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Insight

Analysis of Recent Developments in Indian Corporate Law

Foreword

Welcome to this issue of *Insight*.

In this issue of *Insight,* as the lead article, we have considered the Securities and Exchange Board of India's proposals on the regulatory framework for algorithmic trading and co-location. We have also covered the Reserve Bank of India's recent "Guidelines for 'on tap' Licensing of Universal Banks in the Private Sector" which contemplates the grant of bank licenses on a continuous basis.

Apart from the above, this issue of *Insight* also captures developments in relation to the various notifications and orders issued by the Ministry of Corporate Affairs in relation to the Companies Act, 2013 as well as circulars and notifications issued by the Reserve Bank of India and the Securities and Exchange Board of India in relation to foreign investment into India and securities laws respectively.

Any feedback and suggestions would be valuable in our pursuit to constantly improve *Insight* and ensure its continued success amongst readers. Please feel free to send any feedback, suggestions or comments to insight@cyrilshroff.com.

Regards,
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REGULATING FLASH BOYS – SEBI DISCUSSION PAPER ON ALGORITHMIC TRADING

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In the recent past, algorithmic trading and high frequency trading i.e. trading done using computer programs/algorithms, has been the subject matter of introspection by securities market regulators worldwide. In order to provide fair and equitable access to the stock exchanges to all categories of investors, the Securities Exchange Board of India ("**SEBI**") on August 5, 2016 issued a discussion paper with a proposal to overhaul the regulatory framework for algorithmic trading and co-location ("**Discussion Paper**"). This issue of *Insight* seeks to analyze the various proposals set out by SEBI in the Discussion Paper and its implications.

Background

Algorithmic trading is, in essence, automated trading wherein trading actions are undertaken by computers based on pre-set rules and strategies. High Frequency Trading, which is a subset of algorithmic trading, uses high speed networks to connect and trade on the trading platform. High speed networks reduce latency and this latency-sensitive technology enables the High Frequency Traders ("**HFTs**") to execute thousands of orders on the stock exchange in less than a second which gives them an edge over the other conventional traders. Further, co-located servers, which are trading units placed very close to the stock exchanges or within the exchanges reduce the time taken for the information to reach the traders, act as a vehicle for the HFTs to capture the trading opportunities. Put simply, HFTs capitalize on the speed at which the instructions reach the exchange on which the stocks are traded on account of faster networks/proximity to the exchange.

Off late, it has been seen that resourceful High Frequency Trading firms which have the means to procure latency-sensitive technology have entered a race to exploit such technology. Moreover, these firms try and place their trading units as close to the exchange as possible thereby minimising the time taken for information to reach traders. Such use of technology and co-location methods by some firms have raised concerns for regulators over the unfair access and inequity to the non-co-located/non-HFT participants who cannot afford such technology and some egregious examples of violations resulting in 'flash crashes' (crashes caused by indiscriminate buy/sell instructions) and front-running caused by algorithms have been the subject matter of books such as Michael Lewis' 2014 book '*Flash Boys*'.

While the existing framework on algorithmic trading and co-location consists of 3 sets of guidelines issued by the SEBI on the recommendation of the Technical Advisory Committee ("**TAC**") dated March 30, 2012, May 21, 2013 and May 13, 2015 ("**Existing Regulations**"), certain allegations were reported in June 2016 regarding a certain exchange providing unfair access to certain traders who were co-located to the exchange. In September 2016, the SEBI had asked the board of the exchange to initiate an independent examination (including forensic investigation by an external agency) to highlight all the irregularities and submit a report to the SEBI within 3 months. In this background, the TAC recommended that a framework be established to detect abuse of the system by algorithmic traders. Further, on September 27, 2016 the SEBI through a circular, aimed at consolidating the norms issued by the erstwhile Forward Market Commission on algorithmic trading, set out certain broad guidelines on algorithmic trading for the National Commodity Derivative Exchanges. These guidelines included instructions for carrying on algorithmic trading and disallowed co-location arrangements in these exchanges.

Need for Amendments: In order to ensure fair and equitable access to the stock exchanges to all categories of investors the SEBI in its Discussion Paper has made 7 proposals which can be divided into the following 3 categories:

1. Increase latency period to provide an opportunity to non-HFTs to trade in par with HFTs – this is based on the premise which has been successfully implemented by some exchanges in the US like IEX that if all market participants are forced to operate at the same speed (latency) then all participants would have equal access.

Minimum Resting Time for Orders	Eliminate 'fleeting orders', i.e. orders that appear and then disappear within a short period of time by placing a minimum 500 millisecond gap between receiving and cancelling orders.
Frequent Batch Auctions	Accumulate buy and sell orders on the order book for a particular length of time (say 100 milliseconds) and match them at the end of such period instead of matching them the moment they are received.
Random Speed Bumps or delays in order processing/ matching	Introduction of the speed bump mechanism which will discourage latency sensitive strategies as such delays would affect HFTs but would not deter non-algorithm order flow for which delay in milliseconds is insignificant.
Maximum order-to-trade ratio	This requires a market participant to execute at least 1 trade for a set number of order messages sent to a trading venue. The mechanism is expected to increase the likelihood of a viewed quote being available to trade and reduce hyper-active order book participation.

2. Provide equal access to the trading platform to all categories of traders.

Randomization of orders received during a period (say 1-2 seconds)	Once the orders are received, the queue is randomly revised and the orders are then sent to the order matching engine. This mechanism restricts the advantage of the co-located players derived on the basis of their physical proximity to the trading platform.
Separate queues for co-location orders and non-co-location orders	Separate queues would be maintained for co-location orders and non-co-location orders. Orders from both the queues will be taken up in the order-book in a round-robin fashion. This provides equal access to the market to co-location and non-co-location traders.

