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FINANCIAL REGULATORY BULLETIN

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FOREWORD

It gives me immense pleasure to share with you the inaugural issue of '*Financial Regulatory Bulletin*', the Firm's quarterly newsletter produced by our Financial Regulatory Practice.

The structure and operation of financial market systems has undergone a dynamic and marked change in the recent times, driven by demonetisation, liberalisation of foreign investment, product innovation, integration, competition and policy and reforms. With financial activities picking up pace, and financial sector regulators, focusing on investor confidence, transparency, and accountability, the onset of regulatory reforms has only just begun.

With this inaugural newsletter, we aim to share our insight on the Financial Resolution and Deposit Insurance Bill, 2017 along with quick updates on the recent key legislative developments in the regulatory space by financial service regulators namely, Reserve Bank of India ("**RBI**"), Securities and Exchange Board of India ("**SEBI**") and Insurance Regulatory and Development Authority of India ("**IRDAI**"). For instance, RBI is implementing strict norms for peer-to -peer lending by declaring peer-to-peer lending platforms as non-banking financial companies. Similarly, in light of the recent discussions and incidents pertaining to bitcoin on the global forum, the RBI is also contemplating India's own cryptocurrency.

We hope you enjoy reading this newsletter. Please feel free to send your comments, feedback and suggestions to cam.mumbai@cyrilshroff.com

Regards,

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An Overhaul in the Insolvency Regime for Financial Institutions – A Snapshot

One of the key legal changes that dominated the mind of India Inc last year was the introduction of the Insolvency and Bankruptcy Code 2016 ("**Bankruptcy Code**"). With the stated intention of consolidating and increasing the efficacy for insolvency resolution of corporations (and individuals), the Bankruptcy Code has largely re – written the manner in which corporate entities would deal with and handle an event of insolvency.

However, having regard to the unique space occupied by financial institutions even within the corporate sphere, the Bankruptcy Code did not address the issue of insolvency of financial institutions and in fact the Ministry of Finance also itself noted that "*the resolution of financial institutions requires a special regime that is faster than any traditional insolvency procedure, where rights of creditors and other stakeholders can be overridden in the interest of the financial system (including the consumers) and the economy.*"[1]

The Financial Resolution and Deposit Insurance Bill, 2017 ("**Financial Resolution Code**") has therefore been drafted by a committee constituted by the Ministry of Finance ("**Committee**") to put in place a bespoke insolvency regime for financial firms. The Financial Resolution Code has been approved by the Union Cabinet[2] and was introduced in the Lok Sabha on August 10, 2017. Further, the Financial Resolution Code has also been referred to a Joint Parliamentary Committee of both the Houses for examination and presenting a report on the Financial Resolution Code.[3]

Advent of the Financial Resolution Code

The idea of the Financial Resolution Code was mooted in the Budget Speech 2016 – 17, when the Finance Minister had announced that a comprehensive code on resolution of financial firms would be prepared and placed as a Bill before the Parliament during the financial year 2016 – 17. However, this was not the first instance of a resolution mechanism being considered specifically for the Indian financial sector.

In 2011 – 2012, India underwent an assessment update under the Financial Sector Assessment Program ("**FSAP**") of the Financial Stability Board ("**FSB**") and one of the recommendations of the FSAP was strengthening of resolution tools.

Subsequently, the recommendations of the Financial Sector Legislative Reforms Commission made in 2013, included the establishment of a 'resolution corporation' for financial firms. In 2014, the High Level Working Group on Resolution Regime for Financial Institutions also proposed that a single 'Financial Resolution Authority' be set up, which would be institutionally independent of other regulators and responsible for resolution of all financial firms.

The Financial Resolution Code drafted by the Committee is premised on the very same principle, that financial firms need a special and separate resolution framework.

The FSB Influence

The Financial Resolution Code has been drafted so as to ensure consistency with the Key Attributes to Effective Resolution Regime issued by the FSB ("**Key Attributes**"). The Key Attributes set out the core principles, which according to the FSB, would help the member jurisdictions achieve resolution of financial firms with minimum loss to taxpayers and maximum preservation of value of the resolving entity.

