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Welcome to this issue of

CLD NUALS Securities Law e-Newsletter

In this issue, as the lead article, we have **Mr. Sumit Agrawal**, a former SEBI Official & Founder of RegStreet Law Advisors, giving insights on “Recent developments in Securities Law”.

Apart from the above, we have also captured the key notifications and circulars issued by the SEBI for the period under review.

Any feedback and suggestions would be valuable in our constant pursuit to improve the e-newsletter and ensure its continued success among the readers.

Please feel free to send any feedback, suggestions or comments to us at cld@nuals.ac.in.

Regards

Editorial Team

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Interview with Mr. Sumit Agrawal

By – Mr. Sumit Agrawal[1]

1. How in your opinion will the Budget 2019 impact the Capital Markets in India?

Budgets come and budgets go. The reaction of markets in terms of index movement is usually temporary. For the Union Budget 2019, the response of the markets has been mixed. Initially the announcement that a mandatory increase in public shareholding in listed companies to 35% from the current 25% is being considered was seen as a downer, especially when achieving 25% itself has not been met with compliance. Now this information seems to have been subsumed and SEBI itself has also shown reservations about implementing this decision in the near future.

The proposal to limit the corporate tax rate cut only to companies with a turnover of up to Rs. 400 crores have not enthused the markets while on the other hand, several expectations of increase in the basic income tax exemption slab and increase in income tax rates for the super-rich have not materialized. If you couple these proposals with the ongoing trade war and the increase in petrol/diesel prices after the cess hike in the Budget, it deals a body blow to the investors who were perhaps hoping for big bang reforms after the incumbent government secured a thumping majority in the general elections. Therefore, the Budget hasn't gained the attraction it was expected to.

2. A lot of Law Schools do not have an adequate Securities Law course in their Curriculum, what in your opinion is the best way for interested students to study this field of law?

Offering courses on specialized subjects have always been a challenge at law schools. This is primarily due to lack of availability of domain expert faculty, geographical challenges and inability of the colleges to attract enough students as well as infrastructural challenges.

Some of the colleges do have a Securities Law course as part of their corporate law curriculums however, the courses need to be structured in a way that students learn practical aspects that are helpful to them when they step in to their chosen area of practice, for example, reading of circulars, informal guidance, etc. along with reading the regulations and bare acts. The gap between academicians' and practitioners' perspective needs to be bridged. This gap is filled to a certain extent by long-term internships but in most cases, it does not prove to be enough.

3. How will Machine Learning (ML) and Artificial Intelligence (AI) change the functioning of Capital Markets?

Machine Learning and Artificial Intelligence are already changing how markets function as we speak. To speak of some of the changes that could be brought about, is the way listed companies deal with their statutory compliances, fund managers and investment advisers providing better

[1] Mr. Sumit Agrawal is the Founder of RegStreet Law Advisors, a former SEBI Official and the author of the Commentary on SEBI Act (Taxmann).

suggestions to their clients based on the analysis of fundamentals combined with machine learning, increase in the efficiency of the markets and so on and so forth. Machine Learning and Artificial Intelligence can be important tools for increasing the quality of the disclosures by finding patterns of words such as “despite” “notwithstanding” “expects” etc. used in disclosures.

However, Machine Learning (ML) and Artificial Intelligence (AI) is likely to bring new 21st century challenges to the regulators and financial regulation. Regulators not only in India, but globally, are exploring if AI and ML could be used to prevent insider trading and securities frauds by incorporating it in their surveillance tools.

It is important to exercise caution here too as we would not want a repeat of what unraveled in the NSE Co-location orders.

4. ***Could you please share your experience and the challenges involved being a founding partner of a law firm?***

As any entrepreneur, as a founder of a law firm, you chose to undertake multiple challenges - right from signing clients to maintaining the quality of deliverables to keeping your team in high spirits. I am one for appreciating diversity in the team as people from different backgrounds and interests bring different perspectives to the process, thus making it robust.

The key, in my opinion, is setting yourself short terms goals and clear objectives that you can keep reassessing from time to time. Finally, I would say that not taking up challenges would be a waste of life, and any failure will only propel us to do things in a better way in future.

5. ***What will be the impact of Cross Listing of Shares in the Securities Market?***

Introduction of Cross listing and direct overseas listing is being considered by the financial regulators for some time. Both of these concepts have inter-related issues. Currently, there are limited ways in which Indian companies can access overseas markets and the same goes for overseas companies in Indian markets. So far, the regulator had been looking at one aspect, that India may lose capital, but now, there is a renewed thinking that is showcasing the talent of Indian companies overseas and attracting good quality foreign companies to list in India.

SEBI is one of India’s most innovative and dynamic regulators and is open to new ideas.

In the domestic context, NSE to list on BSE and BSE to list on NSE has been a bone of contention for some time. Overseas Cross Listing has always been a sticky subject owing to concerns such as flight of capital or the extent of the regulatory ambit but with an unambiguous framework, it could prove to be beneficial in the long-run. By allowing companies with new fund-raising avenues and diversifying investors, cross listing can help make the markets more competitive.

Once the tax related considerations and jurisdictional issues are figured out, there is strong economic sense in allowing cross listing. There is a case for such economic liberalization.

6. ***How will the recent SEBI Circular on confidentiality impact settlement proceedings?***

In my respectful view, SEBI's circular on confidentiality is broad-based and is fraught with excessive discretion and does not achieve the purpose for which confidentiality is sought by listed companies, intermediaries, or other persons associated with securities market. SEBI Circular dated June 18, 2019 is akin to reward of confidentiality to a whistleblower for providing assistance to regulator. Time will tell how it is implemented in practice.

While Circular dated June 18, 2019 aims to provide certain guidance for considering approval or denial of confidentiality in settlement proceedings, unless the reasoned orders (of such approval or denial) are made available in public domain, markets will only be guessing the regulatory thoughts and concerns.

7. ***How different is the field of Securities Law from when you first entered the profession?***

Securities Law is one field which is very dynamic. That's the nature of the beast.

Straight from National Law University Jodhpur's second batch, I had chosen to join SEBI as a Legal Officer where I learnt the perspective of regulator and public service. I also learnt a lot while authoring the book on SEBI Act and teaching at Government Law College. The questions from securities law aspirants or working professionals enlarges one's horizons.

Today, as a practitioner on the other side, I experience that the perspective of corporates are usually at divergence with what regulators behold. Sometimes regulations are made sitting in ivory towers while sometimes regulated entities look to walk the thin line. There are various permutations and combinations of perspectives on enforcement and policy. Viewed from that point, my experience is and has been very different from others. I have thoroughly enjoyed my journey and continue to do so.

Field of Securities Law today has become more diverse, vibrant and lucrative as well. Given the dynamism of the field, it also brings the pressure to remain at the top of things in no time. In my view, the field of securities law is always growing and would be a fertile ground for new graduates to make a mark.

TECH COS. AND DIFFERENTIAL VOTING RIGHTS IN INDIA – THE BEGINNING OF A PROMISING JOURNEY

By – *Tejas Mundley* (V Year - Hidayatullah National Law University, Raipur)

WHAT ARE 'DVR' SHARES?

Dual class shares ('DCS') or shares with differential voting rights ('DVRs') are shares where rights are disproportionate to economic ownership. Thus, while one share generally has one vote, a company may opt for a shareholding pattern where one share may carry ten votes and/or yet another class of shares may be such that ten shares will confer on the shareholder only one vote.

GLOBAL SCENARIO AND NEED FOR THE SAME IN INDIA

With more than fifteen start-ups in India now in the 'Unicorn Club', access to greater funding for their ventures without dilution in promoter shareholding is now the need of the hour. Global tech giants like Facebook, Google, etc. have adopted a shareholding structure where shares are separated into different classes enabling promoters like Mark Zuckerberg to enjoy voting rights in excess of 50% whilst holding only around 14% of the share capital. Ola's Bhavish Aggarwal has led calls for enabling DCS structures because they allow promoters to take long term decisions without having to worry about institutional shareholders and 'short-termism' (which refers to forsaking of long-term objectives with short term goals for better balance sheets in the immediate future) thus allowing them to steer their companies in the direction they want to (at least for a certain period of time, say five to ten years) without having to worry about hostile takeovers and unnecessary shareholder interference. In March 2019, SEBI released a consultation paper titled 'Issuance of Shares with Differential Voting Rights' to deal with this issue. An analysis of the paper is contained in the subsequent paragraphs.