3. Achieve information symmetry throughout the market.

Review of Tick-by-Tick data feed ("TBT Data")	At present, the exchanges provide TBT Data feeds to any desirous market participant upon payment of requisite fee. SEBI proposes to provide certain structured data to all the market participants at a prescribed time interval to ensure information symmetry.

On October 20, 2016, it was reported that after receiving feedback from market participants, SEBI was of the opinion that capping the order to trade ratio and reviewing TBT Data would be the easiest to implement at the initial stages.

Conclusion

There are currently no regulations governing algorithmic trading and high frequency trading. The SEBI in its Discussion Paper has proposed measures for regulating this type of trading.

The regulator invited comments on the Discussion Paper from the market participants. Based on the comments received and the ability of the exchanges and market participants to implement the changes, new regulations are expected to be framed. The new regulations would have to balance the requirement for speedy execution of trades in the need for regulating the market and providing equal access.

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RBI GUIDELINES FOR 'ON-TAP' LICENSING OF UNIVERSAL BANKS IN THE PRIVATE SECTOR

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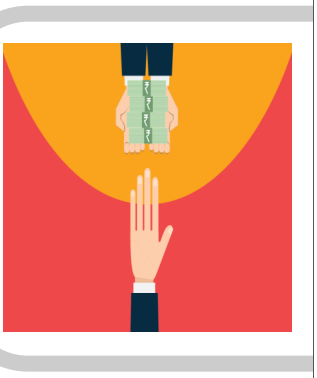
Previously, private sector bank licenses in India were issued on a 'Stop and Go' basis i.e. by way of specific notifications issued intermittently by the Reserve Bank of India ("**RBI**") seeking applications from time to time and a limited number of licenses being issued in each such round. Based on a review of the then existing licensing regime, a case was made *vide* RBI's discussion paper on 'Banking Structures in India – The Way Forward' dated August 27, 2013 for considering a 'continuous authorisation' policy as opposed to the existing policy, on grounds of enhanced competition and the introduction of new ideas into the banking system. Pursuant to the same, the RBI has on August 01, 2016 released the "Guidelines for 'on tap' Licensing of Universal Banks in the Private Sector" ("**Guidelines**") for granting licences for setting up private sector universal banks on a continuous basis, the key terms of which are set out below:

- **Procedure for application**: The Guidelines prescribe a revised procedure for application for a license, as set out below:
  - ✓ The licensing window will now be open '**on-tap**', and applications can now be submitted to the RBI at any point of time.
  - ✓ The applications will be referred to a Standing External Advisory Committee to be set up by the RBI.
  - ✓ The RBI will take decisions to issue an in-principle approval for setting up a bank, which will be valid for 18 months and would thereafter lapse automatically.
  - ✓ The names of the applicants who have applied for and those that are found suitable for grant of in-principle approval will be placed on the RBI's website periodically.
- **Qualification and Compliance Requirements**: The Guidelines also prescribe other requirements which are similar to those applicable to small finance banks including, *inter alia*, the following:
  - ✓ **Eligible Promoters** include the following entities/persons having sound financials, credentials and integrity: (a) Indian owned and controlled NBFCs having a successful track record for at least 10 years. NBFCs from groups having assets of Rs. 50 billion or more are eligible only where the group's non-financial assets/ income is less than 40% of its total assets/income; (b) 'Resident' individuals/ professionals having **10** years of experience in banking and finance at a senior level; and (c) Indian owned and controlled private sector entities/groups having a successful track record for at least 10 years, provided that for an entity/group having total assets of Rs. 50 billion or more, the group's non-financial assets/ income is less than 40% of its total assets/income.



- ✓ The promoters/ promoting entities are required to set up a bank only through a Non -Operative Financial Holding Company ("**NOFHC**"), which should be owned (more than 51% stake) and controlled (significant influence) by the promoters. Specialised activities may be carried out through a separate entity under the NOFHC, with prior RBI approval.

- ✓ The initial **minimum paid-up voting equity capital** for a bank shall be Rs. 5 billion. Thereafter, the bank's minimum net worth shall be Rs. 5 billion at all times. The promoter/s and the promoter group/NOFHC, as the case may be, shall hold a minimum of 40% of the bank's paid-up voting equity capital which shall be locked-in for 5 years from the commencement of the bank's business. Such shareholding shall be brought down to 15% within 15 years from the commencement of the bank's business.

- ✓ The **foreign shareholding** in the bank shall be as per limits under the extant FDI policy (currently, 74%) subject to minimum promoter shareholding requirement as set out above.

- ✓ The bank shall comply with provisions of the Banking Regulation Act, 1949 and prudential norms applicable to scheduled commercial banks and the extant exposure norms shall apply i.e. banks are precluded from having any exposure to its promoters, their relatives/entities where the promoters have significant influence/ control or major shareholders holding 10% or more of the paid-up equity shares of the bank.

- ✓ The bank shall submit a realistic and viable **business plan** setting out its proposal to achieve financial inclusion.

- ✓ Shares of the bank shall be **mandatorily listed** on the stock exchanges within 6 years of commencement of the bank's business.

- ✓ The bank shall open at least 25% of its branches in **unbanked rural centres** and comply with priority sector lending targets and sub-targets, as applicable.

- ✓ The board of the bank shall have a majority of **independent directors**.

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COMPANY LAW UPDATE

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Ministry of Corporate Affairs ("**MCA**") notifies provision in relation to Special Courts under the Companies Act, 2013 ("**2013 Act**")

- ➢ MCA has notified provisions in respect of Special Courts for trial of offences punishable under the 2013 Act with imprisonment of 2 years or more in terms of Section 435 of the 2013 Act (*Establishment of Special Courts*).

- ➢ Accordingly, Sections 2(29)(iv) (*definition of Courts to include Special Courts*), Sections 435 (*Establishment of Special Courts*), 436 (*Offences triable by Special Courts*), 437 (*Appeal and Revision*), 438 (*Application of the Code of Criminal Procedure, 1973 to proceedings before Special Courts*) and 440 (*Transitional provision until a Special Court is established*) stand notified with effect from May 18, 2016.