The modeling of the Financial Resolution Code on the Key Attributes is an ambitious move considering that the Second Thematic Review of Resolution Regimes by the FSB (2016) notes that a number of jurisdictions continue to have gaps in bank resolution powers. For instance, Hong Kong is in the process of enacting a cross – sectoral resolution regime which would comply with the FSB Key Attributes standards. The Monetary Authority of Singapore is also in the midst of implementing a resolution regime in line with the Key Attributes.

[1] Press Release of Ministry of Finance dated September 28, 2016
[2] Press Release of Government of India dated June 14, 2017
[3] Press Release of Ministry of Parliamentary Affairs dated September 8, 2017

The formulation of the Financial Resolution Code certainly seems to be symptomatic of the global trend to focus on resolution of financial firms.

Key Features of the Financial Resolution Code

(i) *Consolidation of a fragmented regime*: Perhaps the most critical aspect of the Financial Resolution Code is that it takes the unprecedented step of seeking to prescribe an insolvency framework for financial firms across the spectrum, including, banks, insurers, non – banking financial companies, payment systems, recognized stock exchanges, depositories, etc. Till date, each category of financial firm has been subject to its own regulatory regime administered by a nodal regulator, such as the Reserve Bank of India ("**RBI**"), the Insurance Regulatory and Development Authority of India ("**IRDA**"), Securities Exchange Board of India ("**SEBI**"), etc. While these financial institutions will continue to be governed by their respective regulators in all other matters, the Financial Resolution Code seeks to consolidate the insolvency regime in order to address issues such as limited cross – sectoral learnings in handling insolvent financial firms, impediment of multi – regulatory interactions in resolution of conglomerates, etc. Further, the Financial Resolution Code also seeks to cover not only traditional financial entities but also entities in the burgeoning fintech space, such as, payment systems, etc., to ensure that any adverse impact to customers undertaking financial transactions digitally through such entities is limited in the event of failure of such entities. Towards this end, the Financial Resolution Code also envisages the establishment of the Resolution Corporation comprised of representatives of various sector regulators as well as independent members.

(ii) *Risk classification and Systemic Importance:* The Financial Resolution Code introduces the concept of 'Systemically Important Financial Institution' ("**SIFIs**") to be identified by the central government, which would subject to more stringent compliances. The Financial Resolution Code has also formulated a five – stage 'risk to viability' framework, namely, low risk, moderate risk, material risk, imminent risk, and critical risk, in terms of which all financial institutions governed under it would be classified.

(iii) Such classification would be made on the basis of adequacy of capital, asset quality, liquidity, leverage ratio, etc. and would involve consultation with the relevant sector regulator. The need for such classification is to ensure that the Resolution Corporation is not overburdened and remains focused on the firms which pose a higher risk to viability. Firms at low and moderate risk would have minimal touch regulation from the Resolution Corporation while those material risk or higher would face greater controls, including, inspections, submission of resolution plans, etc. An exception has been made with respect to SIFIs which would continue to be closely monitored irrespective of their risk classification. In theory, the calibration of oversight as dependant on the risk classification of the financial institution is an innovative scheme to ensure that the focus of the Resolution Corporation remains relevant. Further, the requirement for financial firm to submit 'resolution plan' and 'restoration plan' once they breach a risk threshold also ensures that the entities themselves internally evaluate and assess how to handle potential insolvency risks at an earlier stage rather than in the last throes of dissolution.

(iv) *Powers of the Resolution Corporation:* The Financial Resolution Code proposes that the Resolution Corporation shall act as an administrator for all firms at the stage of 'critical' risk to viability. The Resolution Corporation may then exercise one of the many tools at its disposal, such as, corporate restructuring of the entity under the guidance of the Resolution Corporation, incorporation of a bridge institution to continue providing financial services while seeking a potential buyer, bail-ins, liquidation through application being made to the National Company Law Tribunal ("**NCLT**") for the appointment of Resolution Corporation as the liquidator, etc. Additionally, in cases of cross – border insolvency, the Financial Resolution Code envisages that the Resolution Corporation would (with approval of the government) enter into arrangements/ understanding with its counterparts internationally, in other jurisdictions for sharing of information and to better manage the cross – border resolution of financial firms.