SEBI'S PROPOSALS: ANALYSED

At present, the issuance of shares with differential rights is permitted under Section 43 (a) (ii) of the Companies Act, 2013. This is however limited by Rule 4 of the Companies (Share Capital & Debentures) Rules, 2014 which stipulates requirements like consistent distributable profits for the preceding financial years, etc. In any case, shares with superior rights ('SRs') are not permitted, with only Fractional Rights ('FRs') shares being permitted to be issued. As to what is meant by SRs and FRs, SEBI has identified them as follows:

1. **SR Shares** – shares with superior voting rights as compared to ordinary equity shares.
2. **FR Shares** – shares with fractional voting rights as compared to ordinary equity shares.

The proposals are as follows:

- SR shares will be permissible but only at the pre-IPO stage. Thus, a company which is already listed will not be able to issue SR shares, however, it will be able to issue shares with FRs, which is in continuance of the existing framework;
- To prevent dilution of rights of shareholders, differential voting rights vis-à-vis ordinary shares, cannot be more than 10:1 for SR shares and 1:10 for FR shares. This is important in light of shareholding patterns adopted by companies like Snap Inc. in the USA, where a class of shares with zero voting rights have existed but have seen meek investor demand;
- The investors typically associated with FR shares are those who seek greater cash flows without exercising control and hence these shares are issued at a discount but with higher dividends. SEBI has now proposed that SR shares, post-IPO shall be entitled to the same dividend as ordinary shares, while FR shares can enjoy a higher dividend. However, dividends to FR shareholders are prohibited when no dividends are given to ordinary shareholders in a financial year;
- To safeguard corporate governance, the following proposals have been made:
  - 'Sunset Clause' on SR shares meaning that they will be converted to ordinary shares upon completion of five years post-IPO (this may be

extended by five years with shareholder approval);

- 'Coat-tail Provisions' which are corporate matters wherein SR shareholders will not have superior voting rights, them being *inter alia:* change in control or constitutional documents of the company, appointment of independent directors, etc.
- SR shares cannot be issued to anyone other than promoters and cannot be transferred *inter se* or encumbered in any manner.

CONCLUSION

The proposal has met with approval on part of the MCA and other regulators with concerns against deterioration of corporate governance being raised in some quarters. It can be argued that there are adequate safeguards that have been put in place by SEBI via sunset clauses and enhanced disclosure requirements, among others. Also, one cannot lose sight of the fact that the target group, primarily start-ups and tech companies have business models which privilege ideas over short-term balance sheet health and this makes access to conventional modes of finance difficult without promoters having to give up control over their companies. Thus, they should be allowed some leeway in the initial phase of growth of their companies so that a vibrant environment is put in place where companies can be incubated from outsider control before accessing the capital markets. Thereafter, they shall be subjected to enhanced disclosure requirements to protect the interest of investors without having to radically change their shareholding structure.

PERMITTING FOREIGN PORTFOLIO INVESTORS TO INVEST IN MUNICIPAL BONDS

By – *Aishwarya Ray, Nikhil* (V Year - National Law University Odisha, Cuttack)

INTRODUCTION

In India, where there has been significant growth in urbanization, the municipal bodies responsible for urban development have constantly faced the issue of inadequate funding mainly attributable to the vastness of the country and increasing population. The large dependency on the traditional method of budget allocation by the government or fund lending institutions such as the World Bank cripple the development of the urban sector. In such a scenario, one of the best alternative sources of funding is an investment in capital markets. This has been successful in the form of Municipal Bonds which are basically debt obligations that are issued by municipalities to finance various urban infrastructural projects.

There are essentially two types of Municipal Bonds: General Obligation Bonds and Revenue Bonds. General Obligation Bonds are those bonds wherein repayment of principal amount and interest is dependent on the faith and credit of Municipalities and not on the revenue generated from projects. These bonds are usually issued for projects such as roads, street lighting, public health, etc. On another hand, Revenue Bonds are those bonds wherein repayment of principal amount and interest is dependent and secured by revenues derived directly from the projects in the form of user fees or service charges. These bonds are usually issued for projects such as toll roads, water, and sewage treatment facilities, etc. In India, the investment in Municipal Bonds dates back to the year 1997 when Bangalore Municipal Corporation issued such bonds for the first time. Subsequently, Ahmedabad Municipal Corporation in 1998 issued tax-free bonds worth INR 100 crore without a government guarantee. However, despite a long history of Municipal Bond in the Indian market, the urban sector especially municipal bodies have not been able to capitalize on the funding opportunity from the issuance of such bonds. Thus, in order to revive the Municipal Bond market, the Securities Exchange Board of India ("**SEBI**") brought in various measures such as notifying SEBI (Issue and Listing of Debt Securities by Municipalities) Regulations, 2015 in order to regulate the debt securities issued by municipalities and recently permitting the Foreign Portfolio Investors ("**FPIs**") to invest in Municipal Bonds. However, the Indian market will have to overcome certain challenges in order to boost the market and raise capital for urban infrastructural projects.

ENABLING FPIS TO INVEST IN MUNICIPAL BONDS

In furtherance of Circular No. 33 released by Reserve Bank of India ("**RBI**") on April 25, 2019 ("**RBI Circular**"), SEBI issued a Circular dated May 08, 2019 giving a green signal for the investment in Municipal Bonds by FPIs. This step attempts at broadening the access of non-resident investors to invest in debt instruments in India. The RBI Circular provides the necessary guidelines for the investment by FPIs in Municipal Bonds and mandates that such investment by FPIs have to be in consonance with the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations,2017 ("**FEMA Regulations**"). In order to facilitate such investment by FPIs, the Government vide its notification dated April 18, 2019, amended the FEMA Regulations. As per the amendment, clause (x1vii) under Regulation 2, has introduced "Municipal Bond" to mean a debt instrument issued by municipalities constituted under Article 243Q of the Constitution of India. The issuance of such bonds shall be governed by SEBI (Issue and Listing of Debt Securities by Municipalities) Regulations, 2015. Further, there has been an amendment to Schedule 5 of the FEMA Regulations which deals with guidelines for *"purchase and sale of securities other than capital instruments by a person resident outside India"*. The amendment has inserted "Municipal Bonds" under "clause m", of Para 1 sub-section A of this Schedule which deals with "*permission to FPIs to purchase instruments*". This amendment essentially introduces Municipal Bonds to the segment of foreign portfolio investment.

The RBI Circular read with Circular No. 26 of RBI dated March 27, 2019 sets out the limit of FPI investment in Municipal Bonds to be within the limit of FPI investment in State Development Loans i.e. 2% of the outstanding stock of securities. Along with this, all the other existing conditions for investment by FPIs in debt securities have remained unchanged. It is also pertinent to note that RBI in its Circular No. 34 dated May 24, 2019 has introduced revised Voluntary Retention Route ("**VRR**") Scheme for facilitating long-term and stable investment by FPIs in debt securities. Para 4 of the Annexure attached in this Circular dealing with "Eligible instruments" for the

VRR Scheme provides *"FPIs may invest in any instrument listed under Schedule 5 of Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2017"*, pursuant to which Municipal Bonds also fall within the ambit of eligible instruments (as per the recent amendment to Schedule 5). Moreover, SEBI has also relaxed the norms of FPIs investment in India through its SEBI (Foreign Portfolio Investors) (Amendment) Regulations, 2018. These steps of opening investment in Municipal Bonds for FPIs, facilitating their investment through VRR Scheme and relaxing regulatory norms can be regarded as progressive steps to attract more foreign portfolio investment in India through capital markets.

ANALYSIS AND WAY AHEAD

The Indian Municipal Bond market has witnessed several phases: tremendous success by Ahmedabad Municipal Corporation in 1998, a hiatus of at least 14 years and then recently raising of approximately INR 600 crores by Municipal Corporation Pune, Hyderabad, and Ahmedabad in 2017, 2018 and 2019 respectively. One would assume that a market based on safe security that serves a public purpose along with additional tax benefits, would be stable with continuing demand, however, the reality tells us otherwise.

There are several hindrances that prevent investing in Municipal Bonds in India from becoming a popular opinion. The lack of interest of FPIs in such bonds is majorly due to the absence of appropriate as well as uniform disclosure and accounting standards that subsequently prevent the proper credit assessment of these bodies. As Moody's Investor Services has noted that the accounting and disclosure standards vary widely between Indian states and even between different tiers of government within the same jurisdiction. In this context, the SEBI (Listing Obligations and Disclosure Requirement) Regulations, 2015 though have imposed more stringent financial disclosure standards on Municipal Corporation, but their slow implementation itself reflects the significant challenges faced by such entities in adhering to minimum disclosure standards. A proper credit assessment can only be done when quantitative, qualitative and contextual factors, such as operational efficiency, technological development, effective management, political stability, past record of debt servicing, etc. are public knowledge. Thus, it is extremely essential for such entities to enhance their disclosure and accounting mechanism in order to be attractive for FPI investment.