- MCA has designated Special Courts for the state of Jammu & Kashmir, Maharashtra, Goa, Gujarat, Madhya Pradesh, West Bengal, Union Territories of Dadra and Nagar Haveli, Daman and Diu, and Andaman and Nicobar Islands.

(MCA Notifications No. S.O. 1795(E) and S.O. 1796(E) published in the Gazette on May 18, 2016)

MCA notifies the Companies (Share Capital and Debentures) Third Amendment Rules, 2016

MCA has published amendments to the Companies (Share Capital and Debentures) Rules, 2014, which *inter alia*, includes the following:

- Insertion of proviso to Rule 4(1)(g) to allow companies which have committed defaults in, *inter alia,* payment of dividends on preference shares, repayment of term loans, etc., to issue equity shares with differential rights upon the expiry of 5 years from the end of the financial year in which such defaults were remedied.
- Insertion of a new proviso to Rule 8(4) to allow start-ups to issue sweat equity shares not exceeding 50% of their paid-up capital up to 5 years from the date of incorporation or registration.
- Exemption provided to start-ups for a period of 5 years from the date of their incorporation or registration, from the applicability of the restrictions set out in sub-clauses (i) and (ii) of Rule 12(1)(c) relating to the definition of employees to whom shares may be offered under an ESOP.
- Deletion of Rule 13(c) to allow unlisted companies to issue partly paid-up shares on a preferential basis.
- Pricing of the equity shares allotted pursuant to conversion of convertible securities issued on a preferential basis, can now be determined either: (i) at the time of the offer for issuance of convertible securities is made; or (ii) not more than 30 days before the date on which the holder of convertible securities becomes entitled to apply for the equity shares, on the basis of the valuation reports. The manner of pricing will need to be decided at the time of offer of convertible securities.
- Amendment to Rule 18(1)(b) to allow companies issuing secured debentures to create charge on the assets or properties of their subsidiaries, holding and associates in addition to their own assets. Corresponding provisions of Rule 18(1)(d) have also been amended.

(MCA Notification No. G.S.R. 704(E) published in the Gazette on July 19, 2016)

MCA clarifies applicability of Section 381(1)(a) of the 2013 Act to Foreign Airlines Companies

In supersession of the notification number G.S.R 59, dated January 6, 1959 issued under Section 594(1) (Accounts of a foreign company) of the Companies Act, 1956, the Central Government has clarified that in respect of the period ending on or after March 31, 2016, a foreign airline company having a share capital, would be deemed to be in compliance with the requirement under Section 381(1)(a) of the 2013 Act, if it submits to the Registrar of Companies ("**ROC**"), *inter alia*, the following documents: (i) copies of

the latest consolidated financial statements of the parent foreign company as submitted by it to the prescribed authority in its country of incorporation; and (ii) a statement of receipts and payments for the financial year in respect of the foreign airlines company's Indian business operations, etc.

(MCA Notification S.O. 2463(E) published in the Gazette on July 19, 2016)

MCA notifies the National Company Law Tribunal Rules, 2016 ("**NCLT Rules**") and the National Company Law Appellate Tribunal Rules, 2016 ("**NCLAT Rules**")

MCA has notified the NCLT Rules and the NCLAT Rules (covered in *Insight: Volume VIII, Issue 3*), which *inter alia* provides for the following:

- The NCLT Rules prescribe the rules of procedure to be followed by the NCLT along with the applicable forms for applications, petitions, schedule of fees and list of documents to be attached with various applications and petitions. It also provides for admissibility of class action suits; powers and functions of the Registrar and the Secretary; various procedures relating to discovery, production and return of documents, appearance of respondents, examination of witnesses, disposal of cases, pronouncement of orders and schedule of fees amongst others.
- The NCLAT Rules prescribe the procedure for institution of appeals, preparation and publication of cause list, record of proceedings, maintenance of registers, service of process, appearance of respondents and objections, inspection of record, schedule of fees amongst others. The Appellate Tribunal also allows for filing of appeal or proceedings through electronic mode such as online filing and provides for rectification of defects by e-mail or internet.

(MCA Notifications G.S.R. No. 716(E) and G.S.R. No. 717(E) published in the Gazette on July 21, 2016)

MCA notifies the Companies (Incorporation) Third Amendment Rules, 2016

The MCA has amended the Companies (Incorporation) Rules, 2014 ("**Incorporation Rules**"), which *inter alia* includes the following:

- Amendment to Rule 26 provide that every company having a website for conducting online business or otherwise, is required to mandatorily disclose/publish its name, address of its registered office, the Corporate Identity Number, telephone number, fax number if any, email and the name of the person who may be contacted in case of any queries or grievances on the landing/home page of its website.
- It has been clarified that shifting of registered office of a company within a state shall be allowed after any inquiry, inspection or investigation that was pending under the 2013 Act has been completed and it is ascertained that no prosecution is envisaged and that no prosecution is pending.
- It has been clarified that a company shall be allowed to change its name after it has rectified it default in relation to its compliance of filing annual returns or financial statements due for filing with the ROC or paying or repaying matured deposits or debentures or interest thereon.
- A new Rule 37 has been inserted setting out the procedure of conversion of an unlimited liability company into a company limited by shares or guarantee.

- Form INC-10 (*Form for verification of signature of subscribers*) has been deleted.
- New forms INC-11 (*Certificate of Incorporation*) and INC-11A (*Certificate of incorporation pursuant to conversion of unlimited liability company into limited liability company*) have been substituted in place of the existing Form INC-11.
- New forms INC-27 (*Application for conversion of public company into private company or private company into public company and conversion of unlimited liability company into a company limited by shares or guarantee*) and INC-27A (*Advertisement to be published in the newspaper for conversion of unlimited liability into limited liability company*) have been substituted in place of the existing Form INC-27.

