

Newsletter
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INDIA'S BANKING SECTOR: A GATEWAY TO UNPARALLELED INVESTMENT OPPORTUNITIES



Editor's note

Dear Readers,

I am pleased to share with you our newsletter for the month of June, 2024, which covers significant legal and regulatory developments.

Recent judicial pronouncements from Andhra Pradesh High Court and Hon'ble Supreme Court have provided significant insights into the evolving landscape of arbitration in India, highlighting the judiciary's approach to various procedural and substantive aspects under the Arbitration and Conciliation Act, 1996.

Under the IBC, Delhi High Court has reiterated that on approval of resolution plan as going concern, all previous claims of persons qua corporate debtor cease to exist

The Reserve Bank of India (RBI) has recently introduced several significant amendments across various regulatory directions, aiming to enhance clarity, operational flexibility, and alignment with evolving financial practices.

SEBI has recently introduced a series of regulatory updates aimed at enhancing compliance, streamlining operations, and improving investor protection within the securities market. Market participants and stakeholders should ensure compliance with these new guidelines and frameworks.

India's banking sector is poised for significant growth, driven by robust economic fundamentals, technological advancements, and favourable regulatory reforms. In this edition, we have also included an article on the investor potential of India's banking sector.

I hope you will find this edition useful.

Best wishes,

Rajesh Narain Gupta

Founder & Chairman,
SNG & Partners

A. A.ARBITRATION

1. **Andhra Pradesh High Court: The Court can appoint an Arbitrator only if parties fail to refer the disputes to the Arbitrator even after a notice**

The single-judge bench of the Andhra Pradesh High Court has held that to maintain an application under Section 11(6) of the Arbitration and Conciliation Act, 1996 it is required to show that the respondents had failed to act as required under the arbitration clause, and had failed to refer the disputes to the Arbitrator even after a notice invoking the arbitration clause had been served on the respondents.

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2. **Jharkhand High Court: While examining an application u/s 11(6) of the Arbitration and Conciliation Act 1996, the Court must look at the existence of the Arbitration Clause only**

The single judge bench of the Jharkhand High Court held that under Section 21 of the Arbitration and Conciliation Act, 1996 a cause of action shall arise for giving notice to the other party for appointment of an arbitrator wherever the parties have reached a bottleneck. Further, the court is required to look into the existence of the arbitration Clause – nothing more nothing less while examining an application under section 11(6) of Arbitration and Conciliation Act, 1996 .

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3. **Allahabad High Court: 'Misplacement of file by the advocate not sufficient ground for condonation delay of 966 days'**

The Allahabad High Court, while dismissing an appeal seeking condonation of delay held that the misplacement of the file by the advocate during the shifting of office, during the festival period, is not sufficient ground for condonation delay of 966 days and the explanation provided was insufficient for the Court to exercise its discretion in condoning the delay.

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4. **Supreme Court: Arbitral Tribunal is required to fix a meeting for a hearing even if the parties to the proceedings do not make such a request**

The Supreme Court has held that only if the established conduct of a claimant is such that it leads only to one conclusion that the claimant has given up, his/her claim can an inference of abandonment be drawn. Merely because a claimant, after filing his statement of claim, does not move the Arbitral Tribunal to fix a date for the hearing, it cannot be said that the claimant has abandoned his claim. The Arbitral Tribunal is required to fix a meeting for a hearing even if the

parties to the proceedings do not make such a request for it is the tribunal's duty to adjudicate upon the dispute. The Court further held that that the power of Section 32(2)(c) of the Arbitration and Conciliation Act 1996, which empower an arbitral tribunal to terminate the arbitration proceedings if the arbitral tribunal finds that the continuation of the proceedings has for any other reason become unnecessary or impossible, could be exercised only if for some reason the continuation of proceedings has become unnecessary or impossible. If the said powers are exercised casually it will defeat the very object of enacting the Arbitration Act.