Further, a major concern revolves around the credibility of Municipal Bonds to yield good returns because of several adverse factors such as: lack of cash flow owing to delays in project implementation, over-dependency on grants from Central and State Government, lack of autonomy to create financial plan as well as to enhance own-source revenue, and unavailability of a function-finance mapping. It is also difficult for FPIs to assess the public information released by these bodies as it is usually in vernacular languages.

Investment by FPIs in Municipal Bonds would ultimately create trust in the market and thereby attract the interest of domestic investors as well. In this regard, the incentive for the former would majorly be good returns while the latter would also get a better quality of life in the cities. Therefore, it is necessary that certain immediate reforms are made in order to attract the interest of FPIs as the Indian market has already witnessed the reduction of approximately $1.25 billion FPI investment as on April 24, 2019, against inflows of $3 billion in March, 2019. In order to convince FPIs of their fiscal strength and credit rating Municipalities should: (i) adopt stringent policies for timely execution of projects and collection of revenue and (ii) create an online portal for proper disclosure of financial and infrastructural plans, budget allocations, accounting standards, etc. A special agency may also be created by the Government to provide end to end support for issuing bonds, including accounting and financial management, credit enhancement, project management, underwriting, etc. Further, adoption of a new and effective tax treatment mechanism has become essential as Municipal Bonds are tax-free only when the bonds carry interest rate below 8% per annum. This makes the bonds unattractive to not only FPIs but also to domestic investors.

Therefore, permitting FPIs to invest in Municipal Bonds is definitely a positive step in raising funds for urban infrastructural projects. However, the immediate adoption of the aforementioned reforms is required in order to reach the desired objective.

INCLUSION OF FINTECH: SEBI'S REGULATORY SANDBOX

By – *Ishita Agarwal* (V Year - School of law, UPES Dehradun)

INTRODUCTION

Amid the sudden spurt in Fintech industry in India and thus the probability of its increasing misuse, regulators are expressing concern towards the black-box nature of artificial intelligence and machine learning to ensure good corporate governance and to secure interests of the various stakeholders involved, especially the investors.

Earlier the Reserve Bank of India **(RBI)** and now the Securities and Exchange Board of India **(SEBI)**, Insurance Regulatory and Development Authority of India **(IRDAI)** and possibly in near future, Pension Fund Regulatory and Development Authority **(PFRDA)** have proposed a new framework for "regulatory sandbox" which will provide a simulated but controlled test environment by making data and systems available for live testing of new products, services and technology for the securities market in India along with regulatory relaxations focused on a set of consumers for a limited period of time. Recently, SEBI vide its circular SEBI/HO/MRD/2019/P/64 dated May 20, 2019, stipulated a framework for "innovation-sandbox" which provided for offline testing and is now further proposing to set a framework for "regulatory-sandbox" for entities regulated by SEBI through a 'Discussion Paper on Framework for Regulatory Sandbox' issued on 28 May 2019.

BACKGROUND AND NEED FOR INCLUSION

The concept of regulatory and innovation sandbox was developed keeping in mind the rapid technological development in financial markets and gaps in the regulation of such technical innovations during the aftermath of the financial crisis in 2007-08.

The history can be traced back to a sandbox structure set up by the U.S. Consumer Financial Protection Bureau in 2012 under Project Catalyst. Afterward, the U.K. Financial Conduct Authority coined the now used term “regulatory-sandbox”. Now, over 20 countries use such mechanisms with India being one of the latest members. To support such regulatory sandboxes, often innovatory Fintech solutions are adopted to give it a broader scope.

The importance of a Fintech sandbox is well-established and manifold. Such sandboxes/platforms are the hubs for harnessing innovation and technology to support financial inclusion. In the aftermath of the crisis in 2007-08 involving new technology-based products like derivatives, this new sandbox will allow SEBI to evaluate the performance of such new models in a restricted environment prior to rolling them out in the live market. Another major advantage will be for the Fintech firms as they will have access to market-related data, particularly related to trading and holding of securities which is not readily available. It may also bring the cost of innovations down and reduce entry barriers.

OVERVIEW OF THE FRAMEWORK

Applicability - The development of this concept was started after SEBI constituted a committee called as the ‘Committee on Financial and Regulatory Technologies (CFRT)’ which was given the duty to deliberate upon a framework for regulatory sandbox as one of its main agendas. This framework is set to increase participation and accessibility supported by greater supervision and lowered costs. The framework will initially be applicable on all the market participants like merchant bankers, underwriters, portfolio managers, stockbrokers, STAs and investment advisers, etc. Afterward, the SEBI may allow firms and startups to participate. Various factors like genuineness of innovation, prior testing, and benefit to users, proper risk management strategies and deployment needs are considered for eligibility.

Exemptions- The framework seeks a robust mechanism against Anti-Money Laundering and KYC under investor protection and market integrity. SEBI will provide either comprehensive or selective regulatory exemptions to the participants on a case-to-case basis. Participants are required to apply for exemptions which prove to be a barrier to them. Relaxations pertaining to net worth, registration fees, SEBI guidelines such as technological risk management and outsourcing and financial soundness are provided. A proper grievance Redressal mechanism and appropriate risk disclosures are also required.

Process- A thorough *application and approval process* on a rolling basis has been provided where the process will be overseen by the market regulation department of SEBI along with the Committee on Financial and Regulatory Technologies. A *review for suitability* within 30 days will be done. *Evaluation* is done for specific conditions and requirements for proposed solutions and furthermore, *testing* is carried out to disseminate potential risks to the users. A one-month window is given to make material changes. Interim reports are to be submitted and a formal exit is made. The proposed timeline is for nine months with a three-month extension. Evaluation is done based on a scoring method and a final report is submitted within 30 days after the testing stage.

Conclusion and Comments

These recent changes have created quite a stir in the financial market and are expected to create a win-win situation for all the stakeholders. It will encourage various participants, firms, and startups to develop and explore new innovative products while cooperating with financial regulators. An experimentation-based approach is considered with an evidence-based testing process and robust mechanisms to avoid potential risks and strength disclosures.

The process provided by SEBI is more comprehensive than that of RBI. However, there is still a need to tackle issues like competition among the participants taking into account the control of fewer firms over significant market share. Better inclusion of intellectual property rights should also be sought. The framework still requires prior offline testing features along with which it needs to include modes for virtual testing. A platform for interaction among the participants and a Grievance Redressal Mechanism for the participants should also be included.

It is necessary for all the regulators specially RBI and SEBI work together to avoid confusions regarding the gaps in their respective frameworks. Consultations from international development organizations, private consulting firms, and other peer financial institutions should also be sought. Regulatory sandboxes are quite new and the lack of data available and diversity in the mechanisms make the potential assessment quite difficult. Still, it is to be understood that a sandbox is not a one-size that fits all solution but should be coupled with other avenues to create a positive environment.

Updating the Securities Framework on Mutual Funds

By – *D. Suchit Reddy* (III Year - National Law University - Jodhpur)

By May 2019, the regulatory framework relating to Mutual Funds in India has already undergone several changes. What makes them crucial is how relevant they are to the changing landscape of new technology as well as a change in regulatory authority. Ever since the Forward Markets Commission merged into the Securities Exchange Board of India **[“SEBI”]** in 2015, more financial products and players have been introduced to compensate for the handful of hedgers or producers in the commodity derivatives market. This article majorly discusses the developments with regard to (i) permitting institutional investors to participate in Exchange Traded Commodity Derivatives **[“ETCDs”]**; (ii) total expense ratio **[“TER”]** and (iii) the role of Artificial Intelligence & Machine Learning **[“AI & ML”]**.

Institutional Participation

Over the past two years, SEBI has been making efforts to promote institutional participation in ETCD. In pursuance of the same, it has gradually permitted two different types of institutional investors to participate in the commodity derivatives market. First, in June 2017, SEBI allowed Category III Alternate Investment Funds **[“AIFs”]** such as hedge funds to become active participants. Second, in October 2018, persons defined as ‘residents outside India’ as per Section 2(w) of the Foreign Exchange Management Act, 1999 were permitted to directly participate in the commodity derivative market. Under the circular, this group of investors was categorised as Eligible Foreign Entities **["EFEs"]**. To be considered as EFEs, investors would be required to- (i) have actual exposure to Indian physical commodity derivate market (ii) be registered with SEBI as Foreign Portfolio Investors (FPIs) or Foreign Venture Capital Investors (FVCIs) and (iii) have a minimum net worth of 500,000 (USD).