(*MCA Notification No. G.S.R. 743(E) published in the Gazette on July 27, 2016*)

MCA designates several courts as 'Special Courts'

- MCA has issued several notifications under Section 435 of the 2013 Act (*Establishment of Special Courts*) whereby certain courts have been designated as Special Courts for speedy trial of offences punishable under the 2013 Act with imprisonment of 2 years or more.
- Special Courts have been designated for the National Capital Territory of Delhi, States of Chhattisgarh, Rajasthan, Punjab, Haryana, Manipur, Union Territories of Chandigarh and Puducherry and Districts of Coimbatore, Dharmapuri, Dindigul, Erode, Krishnagiri, Namakkal, Nilgiris, Salem and Tirupur.

(*MCA Notifications No. S.O. 2554(E) and S.O. 2843(E) published in the Gazette on July 27, 2016 and September 1, 2016 respectively*)

MCA publishes the Companies (Share Capital and Debenture) Fourth Amendment Rules, 2016

MCA has amended Rule 18 of the Companies (Share Capital and Debenture) Rules, 2014 exempting the issuance of rupee denominated bonds solely to overseas investors (i.e. 'Masala Bonds') issued in accordance with RBI's A.P. (DIR Series) Circular No. 17 dated September 29, 2015, from the applicability of Chapter III (*Prospectus and Allotment of Securities*) of the 2013 Act and Rule 18 of the Share Capital and Debenture Rules, 2014.

(*General Circular No: 09/2016 dated August 3, 2016 and G.S.R. 791(E) dated August 12, 2016*)

MCA notifies provisions of the Insolvency and Bankruptcy Code, 2016 ("**Code**")

- MCA has notified Sections 188 to 194 of the Code which, *inter alia,* pertain to establishment, incorporation, constitution, management and powers of the Insolvency and Bankruptcy Board of India ("**Board**") effective from August 5, 2016.

- Certain sub-sections of Section 3 (i.e. definitions of Board, Chairperson, Notification, Prescribed and Regulations, etc.) and Section 221 (*Freezing of assets of company on inquiry and investigation*), 222 (*Imposition of restrictions upon securities*), 225 (*Expenses of investigation*), 226 (*Voluntary winding up of company, etc., not to stop investigation proceedings*), 230 (*Power to compromise or make arrangements with creditors and members*), 232 (*Merger and amalgamation of companies*), 233 (*Merger or amalgamation of certain companies)* and certain sub-clauses of sections 239 and 240 (relating to, *inter alia*, grants of funds by the Central Government to the Board, insolvency and bankruptcy fund, budget, annual report of the Board and rule making power of the Central Government) have been notified as being effective from August 19, 2016.

(*MCA Notifications No S.O. 2618(E) and S.O. 2746(E) published in the Gazette on August 5, 2016 and August 19, 2016 respectively*)

MCA notifies provisions in relation to Unpaid Dividend Account ("**UDA**")and Investor Education and Protection Fund ("**IEPF**")

MCA has notified Section 124 (relating to the UDA) and sub-sections (1) to (4) and (6) (relating to the manner of administration of the IEPF) and sub-sections (8) to (11) of Section 125 (relating to the establishment of the IEPF by the government) of the 2013 Act as being effective from September 7, 2016.

(*MCA Notification S.O. 2866(E) published in the Gazette on September 5, 2016*)

MCA relaxes last date and the requirement for additional fee payment for filing Form IEPF-1

Pursuant to the notification of the IEPF (Accounting, Audit, Transfer and Refund) Rules, 2016, the MCA has, as a one time measure, allowed companies who had not filed the required information in Form INV-1, to file the same in Form IEPF-1 (*Statement of amounts credited to IEPF*) latest by October 6, 2016, without being required to pay additional fees.

(*MCA Circular No. 10/2016 dated September 7, 2016*)

MCA notifies Section 227, clause (b) of sub-section (1) of Section 242, clauses (c) & (g) of sub-section (2) of Section 242, Section 246 and Sections 337 to 341 (to the extent of their applicability for Section 246) of the 2013 Act

The MCA has appointed September 9, 2016, as the date on which the provisions of the following sections of the 2013 Act shall come into force:

- Section 227 (*Legal advisers and bankers not to disclose certain information*);
- Sections 242(1)(b) and 242(2) (c) and (g) (*Powers of Tribunal*);
- Sections 246 (*Application of certain provisions to proceedings under Section 241 or Section 245*);

- Section 337 (*Penalty for frauds by officers*);
- Section 338 (*Liability where proper accounts not kept*);
- Section 339 (*Liability for fraudulent conduct of business*);
- Section 340 (*Power of Tribunal to assess damages against delinquent directors, etc.*); and
- Section 341 (*Liability under Sections 339 and 340 to extend to partners or directors in firms or companies*).

(MCA Notification S.O. 2912(E) published in the Gazette on September 9, 2016)

MCA amends Schedule V of the 2013 Act

MCA has amended Part II, Section II (*Remuneration*) of Schedule V of the 2013 Act to *inter alia*, provide the following:

- The limits on the remuneration that can be paid to managerial persons by companies having no profit or inadequate profit without central government approval have been increased, subject to the company complying with the conditions prescribed therein.
- If the company has committed a default in payment/repayment of its debt/debentures/interest thereon, then prior approval of the secured creditors has to be obtained for the proposed remuneration to the managerial personnel and the same has to be passed by an ordinary or special resolution (as applicable).