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B. INSOLVENCY AND BANKRUPTCY CODE, 2016 (IBC)

1. **Delhi High Court: Upon approval of resolution plan as a going concern, all previous liabilities of persons qua corporate debtor cease to exist**

The Hon'ble Delhi High Court has expounded that once a Resolution Plan is duly approved by the adjudicating authority under Section 31 (1) of IBC, 2016, the claims as provided in the Resolution Plan stand frozen and it will be binding on the corporate debtor and its employees, members, creditors, including the Central Government, any State Government or any local authority, guarantors and other stake holders. On the date of approval of Resolution Plan by the adjudicating authority, all such claims, which are not part of the Resolution Plan, shall stand extinguished, and no person will be entitled to initiate or continue any proceedings in respect to a claim, which is not part of the Resolution Plan.

Further, upon approval of resolution plan or sale as a going concern, all previous liabilities and claims of person qua corporate debtor cease to exist.

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C. RESERVE BANK OF INDIA (RBI)

1. Amendment to Master Direction - Reserve Bank of India (Interest Rate on Deposits) Directions, 2016

Definition of 'Bulk Deposits' has been provided under Paragraph 3(a)(i) of the Master Direction- Reserve Bank of India (Interest Rate on Deposits) Directions, 2016 dated March 03, 2016.

A review was conducted based on which it has been decided to revise the definition of bulk deposits for all Scheduled Commercial Banks (excluding RRBs), Small Finance Banks and Local Area Banks.

Now, the term "Bulk Deposit" means:

- a. Single Rupee term deposits of Rupees three crore and above for Scheduled Commercial Banks (excluding RRBs) and Small Finance Banks.
- b. Single Rupee term deposits of Rupees one crore and above for Local Area Banks as applicable in case of Regional Rural Banks.

The said circular is applicable to all Scheduled Commercial Banks (excluding RRBs), Small Finance Banks and Local Area Banks. It will come into effect immediately.

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2. Foreign Exchange Management (Overseas Investment) Directions, 2022 - Investments in Overseas Funds

As per Foreign Exchange Management (Overseas Investment) Directions, 2022 ("OI Directions"), the investment (including sponsor contribution) in units of any investment fund overseas, duly regulated by the regulator for the financial sector in the host jurisdiction, shall be considered as Overseas Portfolio Investment. Further, as per the provisions of Paragraph 1(ix)(e) and Paragraph 24(1) of OI Directions, investments can be made in "units" of investment funds.

For clarity and alignment, it has been decided to amend the OI Directions as under:

- a. Replace existing paragraph 1(ix)(e) of FEM (OI) Directions, 2022 with the following:
"The investment (including sponsor contribution) in units or any other instrument (by whatever name called) issued by an investment fund overseas, duly regulated by the regulator for the financial sector in the host jurisdiction, shall be treated as OPI. Accordingly, in jurisdictions other than IFSCs, listed Indian companies and resident individuals may make such investment. Whereas in

IFSCs, an unlisted Indian entity also may make such OPI in units or any other instrument (by whatever name called) issued by an investment fund or vehicle, in terms of schedule V of the OI Rules subject to limits, as applicable.

Explanation: 'investment fund overseas, duly regulated' for the purpose of this para shall also include funds whose activities are regulated by financial sector regulator of host country or jurisdiction through a fund manager."

- b. Replace existing Paragraph 24(1) of FEM (OI) Directions, 2022 with the following:

"A person resident in India, being an Indian entity or a resident individual, may make investment (including sponsor contribution) in units or any other instrument (by whatever name called) issued by an investment fund or vehicle set up in an IFSC, as OPI. Accordingly, in addition to listed Indian companies and resident individuals, unlisted Indian entities also may make such investment in IFSC."

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3. International Trade Settlement in Indian Rupees (INR) – Opening of additional Current Account for settlement of trade transactions

AD Category-I banks maintaining Special Rupee Vostro Account vide A.P. (DIR Series) Circular No.10 dated July 11, 2022 on International Trade Settlement in Indian Rupees (INR) were permitted to open an additional special current account for its constituents, exclusively for settlement of export transactions.

A review was conducted. For better operational flexibility, it has been decided that the facility of opening an additional special current account by the AD Category-I banks (maintaining Special Rupee Vostro Account in terms of the RBI circular dated July 11, 2022 referred above) for its constituents may be extended for settlement of their export as well as import transactions.