The purpose of promoting institutional participation in the commodity derivatives market in India is to improve the process (referred to as 'price discovery') and efficiency of determining the price of an asset, commodity or security so as to better manage the volatility in the value of the same (i.e 'price risk management'). SEBI intends to do so by introducing more players in two phases. The first phase would see permitting certain investors that were erstwhile not allowed to do so such as Category III AIFs, foreign participants having actual exposure to commodities (later officially categorised as EFEs by circular dated October 9, 2018), Portfolio Management Services and Mutual Funds (discussed hereunder). In the second phase- banks, insurance/reinsurance Companies, FPIs and Pension Funds would be gradually permitted become participants. The introduction of more players is pertinent to price discovery as the process relies *inter alia* on supply and demand in a financial market.

Most recently, in May 2019, SEBI notified that Mutual Funds would also be permitted to participate in ETCDs. However, this comes with certain strings attached. It must be noted that Category III AIFs, EFEs, and Mutual Funds are permitted to participate in commodity derivatives with the exception of 'sensitive commodities' i.e agricultural commodities prone to "government/external interventions" or those which have observed "frequent instances of price manipulation". In addition to this, Mutual Funds schemes are not permitted to invest in physical goods *except* 'gold' through Gold ETFs and hybrid schemes. So what exactly does this authorisation entail?

Apart from the abovementioned conditions, SEBI has also laid down certain disclosure requirements and investment limitations for Mutual Funds. The investment limitations differ on the basis of the type of scheme and their net asset value **["NAV"]**. For example, the permitted exposure of multi-asset allocation schemes is capped at 30% of their NAV whereas hybrid schemes are permitted only up to 10% of their NAV. Coming to compliance/ disclosure requirements, asset management companies **["AMCs"]** are required to (i) update their NAVs of the schemes on a daily basis on their website as well as on the website of the Association of Mutual Funds in India **["AMFI"]**; (ii) modify the formats for monthly and half-yearly portfolio to reflect investments in ETDCs and (iii) disclose the total exposure to ETDCs in the Monthly Cumulative Report.

REGULATION 52, SEBI (MUTUAL FUND) REGULATIONS, 1996

Along with permitting Mutual Funds to become a participant in the commodity derivatives market, the SEBI (Mutual Fund) Regulations, 1996 **["MF Regulations"]** were parallelly amended earlier this year to synchronise the regulatory framework with the same.

Regulation 52 of the MF Regulations which deals with '*Limitation on fees and expenses on the issue of schemes*' was amended to include- (i) 'expenses incurred towards storage and handling of the underlying goods, due to physical settlement of such contracts' within the definition of 'recurring expenses' by way of addition of clause (*b*)(*xii-e*) under Regulation 52(4) and (ii) Regulation 52(5A) which provides that a scheme would be considered an 'equity-oriented scheme' if it invests a minimum of 65% of its NAV in equity or equity-related instruments. The purpose of clause (5A) is to limit the costs of managing and operating a mutual fund usually those relating to auditor fees, legal fees, management fees, trading fees, etc. i.e TER.

However, the most important amendment is witnessed by clause (6) as it puts into effect the above two amendments. The amendment substitutes the previously existing limits on TER depending on the nature of scheme which is open-ended (such as funds schemes) or closed-ended. Such a variation exists as the NAV of an open-ended fun is based on how many shares are sold at the end of each trading day and is then reset the next day. Since there is no limit on how many shares an open-ended fund can issue, the TER is applied accordingly. Whereas the NAV of close-ended schemes is purely reliant on supply and demand as they are traded on the market.

ARTIFICIAL INTELLIGENCE (AI) AND MACHINE LEARNING (ML)

Innovative technological developments have seen a widespread application in the financial world to an extent where they've come to be recognized as FinTech. AI/ML aren't exceptions. The combination enables an adaptive predicting power capable of autonomous learning which is particularly essential for pattern recognition, developing investment strategies or advice, compliance or management services, etc. To develop policies in the future, SEBI has recently announced that it would be conducting a study to understand how AI/ML is applied in 'investor and consumer-facing products.'

Therefore, SEBI has required all Mutual Funds and AMCs to report on systems based on AI/ML. These include systems that gather big data intelligence, systems that learn and improve feedback, Neural Network systems, etc. Upon perusal of the form for intimation and reporting on AI/ML, it can be observed that these systems are categorised on their purposes such as advisory service, compliance, enforcing KYC and AMI regulations.

SEBI'S UNPRECEDENTED MOVE OF BANNING NSE FROM THE SECURITIES MARKET

By – *Shauree Gaikwad* (III Year – Maharashtra National Law University, Aurangabad)

BACKGROUND

In 2010, NSE started offering a co-location facility wherein brokers could place their servers at the same location as the NSE. Allegedly, the co-location servers at the NSE, were rigged by these brokers by colluding with some NSE officials and also with a company named OPG Securities, which provided the technology to NSE, from the time period of 2010 to 2014, therefore allowing some brokers to get prior market price information and differential advantage than and over the rest of the market, which was allegedly against the SEBI regulations and transparency-based mechanism. After getting the permission to access the co-location facility, two brokers laid down a dark fiber net connectivity in that facility for faster trade execution, and the same was allowed by NSE to continue running even though this connection was unauthorized. Meanwhile, similar requests of setting up a dark fiber connection from other brokers were not approved by the NSE. Therefore, the brokers who were connected to these servers gained information faster than all the other trading members, which led to distribution asymmetric information in the market – a violation of the basic norm of fairness and equitability of the SEBI Regulations.

This fraudulent practice came into light after a whistle-blower's letter addressed to the SEBI complained about the same in 2015. The whistle-blower also alleged the brokers were able to capitalize on advance knowledge by colluding with some officials of the NSE.

THE SEBI ORDER BANNING NSE FROM ACCESSING SECURITIES MARKETS

On 30th April, whole time SEBI member, G. Mahalingam, passed an order banning NSE from accessing the securities markets along with a direction to disgorge approximately, Rs. 1,000 Crore - i.e., Rs. 624.89 crore plus 12% interest from April 1, 2014, due to NSE's failure to exercise due diligence while offering co-location facility, thereby affecting market transparency and integrity, which is a violation of SEBI (Stock Exchanges and Clearing Corporations) Regulations, 2018 ("**SECC Regulations**"). Along with the above directions, SEBI has also taken a bold step against former executives - Ravi Narain and C.B. Bhave, ordering them to disgorge 25% of their salaries drawn during 2011-2014. Both have also been barred from being associated with any listed firm or a Market Infrastructure Institution for the time period of five years. The disgorgement has to be made towards SEBI's Investor Protection and Education Fund ("**IPEF**").

While passing the order, SEBI was of the view that, although sufficient evidence is not available to conclude that NSE has violated the SEBI (PFUTP) Regulations, the whole time member finds that it is established beyond doubt that NSE has not exercised the requisite due diligence while offering the co-location facility and, failure to exercise due diligence is in violation of Regulation 41(2) of SEBI (Stock Exchanges and Clearing Corporations) Regulations, 2018 ("**SECC) Regulations**"). The whole time member emphasized on the tremendous importance of compliance of the NSE with the SECC Regulations. Therefore, the non-compliance with the same resulted in SEBI's unprecedented move of banning NSE from the securities market for the time period of 6 months, effective immediately.

SIGNIFICANCE OF SEBI (SECC) REGULATIONS

Regulation 41(2) of the SECC Regulations, 2012 casts a duty on every stock exchange to provide equal, fair and transparent access. The SECC Regulations envisages every stock exchange to practice "fair trade practices" in order for it to become a mechanism for growth of the securities market. The SECC Regulations also provide for the directors of these stock markets to analyse and administer the stock exchange with fairness and impartiality and in consonance with the code of ethics. One of the code of ethics under the SECC Regulations is that the directors should establish a fair and transparent market place. Hence, the law has mandated a high standard of ethics for the business of conduct of a stock exchange in general by laying down these responsibilities on the directors.

Therefore, ultimately, SECC emphasized that the directors of recognized stock exchanges should be committed to the task of enhancing fairness and maintaining the integrity of the system in letter and spirit.

ANALYSIS OF THE SEBI ORDER

SEBI's unprecedented move of banning NSE from the stock market for a period of 6 months along with the disgorgement order, has received mixed responses. This move is welcomed by some as according to them through this order SEBI sets a strong precedent by making it clear through SEBI laws, circulars and past judgements of the High Courts that, stock markets should carry out their activities in such a way that it does not take away the trust of the investors from the market; violations of any of the SEBI regulations will not be taken lightly and will be dealt with in a strict manner; and that each market regulator has an unquestionable responsibility to ensure that trading takes place in a fair and equitable manner.

While this move is welcomed by some, others find it to be an unnecessary drastic measure on SEBI's part. The reason that this move is found unnecessary is that although it was alleged that NSE has violated SEBI (PFUTP) Regulations but the same could not be proven and therefore NSE was not held guilty for it.