(MCA Notification S.O. 2922(E) published in the Gazette on September 12, 2016)

MCA notifies Companies (Management and Administration) Amendment Rules, 2016

The MCA has amended the Companies (Management and Administration) Rules, 2014, which provide, *inter alia,* as follows:

- Existing companies registered under the Companies Act, 1956 and either limited by shares or not having a share capital are now required to maintain the new register of members as per Form No. MGT-1.
- Listed companies are required to file with the ROC in Form MGT-10, details with respect to change in the shareholding position of the promoters and top 10 shareholders representing a change of 2% or more of the paid up share capital of the company.
- Rule 20 sub-rule (2) (*Voting through electronic means*) has been substituted to provide that a company which has its equity shares listed on a recognised stock exchange, and every company having not less than 1000 members shall provide to its members facility to exercise their right to vote on resolutions proposed to be considered at a general meeting by electronic means.
- Form MGT-6 (*Form of return to be filed with the ROC under Section 89 of the 2013 Act*) has been substituted with a revised Form MGT-6.

(MCA Notification No. G.S.R. 908(E) published in the Gazette on September 23, 2016)

FOREIGN INVESTMENT AND RBI UPDATES

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Cabinet increases limit for foreign investment in Stock Exchanges from 5% to 15%

- Following the Union Budget Announcements (2016-17) regarding reforms in Foreign Direct Investment ("**FDI**") Policy for enhancement of investment limit for foreign entities in Indian stock exchanges, *vide* a press release, it has been announced that the Union Cabinet has granted its approval for raising the foreign shareholding limit in Indian stock exchanges from 5% to 15% for a stock exchange, a depository, a banking company, an insurance company and a commodity derivative exchange.
  - ✓ At present, Regulation 17(3) of the Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2012 ("**SCR SE Regulations**") states that no person resident outside India shall, directly or indirectly, either individually or together with persons acting in concert, acquire or hold more than 5% of the paid-up equity share capital in a recognised stock exchange.
- In addition, the Cabinet has approved the acquisition by Foreign Portfolio Investors ("**FPIs**") of shares of a recognised stock exchange by initial allotment (besides the secondary market).
  - ✓ Currently, Regulation 17(4)(c) of the SCR SE Regulations prohibits FPIs from acquiring shares of a recognised stock exchange otherwise than through secondary market.
- It is believed that this move will pave the way for better overall growth and development of the Indian capital markets. This move is further significant as it comes after Bombay Stock Exchange ("**BSE**")and National Stock Exchange ("**NSE**") have expressed their intent to go public.
- The actual policy change *vide* issuance of a Press Note by the Department of Industrial Policy and Promotion ("**DIPP**") is awaited.

(*Cabinet Press Release dated July 27, 2016*)

Discontinuation of reporting of Bank Guarantee on behalf of Service Importers

- In terms of the Master Direction on 'Reporting under Foreign Exchange Management Act, 1999' dated January 1, 2016, the RBI had permitted Authorized Dealer ("**AD**") Category-I banks to issue guarantees in favour of a non-resident service providers on behalf of their resident customers importing services.
- With a view to reduce the compliance burden on AD Category-I banks, the requirement of reporting to the RBI details of invocation of such bank guarantees has been discontinued.
- However, AD Category-I banks may maintain records of such invocations and furnish requisite details to the RBI whenever sought.

(*A.P. (DIR Series) Circular No. 1 – RBI Circular dated July 7, 2016*)

RBI amends the Foreign Exchange Management (Deposit) Regulations, 2016 ("**Deposit Regulations**")

- Pursuant to amendments, by way of a corrigendum, to Schedule 1, paragraph 6(3) of the Deposit Regulations, "*relending or carrying on agricultural/ plantation activities or for investment in real estate business*" has been *deleted* from the list of impermissible activities for which loans could be granted by the AD branches against the security of funds held in a Non-Resident External account ("**NRE account**").
- Thus, ADs may allow their branches/ correspondents outside India to grant loans to or in favour of non-resident depositor or to third parties at the request of depositor for *bona fide* purpose, against the security of funds held in the NRE accounts in India and also agree for remittance of the funds from India, if necessary, for liquidation of the outstanding.

(*G.S.R. 869(E) dated September 8, 2016*)

Amendments to FEMA 20 permitting foreign investment in Other Financial Services sectors

- The RBI has amended Paragraph F.8, in Annex B of Schedule 1 of Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000 ("**FEMA 20**") to give effect to the Cabinet Press Release of August 10, 2016 approving foreign investment in Other Financial Services sector. Pursuant to the said amendments:
  - ✓ 100% FDI under the automatic route is allowed in financial service activities regulated by financial sector regulators (*viz*., RBI, SEBI, Insurance Regulatory and Development Authority, Pension Fund Regulatory and Development Authority, National Housing Bank or any other financial sector regulator as may be notified by the Government of India);
  - ✓ minimum capitalisation norms to be complied with as per those prescribed by the concerned sector regulator;
  - ✓ with regards to those financial service activities which are not regulated by financial regulators or only partially regulated, up to 100% investment would be allowed under the government approval route;
  - ✓ for an activity which is regulated by a specific Act, the foreign investment limits mentioned in the Act, if any, shall apply; and
  - ✓ downstream investment by any of the entities in "Other Financial Services" shall be subject to the extant sectoral regulations and the provisions of FEMA 20.

(*Notification No. FEMA. 375/ 2016-RB dated September 9, 2016 and A.P. (DIR Series) Circular No. 8 – RBI Circular dated October 20, 2016*)

SECURITIES LAW UPDATE

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Securities and Exchange Board of India ("**SEBI**") prescribes formats for submission of financial results and implementation of Ind-AS by listed entities

- SEBI has prescribed that the formats mentioned in its circular CIR/CFD/CMD/15/2015 dated November 30, 2015 for unaudited/audited quarterly financial results to be submitted by listed entities shall continue till the period ending December 31, 2016. For the period ending on or after March 31, 2017, the formats for the quarterly financial results shall be as prescribed in Schedule III to the 2013 Act.
- Further, until Companies (Indian Accounting Standards) Rules, 2015 ("**Ind-AS Rules**") come into force, listed entities shall adopt Companies (Accounting Standards) Rules, 2006. Relaxations and extensions have been given to listed entities to which Ind-AS Rules are applicable from the accounting period beginning on or after April 1, 2016.