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4. Priority Sector Lending – Amendments to the Master Directions

Following amendments have been made to Master Directions (“MD”) on Priority Sector Lending (“PSL”) dated September 04, 2020:

a. Para 7- Adjustments for weights in PSL Achievement

The MD specifies that the lists of districts with comparatively high and low PSL credit detailed in Annex IA and IB of the MD are valid until FY 2023-24 subject to review thereafter. Based on a review, the lists of districts have been updated. These lists will remain valid until FY 2026-27 and will be reviewed thereafter.

Accordingly, from FY 2024-25 onwards, a higher weight (125%) would be assigned to the incremental priority sector credit in the identified districts where the credit flow is comparatively lower (per capita PSL less than 9,000), and a lower weight (90%) would be assigned for incremental priority sector credit in the identified districts where the credit flow is comparatively higher (per capita PSL greater than 42,000).

b. Para 9- Micro, Small & Medium Enterprises

The definition of MSMEs has been referenced to the Master Direction - Lending to Micro, Small & Medium Enterprises (MSME) Sector, for clarity. Accordingly for the purpose of MD, an enterprise shall be classified as a micro, small or medium enterprise on the basis of the following criteria viz.,

- i. a micro enterprise, where the investment in plant and machinery or equipment does not exceed 1 crore and turnover does not exceed 5 crore;
- ii. a small enterprise, where the investment in plant and machinery or equipment does not exceed 10 crore and turnover does not exceed 50 crore; and
- iii. a medium enterprise, where the investment in plant and machinery or equipment does not exceed 50 crore and turnover does not exceed 250 crore.

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D. SECURITIES AND EXCHANGE BOARD OF INDIA (SEBI)

1. Guidelines on Anti-Money Laundering (AML) Standards and Combating the Financing of Terrorism (CFT) /Obligations of Securities Market Intermediaries under the Prevention of Money Laundering Act, 2002 and Rules framed there under

SEBI has released guidelines that stipulate the essential principles for combating Money Laundering (ML) and Terrorist Financing (TF) and provide detailed procedures and obligations to be followed and complied with by all the registered intermediaries.

The said guidelines will also apply to branches of stock exchanges, registered intermediaries and their subsidiaries abroad.

A general summary/background has been provided of the main provisions of the applicable anti-money laundering and anti-terrorist financing legislations in India.

A guidance on practical implications of the Prevention of Money Laundering Act, 2002 (PMLA) is also provided.

Additionally, steps required to be taken by a registered intermediary and its representatives to discourage and to identify any money laundering or terrorist financing activities are also listed out.

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2. Master Circular for Portfolio Managers

To ensure that stakeholders have access to all the applicable requirements in one place, the Master Circular has been issued for effective regulation of Portfolio Managers.

The Master Circular in various heads consolidates all the relevant circulars.

The heads are registration and post-registration activity, operating guidelines, investment by portfolio managers, disclosure requirements, reporting requirements, fees and charges and grievance redressal.

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3. Master Circular for Electronic Gold Receipts (EGRs)

A master circular has been issued for ERGs to consolidate all circulars in one place and provide easy access. All relevant circulars issued on EGRs till May 31, 2024 are consolidated in this master circular.

The master circular shall come into force from the date of its issue.

The relevant chapters for consolidating circulars are:

- a. Framework for operationalizing trading of EGR
- b. Trading features
- c. Standard Operating guidelines and modalities for vault managers and depositories
- d. Product specifications
- e. Comprehensive risk management framework

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4. Master Circular for Mutual Funds

For effective regulation of mutual fund industry, SEBI has issued various circulars from time to time. Now, a master circular has been issued to provide all circulars in one place.

Some of the relevant chapters under the master circular are:

- a. Offer document for schemes
- b. Registration
- c. New products
- d. Risk Management Framework
- e. Disclosures and reporting norms
- f. Governing norms
- g. Secondary market issues
- h. Net asset value
- i. Valuation
- j. Loans, fees, charges and expenses

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5. Enhancement of operational efficiency and Risk Reduction - Pay-out of securities directly to client demat account

SEBI has decided to make the process of securities payout directly to the client account mandatory.

After extensive deliberations, the following has been decided:

- a. The securities for pay-out shall be credited directly to the respective client's demat account by the CCs.
- b. CCs shall provide a mechanism for Trading Member/ Clearing Members to identify the unpaid securities and funded stocks under the margin trading facility

In case of any shortages, arising due to inter se netting of positions between clients i.e., internal shortages the following measures shall be taken to streamline the process of handling of such shortages across the market:

- a. Trading Member/ Clearing Members shall handle such shortages through the process of auction as specified by CCs
- b. In such cases, brokers shall not levy any charges on the client over and above the charges levied by the CCs.