SEBI has also relied on cases and provisions of the SECC Regulations where a lot of emphasis has been laid on SEBI being a front line regulator of the stock exchange markets, but had not raised a question on SEBI's own role as the last line regulator even though it is SEBI who approves the appointment of the top officials of the respective stock exchange markets.

While ordering for disgorgement towards the IPEF, SEBI stated that the reason for the same was that proper due diligence in relation to the collocation facility was not exercised by the NSE which led to asymmetric information in the market. The question that arises is that did asymmetric information cause disproportionate profits to any of its trading members? Even if the answer is yes, SEBI has not found anything to support this claim, and hence NSE is not guilty of the same. The fine of disgorgement presumes that all profits made out of the colocation facility were ill-gotten. Having a hefty fine ordered on such a presumption is wrong on SEBI's part. The imposition of a fine of disgorgement while holding that none of the NSE employees are guilty of fraud under the SEBI (PFUTP) Regulations, makes the fine even more questionable.

One should also consider the fact that Indian policymakers assume self-regulatory organizations such as the NSE, to not have any flaw in the execution of the self-regulatory mechanism, but this assumption was challenged by the co-location scam wherein NSE officials themselves colluded with its trading members. It has also brought this idea into light that, even though SEBI lays emphasis on governance through fair and equitable trading and listing rules, it still does not limit the scope for collusion and corruption at every level of management at the stock markets.

Conclusion

The co-location scam only came to light after a whistleblower highlighted the same. This shows that India's market institutions need an infallible whistle-blower mechanism. While the disgorgement order takes away from those who wrongly profited from the co-location scam, it does not give back to the ones who actually lost the money due to the scam, instead, it is directed towards IPEF. SEBI's orders in relation to the co-relation scam such as barring top officials of NSE, charging a hefty fine in way of disgorgement orders show SEBI's strictness when it comes to the violation of market regulations and lays down a strong precedent but the basis for issuing these directions is weak as it could not be proved if any actions that took place which violated SEBI (PFUTP) Regulations. It is, therefore, SEBI's basis for passing directions and not the directions in themselves, which set a bad precedent.

Liberalizing Angel Finance in India: A Regulatory Appraisal

By – *Rashmi Birmole* (III Year – ILS Law College, Pune University)

Introduction

In the early 1900s, the term 'angel investor' was first used to refer to the wealthy patrons who financed the Broadway musical theatre in New York. Over the course of time, the term has evolved to refer to high net worth individuals with established business acumen, who provide early stage, high-risk capital for start-up enterprises. An angel fund is a form of private equity that pools funds and resources from angel investors in order to invest in new idea enterprises and are often among the first external capital providers. In a country that has been touted as a new entrepreneurship powerhouse and the next "Asian miracle", it is reasonable to say that angel finance has carved out its own niche in the evolving start-up ecosystem in India.

Angel Finance- as a Seed Stage Investment

The significance of angel finance becomes pronounced when understood in terms of the hurdles faced by early stage enterprises in accessing debt instruments and traditional banking facilities, on account of the latter's reliance on adequate collateral and an established business model as a measure of creditworthiness. While accessing early stage finance from banks and institutional investors might seem like a herculean task to most start-up enterprises, the process becomes comparatively easier in the growth stage. It is during this transitional period that angel investors step in to address the financing gap and perceived market failure. Angel investors also strategically guide and play a crucial role in scaling up the business to make way for institutional investors and venture capital funds that typically look for a proven business model and adequate credibility prior to investment.

REGULATORY FRAMEWORK - AN OVERVIEW

Angel Funds are elaborately dealt with and are defined as a sub-category of Venture Capital Funds under the collective umbrella of Category-I Alternative Investment Funds in India. An Angel Fund raises funds by issue of units from angel investors and invests sizeable amounts of it in small businesses and entrepreneurs, enabling access to early stage finance. Owing to the high-risk nature of the investment, start-up enterprises, interested angel investors and the angel funds have to adhere to certain regulations to ensure adequate safeguards against misuse and money-laundering practices, while encouraging the entrepreneurial ecosystem in India.

RECENT DEVELOPMENTS

In light of the rapid growth of start-ups and early stage ventures in India, the Securities and Exchange Board of India ("**SEBI**"), the primary capital markets regulator, effectuated certain amendments in the SEBI (Alternative Investment Funds) (Amendment) Regulations vide Notification dated 1st June, 2018 in a bid to incentivize seed stage investment and relax norms surrounding the operation of Angel Funds in India. An attempt has been made to assess the existing regulatory and policy landscape surrounding Angel finance by highlighting the key developments brought about by the said amendment and subsequent notifications below:

a. Expanded Definition of Startups

The Department for Promotion of Industry and Internal Trade ("**DPIIT**"), exercising its authority under Regulation 19F (1)(a), expanded the definition of a start-up to realign it with its "Start-up Policy", by way of a notification dated 19th February, 2019 to mean an entity working towards innovation and development with a scalable business model, with an annual turnover not exceeding one hundred crore rupees. This was increased from the earlier twenty-five crore rupees. In addition to fulfilling these requirements, an entity can be classified as a start-up for up to a period of ten years from the date of incorporation as opposed to the earlier five. The relaxation of norms for an entity to be eligible to receive angel funding was a welcome move to facilitate easier access to capital and increased liquidity in markets.

b. Minimum Corpus Fund

In an endeavour to ease the norms surrounding the registration and operation of Angel funds in India, the SEBI has reduced the minimum corpus fund requirement from ten crore rupees to five crore rupees.

c. Maximum Investment

The maximum amount that can be invested by an Angel Fund by way of paid-up share capital, in a venture capital undertaking or start-up was increased by the DPIIT notification to twenty-five crore from the previous ten crore rupees, and the maximum period of accepting investments from angel investors was increased to five years from the previous three years. This will provide angel funds with appropriate time to identify other opportunities and invest in other start-ups with latent potential.

d. Disclosure Requirements

Angel Funds, under the recent amendments, are required to file term sheets outlining material information and changes prior to launching a scheme. By way of a circular released by the SEBI dated 29th June, 2018 (CIR/IMD/DF1/102/2018), the Board has clarified that the said term sheet is to be filed within ten days of launching a scheme and should contain adequate disclosure of the investment, the investee, compliance with SEBI regulations, and material changes from the last filed term sheet, if any. This has done away with the review of the scheme memorandum by the SEBI, as was the earlier prerequisite, making the filing of term sheet a comparatively objective process.

THE ANGEL TAX EXEMPTION

The DPIIT, by way of its notification dated 19th February, 2019 exempted start-ups from the applicability of S. 56(2)(viib) of the Income Tax Act, in what seems like a long-overdue relief for start-ups in India. Commonly referred to as the 'angel tax' due to its implications on angel finance, S. 56(2)(viib) deemed the amount raised by a start-up by the issuance of shares higher than its fair market value as "income from other sources" taxable at a rate of about 30.9%. This severely impacted angel finance in India at a stage where shares are issued as a premium for the idea and valuations are based on projected earnings and discounted cash flows. Up to 73% of the start-ups that received initial angel funding were slapped with tax notices from the Income Tax Department, stifling seed-stage investments to a considerable extent. Under the current notification, start-ups that are recognised by the DPIIT, with an aggregate amount of share capital not exceeding twenty-five crore rupees are exempted from the provisions of S. 56(2)(viib) provided that they have not invested in immovable property, shares, and securities, motor vehicles, among other asset classes. The exemption was further confirmed by the Central Government by way of a notification released by the Central Board of Direct Taxes dated 5th March 2019.

CONCLUSION

The recently orchestrated changes in the regulatory regime surrounding angel finance in India have marked a progressive step towards encouraging early stage investments in start-ups which form an integral part of the Indian economy. The relaxation of investment norms and modified tax structures seek to provide a conducive regulatory environment and necessary leeway to enable Indian start-ups to contribute to the growth of Indian economy without being held down by restrictive laws and bureaucratic procedures. Although the question of red-tapeism in identifying eligible start-ups still remains unanswered, the multiple benefits of the newly adopted liberalized policy cannot be disputed.

ENHANCEMENT IN THE REGULATIONS FOR CREDIT RATING AGENCIES

By – *Rupal Gupta* (III Year – Amity Law School Delhi, Affiliated to GGSIPU)

The Reserve Bank of India on June 13, 2019 took out a circular prescribing new guidelines for enhanced disclosure of Credit Rating Agencies. The following enhancements have been made:

- Probability of Default (PD) benchmarks

i. The Credit Rating Agencies in deliberation with the regulator will prepare and disclose standardized and uniform PD benchmarks for each category of rating, for one-year, two-year and three-year cumulative default rates, both for the short run and long run.

ii. The PD benchmark for AAA papers shall be zero for one, two- and three-year default rates with a tolerance level of 1 percent. In the case of AA papers, it will be zero for one- and two-year default rates with a tolerance level of 2%. For A-rated papers, it will be zero for a one-year default rate with a tolerance level of 3%.