Conclusion – The Way Ahead

Shortly after the introduction of the Financial Resolution and Deposit Insurance Bill, 2016 based on which the present Financial Resolution Code has been drafted, Moody's had categorized it as a 'credit positive' for banks in the country, noting that "*it is an important step to having a comprehensive framework in place for the resolution of financial firms.*"

It is undeniable that the introduction of a streamlined resolution framework for financial firms is a critical step in ensuring economic stability and meeting the FSB Key Attributes standards. With the introduction of the Financial Resolution Code in the Lok Sabha on August 10, 2017 and appointment of the Joint Parliamentary Committee on September 8, 2017 to review the Code, we hope to see swift implementation of the Code in the near future.

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Regulatory Updates

RESERVE BANK OF INDIA ("RBI")

1. ***RBI releases Compendium of Guidelines on Financial Inclusion and Development for Small Finance Banks***

   Considering the differentiated nature of business and financial focus of Small Finance Banks ("**SFBs**") and taking into account the important role they can play in the supply of credit to micro and small enterprises, agriculture and banking services, a comprehensive set of guidelines have been formulated by RBI for SFBs covering, *inter alia*, targets for various sub-sectors under priority sector lending; lending to micro, small and medium enterprises; and guidelines for cash management by business correspondents engaged by SFBs.

2. ***NBFCs permitted to undertake Point of Presence Services under PFRDA for National Pension System***

   In the interest of the public, RBI had previously rejected proposals to allow Non-Banking Financial Companies ("**NBFCs**") to provide Point of Presence services under the Pension Fund Regulatory and Development Authority for National Pension System ("**NPS**"). However, on review, RBI has now allowed NBFCs having a minimum asset size of INR 500 crore, a prescribed capital to risk weighted assets ratio and having made a net profit in the preceding financial year, to provide such services for the NPS. Therefore, eligible NBFCs can now operate as the first point of interaction between a NPS subscriber and the NPS by providing various customer services.

3. ***Insolvency proceedings invoked under the directions of RBI not to be accorded priority by NCLT***

   Pursuant to the amendments to the Banking Regulation Act 1949, introduced through the Banking Regulation (Amendment) Ordinance 2017, and the notification issued thereafter by the Central Government, RBI is empowered to issue directions to banking companies to initiate insolvency resolution process in respect of a

[4] See Moody's Investor Services Announcement dated October 18, 2016 available at https://www.moodys.com/research/Moodys-Indias-draft-bill-on-resolution-of-financial-firms-is--PR_356582

default, under the provisions of the Insolvency and Bankruptcy Code, 2016 ("**IBC**"). In its press release dated June 13, 2017, RBI stated that it would issue directions to banks to file for insolvency proceedings under the IBC in respect of certain identified accounts, which would be accorded priority by the National Company Law Tribunal ("**NCLT**")

However, in relation to a writ petition filed by Essar Steel Limited against RBI's decision to initiate insolvency proceedings against it, the High Court of Gujarat observed that *"nobody was entitled or empowered to advise, guide or direct a judicial or quasi-judicial authority in any manner whatsoever"*. RBI has subsequently amended its press release of June 13, 2017 such that the NCLT is not required to prioritise insolvency proceedings directed to be filed by RBI under the IBC in respect of the identified accounts.

4. *Amendment in primary banking law*

The Banking Regulation Act, 1949 is amended to empower RBI to issue directions to banking companies for resolution of stressed assets, providing RBI with more effective legal tools to clean up the non-performing assets in the Indian banking system. Further, RBI is authorized to appoint authorities or committees, if required, to advise such banking companies in this respect, which will also shield bankers from any subsequent action by investigative agencies looking into loan recasts.