The circular shall come into force with effect from October 14, 2024.

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6. Framework for providing flexibility to Foreign Portfolio Investors in dealing with their securities post expiry of their registration

SEBI has made the following amendments to the FPI Master Circular dated May 30, 2024:

- a. Para 4 - Continuance of Registration
 - i. FPIs who wish to continue with their registration for the subsequent block of three years, should pay the fees to their Designated Depository Participants (DDPs) and inform change in information, if any, as submitted earlier.
 - ii. In case of no change in information, FPIs shall give declaration that there is no change in the information, as previously furnished.
 - iii. FPI shall provide the additional information, if applicable, along with supporting documents including fees for continuance of its registration at least 15 days prior to current validity of its registration in order to facilitate a smooth continuance process. FPI is required to submit a reason for delay, if any, in delayed submission of such information/fees.

b. Para 13 - Reclassification

If an FPI registered under a particular category/sub-category fails to comply with applicable eligibility requirements, it shall notify this change to its DDP to be reclassified under appropriate category/sub-category in accordance with Para 14(i) below. FPI may be required to provide to the DDP with additional KYC documents, as applicable. The concerned DDP / Custodian shall not allow such FPI to make fresh purchases till additional KYC requirements (if any) are complied with. However, such FPI shall be allowed to continue to sell the securities already purchased by it until expiry of its existing registration block or 180 days from the date of notification of change by the FPI, whichever is later.

c. Para 15 - Change in Status of a Compliant Jurisdiction

If a jurisdiction, which was a compliant jurisdiction at the time of grant of registration to FPI, becomes non-compliant i.e. a) ceases to be a member of IOSCO/ Bilateral Memorandum of Understanding with SEBI/ BIS or b) becomes listed in FATF public statement as a “high risk” and “non-cooperative” jurisdiction, then the Custodian shall not allow such FPIs to make fresh purchases until the jurisdiction/FPI is compliant with the Regulations.

However, the FPI shall be allowed to sell the securities or continue to hold the securities already purchased by it until expiry of its existing registration block or 180 days from the date of change in status of the jurisdiction, whichever is later. The DDP shall inform to SEBI details of such FPIs upon such change.

Further, in case the FPI itself or its underlying investors contributing twenty-five percent or more in the corpus of the FPI or identified on the basis of control, come under the Sanctions List notified by the United Nations Security Council, the custodian shall not allow any further buy/sell in the account of such FPI and shall as soon as possible but not later than two working days notify such instances to SEBI.

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7. Disclosures of Material Changes and Other Obligations for Foreign Portfolio Investors

The FPI master circular dated May 30, 2024 stands modified by SEBI. Some of the amendments are:

a. Para 14 of Part A

In terms of Regulation 22, if there is any change in the material information previously furnished by the FPI to the DDP and/or SEBI, which has a bearing on the certificate granted by the DDP on behalf of the Board, it shall inform the DDP and/or the Board in writing, in the manner as provided.

b. Para 12(iii) of Part A

Deletion of sub-fund/share classes/equivalent structure that invests in India, shall be considered a 'Type II' material change in terms of Para 14(i) below."

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8. Framework of "Financial Disincentives for Surveillance Related Lapses" at Market Infrastructure Institutions

SEBI has decided to implement a framework for Surveillance Related Lapses at Market Infrastructure Institutions.

Surveillance Related Lapses shall mean:

a. Any lapse observed in the implementation of decisions taken during the Surveillance Meetings including any non-implementation or partial implementation or delayed implementation of any decision or communication of SEBI relating to surveillance as per agreed scope and timelines;

b. Any lapse observed in discharge of surveillance activities as per agreed scope and timelines; and

c. Any inadequate reporting or non-reporting of surveillance related activity as per agreed timelines

A procedure has been provided upon identification of surveillance related lapses:

a. SEBI shall provide an opportunity to the concerned Market Infrastructure Institutions (MII) to make its submissions, in respect of the SRL

b. The submissions made by the concerned MII shall be considered by SEBI before imposing any "Financial Disincentive" on the concerned MII as per the framework.

c. The "Financial Disincentive(s)" under the framework of financial disincentives for Surveillance Related

Lapses (FDSRL), if imposed, shall be credited by the MII concerned within 15 working days, to the Investor Protection and Education Fund ("SEBI-IPEF") established under the SEBI Act, 1992 and a confirmation of payment in this regard shall be forwarded to SEBI.