- Calculation of Cumulative Default Rates (CDR)

i. The CDR will be calculated as per the issuer using the marginal default rate approach, using monthly static pools.

ii. The disclosures shall be made on a consolidated basis for all financial instruments rated by a Credit Rating Agency. Moreover, the historical data on the default rates disclosed every year for the preceding ten years shall be archived and made available on the website of each Credit Rating Agency.

- Standard Operating Procedure (SOP)

i. In order to achieve a consistent and uniform approach, Credit Rating Agencies, in consultation and deliberation with SEBI, shall frame a uniform SOP in respect of tracking and timely recognition of default, which shall be uploaded on the website of each Credit Rating Agency.

- Assigning of Rating Symbol for Instruments having explicit Credit Enhancement (CE) feature

i. Credit Rating Agencies will now attach the suffix CE to ratings of instruments having an explicit credit enhancement feature.

ii. CRAs shall upload new rating symbols and definitions on their websites.

iii. Disclosing of unsupported and supported ratings.

iv. The Credit Rating Agencies shall design a model to assess the adequacy of a credit enhancement structure under various scenarios including stress scenarios.

- Disclosure in Press Releases of Rating Sensitivities.

i. To improve transparency, the disclosure of factors, which the rating is sensitive to, is essential for the final users to understand the factors that would have the potential to impact the creditworthiness of the entity.

- Tracking of Deviation in Bond Spreads

i. The Credit Rating Agencies may treat sharp deviations in bond spreads of debt instruments with respect to relevant benchmark yield as a material event while reviewing material events.

- Liquidity Indicators' Disclosure

i. The CRAs can use the following indicators: Strong/ Superior, Adequate, Stretched and Poor along with an explanation for the same.

These new regulations will help in making the functioning of these Credit Rating Agencies more investor-friendly by paving a way for a more transparent, just, efficient and systematic credit rating in the country.

Cyber Security & Cyber Resilience Framework

By – *Aman Kumar Yadav* & *Arjun Chakladar* (II Year – National Law Institute University, Bhopal)

To combat privacy breaches and protect the integrity of data, Securities and Exchange Board of India (SEBI) in the exercise of powers conferred under Section 11 (1) of the Securities and Exchange Board of India Act, 1992 ('The Act') issued two circulars dealing with cybersecurity.

The first circular issued on December 3, 2018, focused on maintaining impenetrable Cyber Security & Cyber Resilience framework for Stock Brokers /Depository Participants ('SB/DP') while the second one issued in January 2019 was to establish a framework which protects data and guard any breaches of privacy exclusively with respect to Mutual Funds/ Asset Management Companies (AMC's). This article is concerned with the second.

Certain mandatory and provisional guidelines have been established in order to safeguard cybersecurity in the second circular. It further establishes the requirement of measures, tools and processes to improve cyber resilience and formulate a cybersecurity framework.

Both these circulars work to incubate and implement a well-framed policy. Accordingly, SEBI shall constitute a technical committee comprising experts that shall review the policy on a half-yearly basis. Improvement of the mechanism for better communication and a better split of responsibilities should be encouraged. The guidelines prescribed under governance are namely, the identification of critical IT assets and the cybersecurity risks related to the assets, the protection of assets by using various methods, tools and controls suitable, the detection of any incidents, anomalies or cyber-attacks through the monitoring of processes and tools.

To protect data from unauthorized access, numerous steps have been directed for several institutions, including stockbrokers or Mutual Funds/AMC's, in order to ensure protection against any risks or liabilities faced over the course of their business.

It is recommended that policies be conceptualized with the purpose of overseeing and regulating the utilization of web and internet based activities. Personnel with authorized access to a critical system, networks, and other resources should be under strict supervision.

In furtherance to the policy governing access control, any highly sensitive and essential systems are to have material as well as physical access minimized, and overseen when required. Furthermore, people leaving the organization should be stripped of their access privileges. With regard to the issue of access control, no person should have absolute access to confidential or integral information, irrespective of the rank or power of the individual.

In terms of network security management, it is advised to create fundamental standards in order to ensure that the application of security configurations are constant and uniform. Maintenance of the foundation standards for other devices such as operating systems network devices, or any mobile network devices within the surrounding IT environment must happen regularly. Adequate security measures are to be taken to facilitate algorithmic trading facilities, installation of network security devices including the likes of firewalls and proxy servers, etc. Additional measures are required to address the problem of malware and ransom attacks.

The next guideline deals with identification. All mutual funds/ AMC's are to identify critical assets which are prone to cyber-attacks and require cyber resilience in an order of priority, as well as the identification of cyber threats. Likewise, the guidelines prescribe that all third-party providers, such as distributors, custodians, and brokers, are to have consistent and uniform standards of information security.

In terms of data security, it is advisable that unauthorized access to data which is held in a fiduciary capacity must be prevented and identification and encryption of critical data should be prioritized. Moreover, only permitted data storage devices should be deployed in their IT infrastructure, that too after fulfilling all the procedural requirements.

SEBI suggests that only hardened hardware and software should be deployed on all systems, as well as the appropriate functions of open ports on networks. The system's functioning should be prevented from being exploited through blocking and creating barriers. Herein highlighting some basic requirements of building cyber resilience as prescribed by the governing bodies that need to be fulfilled include:

1. Providing application security to the customer-facing applications offered over the internet including the likes of IBTs (Internet Based Trading applications);
2. Ensuring that products which are primarily off the shelf which are to be used for core business functionality should contain the Indian Common criteria certification of Evaluation Assurance Level 4. This certificate is provided by the Ministry of Electronics and Information Technology in the form of the Standardization Testing and Quality Certification (STQC). Technologies which are developed for custom usage or any in-house software and components are exempt from this but have to undergo rigorous testing, etc.
3. Establishing the patch management system, which includes acquiring, testing, and installing code changes and ensuring that it includes procedures like identification, categorization, etc. It is to be made sure that these patches are implemented in a time-sensitive manner while being subjected to rigorous testing.

A special focus has been given to data retention and suitable storage media devices. It is suggested that the removal of any highly sensitive data on such systems and devices should be conducted by methods such as crypto shredding/degaussing or physical/material destruction. As a fail-safe measure, accounts shall be locked after multiple failed attempts are made. In the event of any employees leaving the organization, a proper 'end of life' mechanism is required to be implemented immediately revoking past privileges, namely access of any prior employees.

Regular security assessments are required to check the exposure and vulnerability of the system and required actions are to be taken in case of threat to the system, as well as the need for regular updating of security measures, such as firewalls followed by yearly based examinations of the network security devices.

The cybersecurity team should have appropriate plans to carry out restoration and recovery operations in a time-bound manner to not affect the working of any system. There has been emphasis laid on the restriction of any physical security, the next guideline being that if any redundancy is present in physical access to systems, it is to be immediately revoked. Additionally, the AMC should certify that the surrounding perimeter of the critical systems is monitored physically by using human, procedural and physical controls where appropriate.

Any further sharing of information about cybersecurity breaches is to be regulated by SEBI and sharing of all useful information must be done in an anonymous and masked manner. Mandatory training programs are to be implemented in order to increase awareness among employees and staff as well as build skills and review matter and remain updated on all events. There ought to be periodic auditing and submission of reports at premeditated intervals along with an assessment of systems by independent CISA (Certified Information Systems Auditor) / CISM's (Certified Information Security Manager) qualified auditors.

These guidelines have been established by SEBI to safeguard and mitigate any cybersecurity threats or risks pertinent to Mutual Funds/AMC's.

SECURITIES UPDATES

MARCH

08.03.2019

SEBI/HO/IMD/DF2/CIR/P/2019/34

Securities and Exchange Board had issued a circular vide which dealt with Filing of Advertisements under SEBI (Mutual Funds) Regulations, 1996. The circular states that in continuation to the various Go Green initiatives in Mutual Funds, the Mutual Funds are now advised to submit links to access the advertisements to be filed under the MF Regulations by sending the same through e-mail to SEBI.

However, advertisement materials like pamphlets may be submitted as an attachment along with e-mail, if the size of the attachment does not exceed 250 KB.

12.03.2019

SEBI/HO/CFD/CMD1/CIR/P/2019/36

Securities and Exchange Board had issued a circular vide which dealt with Modification of circular dated December 7, 2018 on Disclosure of significant beneficial ownership in the shareholding pattern. The same circular is issued because the earlier circular was based on the Companies (Significant Beneficial Owners) Rules, 2018 but after the issuance of circular the rules were amended. In the view of amendments to the rules Circular No. SEBI/HO/CFD/CMD1/CIR/P/2018/00000 00149 dated December 7, 2018 shall stand modified to the extent as specified in the circular.