(SEBI Circular CIR/CFD/FAC/62/2016 dated July 5, 2016)

Amendments to the SEBI (FPI) Regulations, 2014 relating to transfer of offshore derivative instruments

SEBI has amended SEBI (FPI) Regulations, 2014 to substitute sub-regulation (2) in Regulation 22 to provide that in addition to compliance with sub-regulation (1) of Regulation 22, an FPI shall ensure that its prior consent is taken for any transfer of offshore derivative issued by or on his behalf. Such prior consent will not be required when the FPI pre-approves the persons to whom the offshore derivative instruments are being transferred.

(SEBI (Foreign Portfolio Investors) (Amendment) Regulations, 2016, dated July 8, 2016)

Amendment to the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ("**Listing Regulations**")

SEBI has notified the SEBI (Listing Obligations and Disclosure Requirements) (Second Amendment) Regulations, 2016, which came into force on July 8, 2016, whereby SEBI has introduced Regulation 43A. The Regulation 43A provides that:

- a dividend distribution policy: (i) shall be formulated by the top 500 listed entities based on market capitalization (calculated as on March 31 of every financial year) and the same shall be disclosed in their annual reports and on their websites; and (ii) may be disclosed by other listed entities on a voluntary basis in their annual reports and on their websites;
- prescribes certain parameters for the dividend distribution policy; and
- in case of any additions to the prescribed parameters or alteration to any parameters for declaration of dividend, the listed entity is now required to disclose such changes along with the rationale for the same in its annual report and on its website.

(SEBI notification dated July 8, 2016)

Consultation paper for disclosures in respect of the SEBI (Infrastructure Investment Trusts) Regulations, 2014 ("**SEBI InvIT's Regulations**")

Pursuant to the recommendations of a committee constituted for prescribing accounting and auditing norms for Infrastructure Investment Trusts ("**InvIT's**"), SEBI had released a consultation paper dated July 8, 2016 proposing a framework for disclosures relating to financial information in offer document or placement memorandum, as the case maybe, and for valuation of the units of the InvITs. The key highlights of the proposals in the consultation paper include:

- Financial disclosures in the offer document or placement memorandum: SEBI has proposed disclosure of annual financial information for the previous 3 years in the offer document or placement memorandum. Further, it indicates the basis of preparation of combined financial statements in case the InvIT has not completed 3 years, along with the minimum requirements in respect of the presentation. Further, the annual financial information is proposed to be prepared in accordance with the Indian Accounting Standards and the rules applicable thereto. Further, it has been prescribed that such financial information should be audited and accompanied by an audit report.
- Interim financial information: In the event the date of offer document or placement memorandum is more than 6 months from the end of the last audited annual financial statements, SEBI has proposed additional disclosure of audited interim financial information for a period ending not earlier than 6 months from the date of the offer document or placement memorandum.
- Other disclosures: SEBI has proposed disclosure requirements with respect to financial information in the following areas: (i) financial information of the investment managers and sponsor(s) of InvIT's; (ii) management discussion and analysis; (iii) projections of revenues and operating cash flows; (iv) payment history and working capital available to an InvIT; (v) contingent liabilities and commitments of InvIT's; (vi) related party transactions; and (vii) capitalization statement.
- Valuation of units of InvITs: SEBI has proposed an amendment in the definition of "registered valuer" under the SEBI InvIT's Regulations, such that the appointment of a valuer is modified in line with the definition provided under the 2013 Act. Further, until the provisions of the 2013 Act comes into force, the definition is proposed to include persons including, *inter alia*, chartered accountant/company secretary/member of institute of engineers, member of council of architecture or the Indian institute of architects etc, amongst others. Further, SEBI has proposed certain mandatory disclosures in the valuation report in the interest of the investors including a brief summary of the valuation report.

(SEBI Consultation Paper dated July 8, 2016)

Consultation paper for amendments to the SEBI (Real Estate Investment Trusts) Regulations, 2014 ("**SEBI REIT Regulations**")

Pursuant to various representations and suggestions from industry bodies and market participants in relation to the SEBI REIT Regulations, SEBI had released a consultation paper for public comments, on July 18, 2016. The consultation paper provides proposals with respect to:

- Permitting Real Estate Investments Trusts ("**REIT(s)**") to invest, upto 2 levels under the REIT, in special purpose vehicles holding investments in other special purpose vehicles, which subsequently hold real estate assets, subject to certain conditions.
- Introducing the concept of materiality for identification of associates by the REIT, for the purposes of relevant disclosures in relation to such material associates.
- Amending the definition of "real estate" to include completed and rent generating assets, even though such assets may fall under the definition of "infrastructure" under the notification of the Ministry of Finance dated October 7, 2013, which are not included in the current definition of "real estate".
- Introducing the concept of "sponsor groups", which may comprise of multiple schemes/funds/affiliates which are under common control of REITs. Further, it has been proposed to increase the number of sponsors that a REIT can have from 3 to 5.
- Relaxing the minimum approval requirement of unit-holders in relation to approving: (i) related party transactions; and (ii) changes in investment manager, investment strategy, delisting of units etc.
- Aligning: (i) the minimum offer made to public at the time of initial public offering with the requirements specified in the Securities Contracts (Regulation) Rules, 1957 *vis-à-vis* the current requirement of 25% of the total outstanding units; and (ii) allowing the minimum number of public unit holders of REIT to 200 only at the time of initial public offer *vis-à-vis* current requirement of minimum 200 unit holders post listing.
- Permitting fungibility within various categories such as under construction assets, securities of companies or body corporate in real estate sector, government securities, money market instruments etc., for investment of 20% of the value of REIT assets (where 80% is to be invested in completed and rent generating assets), *vis-à-vis* current restriction limiting investment in under construction/non-rent generating properties to 10% out of 20%.
- Excluding associates of trustees from the list of related party transactions, permitting associates of trustees to invest in units of the REIT (at an arms length basis), and deleting the requirement to disclose litigation relating to associates of trustees in the offer document.
- Amending operational aspects including liability of unit holders, pricing of related party transactions and implications in case of change in sponsor/re-designated sponsors, pursuant to change in their control.