The circular shall come into effect from July 01, 2024.

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9. Uploading of KYC information by KYC Registration Agencies (KRAs) to Central KYC Records Registry (CKYCRR)

Based on the feedback received from stakeholders in the securities market and to enable ease of doing business, the following has been amended by SEBI in the master circular on KYC norms:

a. Insertion of Para 114(a)

Registered intermediaries shall continue to upload/download/modify the KYC information with proper authentication on the systems of KRA, as per the provisions of SEBI KRA Regulations, 2011.

b. Para 116

KRAs shall ensure that existing KYC records of legal entities and of individual clients are uploaded onto CKYCRR within a period of 6 months from August 01, 2024.

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10. Circular on Ease of doing business

Based on the representations received from the market representatives, for ease of compliance and investor convenience, the following has been decided for existing investors/ unitholders:

- a. Non-submission of 'choice of nomination' shall not result in freezing of Demat Accounts as well as Mutual Fund Folios
- b. Securityholders holding securities in physical form shall be eligible for receipt of any payment including dividend, interest or redemption payment as well as to lodge grievance or avail any service request from the RTA even if 'choice of nomination' is not submitted by these securityholders

-
-
- c. Payments including dividend, interest or redemption payment withheld presently by the Listed Companies/ RTAs, only for want of 'choice of nomination' shall be processed accordingly.

All existing investors/ unitholders are encouraged, in their own interest, to provide 'choice of nomination' for ensuring smooth transmission of securities held by them as well as to prevent accumulation of unclaimed assets in securities market. The formats for providing Nomination and Opting-out of Nomination both in case of Demat Account and MF Folios are provided at Annexure-A and Annexure-B respectively of the circular.

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E. INDIA'S BANKING SECTOR: A GATEWAY TO UNPARALLELED INVESTMENT OPPORTUNITIES

India's banking sector stands at the cusp of unprecedented growth, fueled by a combination of robust economic fundamentals, technological advancements, and favorable regulatory reforms. In this article, we delve into the micro-level dynamics of the Indian banking landscape, unveiling the myriad opportunities it presents for foreign entities seeking to invest in one of the world's most dynamic financial ecosystems.

Financial Inclusion and Indian Digital Infrastructure

World Bank G20 Report stated "The India Stack exemplifies digital public infrastructure (DPI) approach, combining digital ID, interoperable payments, a digital credentials ledger, and account aggregation. In just six years, it has achieved a remarkable 80% financial inclusion rate- a feat that would have taken nearly five decades without a DPI approach".

As per the World Bank, the Unified Payments Interface (UPI) transactions in India exceeded INR 14.89 trillion alone by May 2023. The global fintech market was valued at USD 133.84 Billion in 2022 and is projected to reach a value of USD 556.58 Billion by 2030. India is among the fastest-growing FinTech markets in the world. The Indian FinTech industry's market size was USD 50 Billion in 2021 and is estimated at USD 150 Billion by 2025.

Digital payments are projected to constitute nearly 65% of all payments by 2026, as opposed to 40% of transactions in 2022. This will lead to 7x growth in digital merchant payments from USD 0.3-0.4 Trillion today to USD 2.5-2.7 Trillion by 2026 and the value of digital payments in India is projected to increase three-fold from USD 3 Trillion today to USD 10 Trillion by 2026.

Banking Structure, Market Valuation Growth, and Regulatory Stability

Stability in repo rates over four consecutive quarters, coupled with well-capitalized banks and soaring market valuations, particularly among medium-sized PSU banks, underscores the regulatory stability and investor confidence in the sector. With 12 public banks, 21 private banks, 46 foreign banks, 12 small finance banks, and a staggering 9327 NBFCs, India's banking sector boasts diversity and resilience. The forecasted real GDP growth in the range of 6.5-6.7% for FY24, amidst upward revisions by economic agencies, augurs well for the banking industry, reflecting a positive economic outlook.