IMD/FPIC/CIR/P/2019/37

SEBI had issued a circular vide which was about the review of Investment by Foreign Portfolio Investors (FPI) in Debt Securities. SEBI and RBI, after mutual consultations, issued a Circular reviewing the requirements w.r.t investment by FPI in Debt securities. Both the circulars had, inter-alia, mandated that no FPI shall have an exposure of more than 20% of its corporate bond portfolio to a single corporate. Now, in order to encourage a wider spectrum of investors to access the Indian corporate debt market, RBI has withdrawn with immediate effect the above provision w.r.t. exposure of more than 20% of FPI's corporate bond portfolio to a single corporate. To give effect to the same in SEBI Circular dated June 15, 2018, the said provision in SEBI Circular dated June 15, 2018, stands withdrawn with immediate effect. Further, in accordance with Regulation 21(5) of SEBI (FPI) Regulations, 2014, in respect of investments in debt securities, the FPI shall also comply with the terms, conditions or directions, specified or issued by the Board or RBI from time to time, in addition to other conditions specified in these regulations.

13.03.2019
SEBI/HO/CFD/DCR2/CIR/P/2019/35

SEBI had issued a circular vide about SEBI (Delisting of Equity Shares) Regulations, 2015 – "Timelines for Counter Offer Process". SEBI (Delisting of Equity Shares) Regulations, 2015 has been amended to allow promoter(s)/acquirer(s) to make "Counter offer", in case price discovered through reverse book building is not acceptable to the promoter(s)/ acquirer(s).

15.03.2019
CIR/HO/MIRSD/DOS2/CIR/PB/2019/038

SEBI vide Circular No. SEBI/HO/MIRSD/CIR/PB/2018/147 dated December 03, 2018, has issued compliance norms for Cyber Security & Cyber Resilience framework for Stock Brokers / Depository Participants. Subsequently, SEBI has received representations from the stockbrokers with respect to para 7 of Annexure-1 to the aforesaid circular. Accordingly, it is clarified that in Para 7, the words "Internal Technology Committee" stands replaced as "Technology Committee".

The Stock Exchanges/Depositories are directed to bring the contents of this circular to the notice of the Stock Brokers/Depository Participants and also disseminate the same on their websites.

18.03.2019
SEBI/HO/MRD/DRMNP/CIR/P/2019/39

The circular was issued in exercise of powers conferred under Section 11 (1) of the Securities and Exchange Board of India Act, 1992, to protect the interests of investors in securities and to promote the development of, and to regulate the securities market. By SEBI circular IMD/HO/FPIC/CIR/P/2017/003 dated January 04, 2017, the Guidelines for participation/functioning of Eligible Foreign Investors (EFIs) and Foreign Portfolio Investors (FPIs) in International Financial Services Centre (IFSC) were issued. This circular provided clarifications on the participation of Eligible Foreign

Investors (EFIs) in Commodity Derivatives in IFSC.

20.03.2019
SEBI/HO/CDMRD/DMP/CIR/P/2019/40

SEBI released the framework for the utilization of regulatory fee foregone by SEBI. With a view to encouraging the participation by Farmers/Farmer Producer Organizations (FPOs) in agricultural commodity derivatives markets, SEBI has reduced the regulatory fee on Stock Exchanges with respect to turnover in agricultural commodity derivatives. The objective was to reduce the cost burden on farmers/FPOs from the amount saved by the Exchanges due to the reduction of regulatory fee.

22.03.2019
SEBI/HO/IMD/DF4/CIR/P/2019/41

In this circular, SEBI released the guidelines for the valuation of money market and debt securities in order to make the existing valuation practices for aforesaid securities more reflective of the realizable value. SEBI replaced circulars IMD/CIR No.16/ 193388/2010 dated February 02, 2010 read with Cir/IMD/DF/6/2012 dated February 28, 2012, which permit amortization based valuation of non-traded money market and debt securities, including floating rate securities, with residual maturity of up to 60 days. With this circular, the 60 days' period has been reduced to 30 days.

26.03.2019
SEBI/HO/MRD/DMS1/CIR/P/2019/43

SEBI vide circular CIR/MRD/DMS/12/2012 dated April 13, 2012, and CIR/MRD/DMS/17/2012 dated June 22, 2012 prescribed framework for Business Continuity Plan (BCP) and Disaster Recovery Site (DRS) for stock exchanges and depositories. With the advancement in technology and improved automation of processes in terms of transitioning time, wherein the operations can be moved from the Primary Data Centre (PDC) to the DRS, it was felt that the extant framework needs to be re-examined. Considering the fact that clearing corporations are systemically important infrastructure institutions, it has been decided that framework on BCP and DR shall also be made applicable to all the clearing corporations

29.03.2019
CIR/CFD/CMD1/44/2019

In this circular, SEBI laid down the Procedure and formats for limited review/audit report of the listed entity and those entities whose accounts are to be consolidated with the listed entity.

APRIL

02.04.2019
SEBI/HO/RRD/RD1/CIR/P/2019/46

SEBI issued a circular regarding the empanelment of Insolvency Professionals (IPs) to be appointed as Administrator, their remuneration and other incidental and connected matters under the Securities and Exchange Board of India (Appointment of Administrator and Procedure for Refunding to the Investors) Regulations, 2018. These regulations which were notified in the official gazette in October 2018, provide, *inter alia*, for the appointment of an Administrator and procedure for refund to the investors.

03.04.2019
SEBI/HO/CFD/DIL2/CIR/P/2019/50

SEBI issued a circular related to its previous circular wherein it had introduced the use of Unified Payments Interface (UPI) as a payment mechanism with Application Supported by Block Amount (ASBA) for applications in public issues by retail individual investors through intermediaries. Now, based on the representations received from the various market intermediaries like Self Certified Syndicate Banks (SCSBs), National Payments Corporation of India (NPCI) and the Association of Investment Bankers of India (AIBI), SEBI in order to ensure that the transition to UPI in ASBA is smooth for all the stakeholders, has decided to extend the timeline for implementation of Phase I of the aforesaid circular by 3 months i.e. till June 30, 2019.

04.04.2019
CIR/LAD/1/2019

SEBI issued a circular explaining the procedure to be followed for issuance of certified copies of orders and circulars based on requests for certified copies of orders passed by the Board, Adjudicating Officers or Recovery Officers or circulars issued by the departments of the Board.

10.04.2019
MRD/DoP2DSA2/CIR/P/2019/51

SEBI issued a circular in furtherance of its previous circulars CIR/MRD/DP/22/2012 dated August 27, 2012, and CIR/MRD/DP/20/2015 dated December 11, 2015 which had introduced the facility of “Basic Services Demat Account” (BSDA) with limited services for eligible individuals. Now, in order to further boost participation in Debt Market and based on the representation received from market participants, in partial modification of the abovementioned SEBI circulars, SEBI has decided to revise the structure of charges for debt securities as defined in SEBI (Issue and Listing of Debt Securities) Regulations, 2008. The depositories are advised to make amendments to the relevant bye-laws, rules, and regulations for the implementation of the above decision as may be applicable/necessary.

SEBI/HO/MRD/DRMNP/CIR/P/2019/55

SEBI issued a circular in which it clarified that in order to ensure that the net worth of a CCP adequately captures the risks faced by it, SEBI vide Regulation 14(3) of SECC Regulations, 2018 has adopted a risk-based approach towards computation of capital and net worth requirements for CCPs. The SEBI in consultation with the recognized Clearing Corporations has decided to issue granular norms related to computation of risk-based capital and net worth requirements for CCPs.

11.04.2019
SEBI/HO/IMD/DF2/CIR/P/2019/57

SEBI came out with revised guidelines for system audit to be conducted by mutual funds and asset management companies (AMCs). The guidelines come after "considering the importance of system audit in technology-driven asset management activity and to enhance and standardize the system audit". AMCs have also been directed to set up a technological committee for reviewing cyber resistance and cyber resilience framework.

SEBI/HO/IMD/DF2/CIR/P/2019/058

To deal with various technology-related issues, which have arisen as a result of rapid technological advancement in the securities market, AMCs are advised to constitute a Technology Committee comprising experts proficient in technology. Such committee shall have at least one independent external expert with adequate experience in the area of technology in Mutual Fund industry / BFSI and the Committee shall review the cybersecurity and cyber resilience framework for Mutual Funds / AMCs in terms of SEBI/HO/IMD/DF2/CIR/P/2019/12.