SEBI had requested for comments on the consultation paper from public by August 7, 2016.

(SEBI Consultation Paper dated July 18, 2016)

SEBI issues frequently asked questions ("**FAQs**") on Electronic Book Mechanism ("**EBM**") for issuance of debt securities on private placement basis

SEBI has issued FAQs on EBM for issuance of debt securities on private placement basis. Electronic Book Provider ("**EBP**") is an online portal used for bidding of debt securities. The FAQs, *inter alia,* mandate the use of EBP service, provided currently by the NSE and the BSE, for all private placement of debt securities of Rs. 500 crores and above in the primary market.

(SEBI FAQs dated July 22, 2016)

Update on SEBI Informal Guidances

- Inter-se transfer of shares from a person to a company where such person holds less than 50% of the shares in such company would not be exempt from the obligation of making an open offer in terms of Regulation 3 and 4 of the SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 2011 ("**SAST Regulations**"), as specified in Regulation 10(1)(a)(iii), as the said holding is less than the 50% threshold.

  (SEBI Informal Guidance SEBI/HO/CFD/DCR1/OW/P/2016/21397/1 dated July 29, 2016)

- Reclassification of 'promoters' as public shareholders, not falling under sub-regulation (5) and (6) of Regulation 31A of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ("**Listing Regulations**") would not require the approval of shareholders of the Company, subject to such company complying with the other provisions of the Listing Regulations.

  (SEBI Informal Guidance CFD/PM/PHV/OW/23525/2016 dated August 23, 2016)

- Acquisition pursuant to inter-se transfer of shares among the existing promoters would be covered under Regulation 10(1)(a)(i) of the SAST Regulations, subject to the condition that the persons involved in such transfers are 'immediate relatives' as defined under the SAST Regulations, and on compliance with the two conditions as stated under the proviso of Regulation 10(1)(a).

  (SEBI Informal Guidance CFD/DCR/OW/2016/23917 dated August 24, 2016)

- Inter-se transfer of shares between the promoters by way of gift would be considered a "sale" for the purposes of Regulation 72(2) of the SEBI (Issue of Capital and Disclosure Requirements) Regulations 2009 ("**ICDR Regulations**") thereby making the promoter(s) and promoter group ineligible for allotment of specified securities on preferential basis. SEBI observed that the primary intention of Regulation 72(2) of the ICDR Regulations was not with respect to 'consideration' but with 'change in ownership of equity shares'.

  (SEBI Informal Guidance CFD/DIL-2/OW/PR/25591/2016 dated September 12, 2016)

Informal Guidance by SEBI

SEBI has, on an application made by Suzlon Energy Limited ("**SEL**") seeking informal guidance under the SEBI (Informal Guidance) Scheme 2003, clarified certain issues to SEL, in relation to the below matters:

- A company may be guided by either the income criteria or the networth as mentioned in Regulation 16(1)(c) of the Listing Regulations. Further, a company may develop stricter criteria than as provided in the aforementioned regulation.
- A company may not take an omnibus approval of shareholders in case the company wishes to dispose of shares in its material subsidiaries resulting in reduction of its shareholding to less than 50%. The requirement of shareholders approval (by way of special resolution) as prescribed under the Regulation 24(5) of the Listing Regulations must be complied with.
- In case the shareholding of the listed company reduces below 50% or the listed company ceases to have control over a material subsidiary, each due to further issuance of shares by the material subsidiaries, the same will require approval of the shareholders of the listed company (by way of special resolution).

(Informal Guidance by SEBI dated August 2, 2016)

SEBI redefines the corporate debt limit for FPIs

SEBI has prescribed that Rs. 244,323 crore corporate debt limit for FPIs shall be redefined to provide for a combined corporate debt limit for all foreign investments in Rupee denominated bonds issued both onshore and overseas by Indian corporates, in line with RBI circular A.P. (DIR Series) Circular No.17 dated September 29, 2015. SEBI has also clarified that these investments shall not be regulated under SEBI (FPI) Regulations 2014 ("**FPI Regulations, 2014**"). The entire combined corporate debt limit shall be available on tap for foreign investors.

(SEBI Circular SEBI/HO/IMD/FPIC/CIR/P/2016/67 dated August 4, 2016)

SEBI issues FAQs on SEBI (Delisting of Equity Shares) Regulations, 2009

- SEBI has revised the FAQs on SEBI (Delisting of Equity Shares) Regulations, 2009 ("**Delisting Regulations**"). SEBI has clarified on the documents to be submitted while tendering one's shares for delisting under the tender offer method. The documents required for submitting shares for delisting in the tender offer method vary for shares which are held in the dematerialised form and for shares in physical form. Eligible sellers can approach their brokers for submitting their shares for delisting.
- SEBI has also provided clarification with regards to participation in the delisting when no tender form is received. Eligible sellers who wish to tender their shares for delisting but have not received the tender form can do by submitting the requisite details to their respective broker.

(FAQs on SEBI (Delisting of Equity Shares) Regulations, 2009 dated August 5, 2016)

SEBI prescribes revised formats for financial results and implementation of Ind-AS by listed entities which have listed their debt securities and/or non-cumulative redeemable preference shares

- In furtherance of its circulars dated November 27, 2015 and July 5, 2016 (refer above), SEBI has prescribed that the formats mentioned in its circular CIR/IMD/DF1/9/2015 dated November 27, 2015 for disclosure of half-yearly and annual financial results to be submitted by listed entities, which have listed their debt securities and/or non-cumulative redeemable preference shares, shall continue till period ending December 31, 2016. For the period ending after December 31, 2016 the disclosure of half-yearly and annual financial results shall be as prescribed in Schedule III to the 2013 Act.
- Banking companies and insurance companies shall follow the formats as prescribed under their respective Acts/Regulations.
- Further, until Ind-AS Rules comes into force, listed entities shall adopt Companies (Accounting Standards) Rules, 2006. Relaxations and extensions have been given to listed entities to which Ind-AS Rules are applicable for the first half year of the adoption of Ind-AS Rules.