India is projected to have a lot faster, a lot bigger, and a lot more serious growth than the growth in the last 10 years. The penetration level of financial products such as mortgages is 11% of the GDP in India, whereas in emerging markets it is 20% of the GDP and 50-70% of the GDP in advanced countries. The total retail credit is 18% of the GDP whereas in the US it is 100%, hence, the growth envisaged in the financial sector is monumental. The size of the Indian credit market from INR 60 lakh crore in 2014 has increased to INR 160 lakh crore in 2024 during all possible crises such as a slow economy from 2010 to 2014, demonetization in 2016, GST implementation in

2017, IL&FS crises, and Covid. The same is projected to be around INR 480 lakh crores in 2034.

The Reserve Bank of India (RBI) has been lauded by the bankers for the reforms, discipline, and good measures, and the same was also recognized by Central Banking as Mr. Shaktikanta Das was awarded as Governor of the Year 2023, considering that the RBI Governor cemented critical reforms, overseen world-leading payments innovation and steered India through difficult times with a steady hand and well-crafted turn of phrase.

Profitability and Operational Efficiency

Banks in India have witnessed substantial profitability, with profits soaring to INR 2.3 trillion at a staggering 35% year-on-year growth rate. Strong growth in interest and other income, coupled with enhanced operational efficiency, underscores the sector's resilience. Marginal improvements in return on assets (ROA) and return on equity (ROE) signal healthy financial performance, further bolstering investor confidence.

Business Expansion and Global Investor Trends

Credit growth has surged, driven by strategic mergers such as the HDFC-HDFC Bank merger, while changing deposit preferences reflect evolving consumer behaviors amidst rising interest rates. Declining gross non-performing assets (GNPAs) and robust risk preparedness underscore the sector's resilience in navigating uncertainties.

Recently, JP Morgan and Bloomberg announced India's inclusion in its Global EM Bond Index and EM Local Currency Government indices, respectively. Hence, over the next five years, experts predict an annual wave of foreign investment of USD 30-40 billion, freeing up an equivalent amount of domestic capital for investment by the private sector.

Private-sector banks, in particular, have garnered significant foreign investor interest, owing to their superior growth prospects, quality management, and consistent profitability. Top global investors, including Capital Research and Management Co., BlackRock Inc., and GIC Private Ltd., are eyeing Indian banks for investment, further bolstering the sector's appeal.

Disinvestment by the Government of India

In FY 2024-2025, the Indian government aimed for an INR 50,000 crore disinvestment. This leads to the first strategic disinvestment of a bank post the April-May general elections. IDBI Bank, formerly public-owned, serves as a pivotal test case for the New Public Sector Enterprises Policy, aimed at decreasing government intervention across sectors, including banking. The policy reflects a belief in the private sector's capacity to foster business expansion.

Experts and Global Investors Bullish on India's Banking Sector

Geopolitical shifts and changing investment dynamics are expected to further propel foreign investment into India's banking sector. Investors are redirecting their attention

to India's banking sector due to shifts in geopolitical dynamics, as highlighted by Sandeep Upadhyay, Managing Director of Infrastructure Practice at Centrum Capital Ltd. Upadhyay emphasized India's emergence as a prime destination for robust financial growth, attracting high-quality investors. Jamie Dimon, Chairman and CEO of JPMorgan Chase, echoed this sentiment during the JP Morgan India Investor Summit in late 2023, citing significant growth in JP Morgan's Indian subsidiary.

Japan's SMFG invested INR 1,300 crore in SMFG India Credit Co Ltd to drive growth, while MUFG made substantial investments in Indian non-bank lenders, including DMI Finance, and proposes to acquire a 20% stake in HDB Financial Services, further highlighting India's allure to global investors.

Mizuho Financial Group, Japan's third-largest lender appointed private equity veteran Sanjay Nayar as external senior advisor for Mizuho Bank India effective March 31, 2024, to support the development of the bank's local growth strategy.

Conclusion

India's banking sector presents a compelling investment proposition for foreign entities, underpinned by strong economic fundamentals, technological prowess, and regulatory stability. As the nation continues its trajectory of robust growth, investors stand to benefit from the myriad opportunities unfolding in one of the world's most dynamic banking ecosystems.

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