23.04.2019
SEBI/HO/DDHS/DDHS/CIR/P/2019/59

SEBI amended SEBI (Infrastructure Investment Trusts) Regulations, 2014 and SEBI (Real Estate Investment Trusts) Regulations, 2014. The amendments have reduced the minimum subscription requirement for InvITs and REITs and have defined the trading lots in terms of the number of units. The limits for aggregate consolidated borrowings and deferred payments, net of cash and cash equivalents, have increased to 70% of the value of InvIT assets.

26.03.2019
SEBI/HO/MRD/DRMNP/CIR/P/2019/60

SEBI has prescribed that all recognized clearing corporations in IFSC have to maintain Rs 50 crore net worth in the form of liquid assets on commencement of operations. Every such clearing corporation will raise over a period of three years from the commencement of operations, its net worth, to be maintained in the form of liquid assets, to a minimum of Rs 100 crore or capital as determined in accordance with the SEBI circular dated April 10.

MAY

08.05.2019
IMD/FPIC/CIR/P/2019/62

RBI vide A.P. (DIR Series) Circular No. 33 dated April 25, 2019 has permitted FPIs to invest in Municipal bonds. SEBI in accordance with the provisions of Regulation 21(1)(p) of SEBI (Foreign Portfolio Investors) Regulations, 2014 has permitted FPI to invest in Municipal bonds.

09.03.2019
SEBI/HO/IMD/DF5/CIR/P/2019/63

SEBI had decided to conduct a survey of AI (Artificial Intelligence) and ML (Machine Learning) applications and systems offered and used by Mutual Funds. This was done in order to ensure preparedness for any AI/ML policies that may arise in the future. Any applications and systems that are offered to investors, or used internally by Mutual Funds to facilitate investing and trading, fall under the scope of the circular. In addition to this, applications and systems used to disseminate investments strategies and advice, and to carry out compliance/operations/activities too fall under the ambit. Mutual Funds using AI/ML are required to make submissions with effect from the quarter ending June 2019.

20.05.2019
SEBI/MRD/CSC/CIR/P/2019/64

To promote innovations in the securities market, SEBI has proposed the framework for Innovation Sandbox, which would be a testing environment where FinTech firms and entities not regulated by SEBI including individuals may use the environment for offline testing of their proposed solutions from the live market, subject to fulfilment of the eligibility criteria, based on market-related data made available by Stock Exchanges, Depositories and Qualified Registrar and

Share Transfer Agents (QRTAs). Indicative datasets which may become part of innovation Sandbox are (i) Depositories data, (ii) Stock Exchange Data, (iii) RTA Data.

21.05.2019
SEBI/HO/IMD/DF2/CIR/P/2019/65

SEBI has permitted mutual funds to participate in Exchange Traded Commodity Derivative (ETCDs), in furtherance to promote institutional participation in ETCDs, and are subject to some conditions listed out in the abovementioned circular. The participation of the mutual funds in ETCDs shall be subject to investment limits listed in the circular.

22.05.2019
SEBI/HO/IMD/DF1/CIR/P/2019/066

SEBI has permitted Portfolio Managers to participate in Exchange Traded Commodity Derivatives (ETCDs) and has made it mandatory for Portfolio Managers to appoint SEBI registered Custodian dealing in ETCDs. Few conditions have been listed out in the circular to which the participation of portfolio managers in ETCDs would be subjected to. The copy of Securities and Exchange Board of India (Portfolio Managers) (Amendment) Regulations, 2019, dated May 10th, 2019 was also enclosed, which had made an amendment to SEBI (Portfolio Managers) Regulations, 1993.

SEBI/HO/CFD/DIL2/CIR/P/2019/67

The circular dealt with the Frameworks for the process of accreditation of investors for the purpose of Innovators Growth Platform (IGP). Any individual with a gross income of 50L annually and has who has a minimum liquid net worth of 5 Crore, or any body-corporate with a net worth of 25 Crore shall be eligible to be considered as an Accredited Investor. The validity of accretion shall be for a period of 3 years from the date of issue of accreditation. At the time of application by a Company for listing on IGP, the merchant bankers shall ensure due diligence with regard to the eligibility of AIs and their Company desirous on listing on IGP is in accordance with the Regulation 283(1) of the ICDR Regulations.

27.03.2019
SEBI/ HO/ MIRSD/ DOS3/CIR/P/2019/68

Guidelines were issued for the enhanced disclosure in the case of listed debt securities. These included guidelines on Disclosure of compensation arrangement with clients by DTs (Debenture Trustees) on their websites; Calendar of interest/ redemptions, due and paid, to be displayed on the website of DT(s) for the financial year; Furnishing of updated list of debenture holders to the DTs by Issuers/ Registrars to an Issue and Share Transfer Agent (RTA); Additional covenants in case of privately placed issues.

28.05.2019
SEBI/HO/MIRSD/DOP/CIR/P/2019/69

The SEBI issued this circular in relation to the implementation of a section 51A of the UAPA,1967. In view of the reorganization of Divisions in the Ministry of Home Affairs and allocation of work relating to countering of terror financing to the Counter-Terrorism and Counter Radicalisation (CTCR) Division, the Government has modified the earlier order dated August 27, 2009, by the order dated March 14, 2019, for strict compliance.

JUNE

13.06.2019
SEBI/HO/MIRSD/DOS3/CIR/P/2019/70

Securities and Exchange Board had issued a circular vide which dealt with guidelines to Credit Rating Agencies and Debenture Trustees registered with SEBI to enhance their disclosures. The fist guideline is regarding computation of Cumulative Default Rate and Probability of Default benchmark for CRA. CRAs shall now affix the suffix CE (Credit enhancement) for rating of instruments with explicit credit enhancement. Annexure B of the circular will be used for ratings or reviews by the CRAs. Press releases are to have a specific section – "Rating sensitivities" which shall explain the broad level of operating and / or financial performance levels. CRAs shall also have to disclose the liquidity indicator using – Superior, adequate, stretched, poor.

18.06.2019
SEBI/HO/CDMRD/DNPMP/CIR/P/2019/71

Securities and Exchange Board had issued a circular vide which dealt with the design of commodity indices and product design for Futures on Commodity Indices by the Commodity Derivatives Advisory Committee (CDAC) of the SEBI. It has been decided to permit recognized stock exchanges with commodity derivative segment to introduce futures on commodity indices. Exchanges will have to submit prior 3 years' data of the index constructed along with the data on monthly volatility, rollover yield for the month and monthly return while seeking approval from the SEBI. Such data shall have to be published on approval.

SEBI/HO/EFD2/CSD/CIR/P/2019/0000000072

Securities and Exchange Board had issued a circular vide which dealt with assuring confidentiality in a settlement application filed under Chapter IX of the SEBI (Settlement Proceedings) Regulations, 2018. The assurance of confidentiality will be on the basis of the nature of assistance provided and the stage of providing such assistance, voluntary or on the basis of terms of the contract and as enumerated in the circular.

20.06.2019

CIR/HO/MIRSD/DOP/CIR/P/2019/75

Securities and Exchange Board had issued a circular vide which dealt with the handling of client's securities by trading members/clearing members. It mentions the previous statutes enacted that deal with the same and also summarises the various circulars issued by it in this regard. It provides clarity with respect to TM/CM maintaining a running account for client services. The circular has to be referred for understanding how the Demat Account for the purpose has to be maintained.

SEBI/HO/CDMRD/DRMP/CIR/P/2019/73

Through a previous notification, SEBI had prescribed the mechanism for levying penalties on short collection or non-collection of margins and that such penalties would be credited to the Investor Protection Fund of the Exchange. But some were crediting the same to the core SGF. To ensure uniformity this circular has been issued. To resolve this disparity and to ensure uniformity, the circular modifies its previous circular dated September 07, 2016 and therefore all penalties levied on short collection or non-collection of margins prescribed, should be credited to the core SGF only. The date of start of clearing function for commodity market would be kept as the beginning date for the IPF trust to transfer the collected penalties with respect to commodity derivative segment.

28.06.2019

SEBI/HO/CFD/DIL2/CIR/P/2019/76

Securities and Exchange Board had issued a circular, dated November 1, 2018, vide which was regarding the implementation of UPI with application supported by Block Amount. It was to go on in a three-phase manner and Phase II would begin from July 1st 2019. According to this, the applications by retail individual investors through intermediaries, the existing process of, investor submitting bid-cum-application form with any intermediary along with bank account details and movement of such application forms from intermediaries to Self-Centred Syndicate banks (SCSBs) for blocking of fund would be discontinued pursuant to channel III at para 5.1 of the same circular. The T= 6 days' timeline would continue. In addition to this, application through UPI in IPOs can be made only through the SCBS / mobile applications whose name appears on the SEBI website.