(SEBI Circular CIR/IMD/DF1/69/2016 dated August 10, 2016)

SEBI issues FAQs on Alternate Investment Funds ("**AIFs**")

SEBI has released FAQs on AIFs pursuant to the SEBI (AIFs) Regulations, 2012 ("**AIF Regulations**"). These FAQs have been prepared with a view to guide market participants on AIFs, and deal with *inter alia* with explanation/definition of AIF, categories of AIF, angel funds, debt funds, fund of funds, corpus of AIF, sponsor, etc.

(FAQs on SEBI (Alternative Investment Funds) Regulations, 2012 dated August 18, 2016)

Amendment to the Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2012 ("**SECC Regulations**")

SEBI has notified the Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) (Third Amendment) Regulations, 2016, which came into force on August 29, 2016, whereby SEBI has replaced the existing Regulation 33 of the SECC Regulations. The amended regulation provides that the contribution to the fund required to be maintained by a recognized clearing corporation to guarantee the settlement of trades executed in the respective segment of a recognized stock exchange, shall be made by the recognized stock exchange, the recognized clearing corporation and the clearing members, in the manner as may be specified by SEBI from time to time. Prior to the amendment, every recognized stock exchange was required to credit 25% of its profits every year to such a fund of the recognized clearing corporation which clears and settles trades executed on that stock exchange. Further, the amended regulation provides that in case of shortfall in the fund, the recognized clearing corporation and the recognized stock exchange shall replenish the fund to the threshold level as may be specified by SEBI from time to time.

(SEBI notification dated August 29, 2016)

SEBI issues FAQs on Know Your Client ("**KYC**") norms for Overseas Direct Investment ("**ODI**") subscribers

SEBI has released FAQs on SEBI Circular CIR/IMD/FPI&C/59/2016 Circular dated June 10, 2016 (covered in detail in *Insight: Volume VIII, Issue 3*) which dealt with KYC norms for ODI subscribers, transferability of ODIs, reporting of suspicious transactions, periodic review of systems and modified ODI reporting format**.** The FAQs clarify, *inter alia*, the following:

- meaning of "beneficial owner of the ODI subscriber entity";
- where no material shareholder/owner entity is identified in the ODI subscriber using the materiality threshold, the identity and address proof of the relevant natural person who holds the position of senior managing official of the ODI subscriber entity should be obtained (ODI subscriber which is a listed company or its subsidiary is exempted);
- definition of Non-Resident Indian ("**NRI**") shall be same as given in Section 115C (e) of Income Tax Act, 1961 and it includes Person of Indian Origin ("**PIO**"); and
- beneficial owners of an ODI subscriber cannot be NRI/PIO. Minor modifications have also been made to the ODI reporting format.

(Updated FAQs dated September 1, 2016 on SEBI circular CIR/IMD/FPI&C/59/2016 dated June 10, 2016)

Minutes of SEBI Board Meeting

SEBI, in its board meeting held in Mumbai on September 23, 2016, made the following decisions:

- Amendments in the SEBI InvIT's Regulations and the SEBI REIT Regulations: (i) Allowing InvITs and REITs to invest in two level SPV structure through holding company subject to certain conditions; (ii) reducing mandatory sponsor holding in an InvIT to 15%; (iii) removing the limit on the number of sponsors of InvITs and REITs and introducing the concept of sponsor group only for REITs; (iv) rationalizing the requirements for private placement of an InvIT; (v) allowing REITs to invest upto 20% in under construction assets; (vi) amending the definition of the "valuer"; (vii) clarifying the definition of "associates" and "related parties"; and (viii) clarifying the definition of 'real estate property', subject to certain conditions under the SEBI REIT Regulations.

- Employee reservation in public issues: In relation to the ICDR Regulations as amended: (i) SEBI has permitted allotment to employees in excess of the extant limit of Rs. 2 lakh under the employee reservation portion; (ii) such an application for an amount beyond Rs. 2 lakh (i.e. additional shares) shall be considered only in the event of under-subscription in the employee reservation portion; (iii) the unsubscribed shares available in the employee reservation portion shall be allotted on a proportionate basis to the employees who have applied for the additional shares; and (iv) the total value of allotment under the employee reservation portion shall not exceed Rs. 5 lakh.

- Corporate governance in compensation agreements: In the context of private equity funds entering into compensation agreements with promoters, directors and key managerial personnel of listed investee companies without prior approval of shareholders, SEBI has proposed to release a consultation paper on bringing changes in the corporate governance requirements of a listed entity, in the Listing Regulations, by introducing the below provisions: (i) requiring companies to disclose and take prior approval of shareholders by way of an ordinary resolution with respect to such agreements; (ii) in case of existing profit sharing agreements, such agreements should be informed to the stock exchanges for public dissemination; and (iii) such approvals shall be obtained from the board of directors and shareholders within the prescribed timelines.

- Increase in limit of foreign investment in Indian stock exchanges: SEBI has decided to make amendments in the SECC Regulations such that: (i) the limit of shareholding of foreign institutional investors in Indian stock exchanges is increased from 5% to 15%; and (ii) FPIs are allowed to acquire shares of unlisted stock exchanges through transactions beyond recognized stock exchanges, including through initial allotment.

(SEBI Board Meeting dated September 23, 2016)

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The views expressed in this newsletter do not necessarily constitute the final opinion of Cyril Amarchand Mangaldas on the issues reported herein and should you have any queries in relation to any of the issues reported herein or on other areas of law, please feel free to contact us at the following co-ordinates:

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