‘Amrit Kaal’. Banking systems will play a pivotal role in fueling this growth which will bring out geographical spread in the footprint of these institutions. The regulatory environment in India is very complex, and the cost of non-compliance is comparatively higher than the cost of doing compliance. Compliance risks can materialise in multiple ways; in case organisations are unaware of the applicable compliances, they do not have a formal compliance organogram, and they do not adopt a methodical way of managing compliance across the organisation are some of the most common reasons for non-compliance.

Technology-based digital solutions can help REs mitigate risks with compliance applicability assessments (thereby providing a list of all applicable compliances) and a tech-enabled platform (to automate the compliance management process). These platforms can help the top management focus on critical/high-risk compliances which may severely impact the company’s reputation and/or stability. With automatic advance reminders for compliance obligations, non-compliance or compliance delays are avoided. Intuitive dashboards and graphical reports help in entity-wise / location-wise / user-wise comparison of compliance performance and help in quick decision-making. By adapting digital solutions, these institutions can avoid penalties brought on by lapses, delays and defaults resulting from ad-hoc, paper-based, and people-dependent compliance processes. These solutions allow REs to stay on top of all RBI's circulars, directions, notices, and advisories.

Technology is transforming the financial institutions and the banking industry. They now have the capability to detect these misdemeanours and take appropriate steps to mitigate and curtail such behaviour. They must take advantage of such capabilities as they are the pillars of the financial system in any economy.



What to Look for in a Compliance Management Solution

A digital compliance management solution is a critical tool that can track and manage the compliance obligations of an organisation. However, REs must be vigilant when implementing and integrating a digital solution. There are some features that one must look for in such a solution:

Centralised Compliance Repository

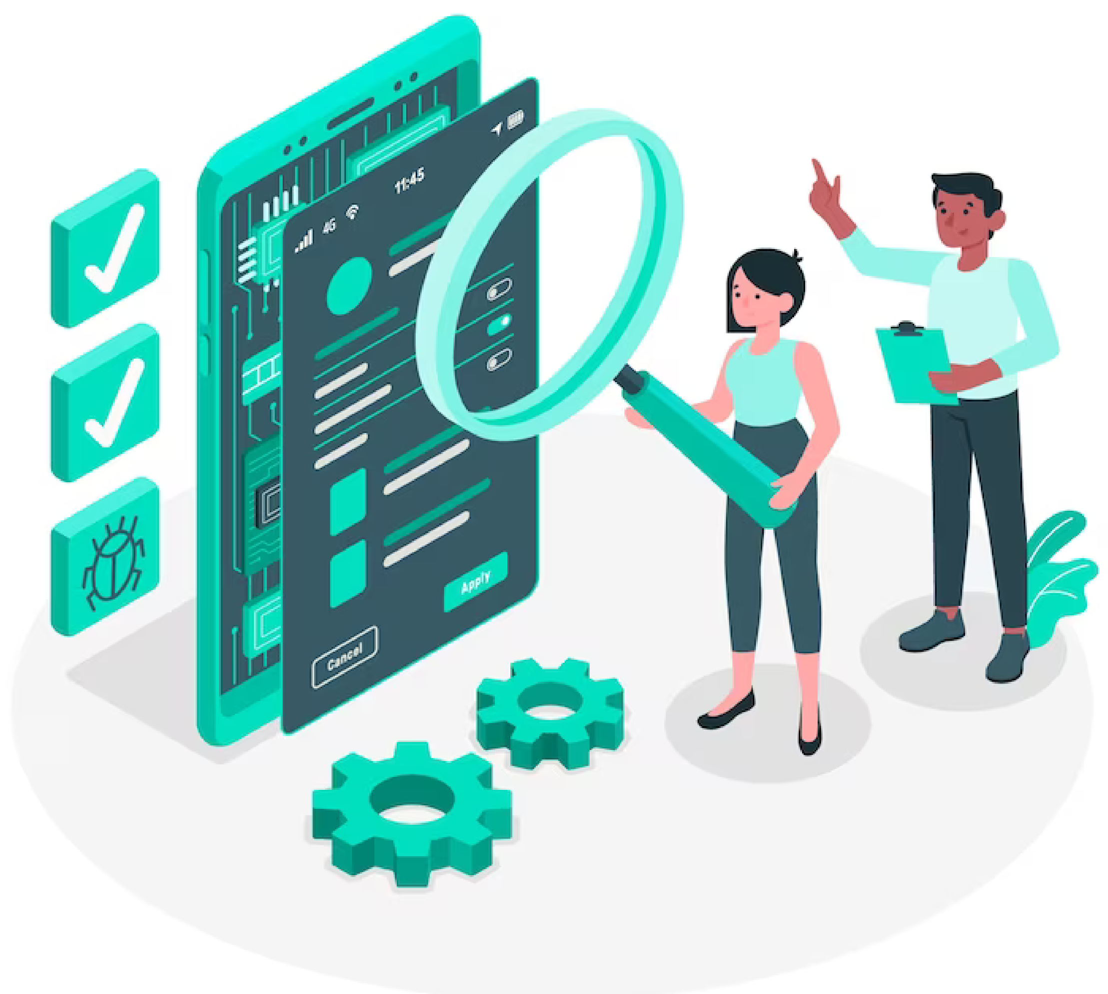
Unified Database: The solution must provide a centralised repository for storing and managing all compliance-related information, eliminating the need for disparate systems and manual tracking.

Streamlined Data Management: The system must be able to organise data in a structured manner, ensuring easy retrieval and efficient management of compliance documentation and records.

Automated Compliance Tracking

Real-time Monitoring: The digital solution should offer real-time monitoring of regulatory changes, ensuring organizations stay abreast of evolving compliance requirements.

Alerts and Notifications: It must provide automated alerts and notifications to keep stakeholders informed about upcoming compliance deadlines, reducing the risk of oversights.



Document Management

Secure Storage: The digital compliance monitoring solution should ensure that compliance-related documents are stored securely in a tamper-proof manner, protecting sensitive information and maintaining confidentiality.

Version Control: A solution equipped with version control features can enable financial institutions to track document changes over time, facilitating accurate audit trails.

Reporting and Analytics

Comprehensive Reporting: The solution should also be able to generate detailed and customised compliance reports, providing insights into the organisation's adherence to regulatory standards.

Analytics for Proactive Management: Utilising analytics tools, it can enable proactive management by identifying trends, potential risks, and areas for improvement in compliance processes.

A good compliance monitoring system should be flexible and automated, provide robust reporting capabilities, support collaboration, and offer strong security features.

TeamLease® RegTech
Helping India Comply

TeamLease Regtech Pvt. Ltd.

Awfis Space Solutions Pvt Ltd, Opposite Commissioner Office,1 Church road, Camp, Pune, Maharashtra 411001, India.

+91 9899245318 sales@tlregtech.com

www.teamleaseregtech.com