5. *RBI releases regulatory framework on Commercial Papers*

RBI has released directions to regulate the issue of Commercial Papers ("**CPs**") with a focus on enhanced disclosure measures, while at the same time easing the rigid eligibility conditions which previously restricted the issue of CPs. In this regard, the minimum net-worth requirement for eligible entities has been removed, now allowing even small and medium sized companies to raise funds through CPs. Further, the directions have modified the process of obtaining ratings from rating agencies and have increased the information required to be disclosed in the offer documents.

6. *CICs now to issue comprehensive Credit Information Reports*

Credit Information Companies ("**CICs**") are required to ensure that the Credit Information Report furnished to the credit institutions incorporates the credit information available in all modules e.g. consumer, commercial and microfinance etc., in respect of a borrower, as opposed to providing specific modules separately and charging differential rates for each, so that lenders are made aware of the entire credit history of the borrower and quality of their credit decisions are not adversely affected.

7. *Greater liquidity in corporate bond market due to RBI's directions to regulate issuance of Tri-Party Repos*

RBI has issued the Tri-Party Repo (Reserve Bank) Directions, 2017, in order to regulate the introduction of tri-party repos, which is a type of repo contract where a third party (apart from the borrower or lender) acts as an intermediary between the two parties to the repo in order to facilitate services like collateral selection, payment and settlement, custody and management during the life of a repo. Tri-party repos are expected to contribute to greater liquidity in the corporate bond market and provide markets with an alternative repo instrument to government securities repos.

8. *RBI's report on household finance in India*

RBI has published a report recommending, *inter alia*, that households be given a suite of simple, customized, financial products with a default opt-out structure to further their participation in formal financial markets. Such simplified products also tie in with the report's suggestion of ensuring an essential minimum financial kit for households when they access any product and finish Know Your Customer ("**KYC**") compliance. Further, the report proposes a uniform set of standards and definition for consumer protection and for providing integrated financial advice to households, including the application of a fiduciary standard to advice and sales of financial products.

9. *Limited liability of customers in unauthorised electronic banking transactions*

With the increased thrust on financial inclusion and customer protection and considering the recent surge in customer grievances relating to unauthorised transactions resulting in debits to their accounts/ cards, the criteria for determining the customer liability in these circumstances have been reviewed by RBI. The revised directions issued by RBI include*, inter alia*, strengthening of systems and procedures by the banks in respect of electronic banking transactions, reporting of unauthorised transactions by the customers to banks and stipulation of conditions for zero and limited liabilities of customers under different circumstances.

10. *RBI's forthcoming developmental and regulatory policies*

RBI has issued a press release on the progress of various developmental and regulatory policy measures announced by it.

Among other measures, RBI announced the forthcoming operationalization of a scheme of simplified hedging facility to simplify the process for hedging exchange rate risk by reducing documentation requirements and avoiding prescriptive stipulations regarding products, purpose and hedging flexibility.

RBI has proposed to allocate a separate limit for investments by foreign portfolio investors ("**FPI**") in bond futures, distinct from the limit prescribed for investment in government securities, in order to facilitate further market development and to ensure FPI access to futures remains uninterrupted during the phase when FPI limits on government securities are under auction.

11. *RBI considers issuing its own cryptocurrency*

In light of the success of the private cryptocurrency "Bitcoin", RBI executive director Shri Sudarshan Sen has said that a group of experts at RBI is examining the possibility of a cryptocurrency issued by RBI as an alternative to the Indian rupee for digital transactions. The proposed cryptocurrency could become a part of RBI's own "blockchain", a distributed digital ledger and technology that supports cryptocurrencies. State Bank of India has taken the lead in bringing lenders and technology companies together for using blockchain technology to share information among banks to help prevent frauds and tackle bad loans in the Indian banking system.

12. *Non-banking entities providing P2P lending platform services to be classified as NBFCs*

RBI has issued a master directions on peer-to-peer ("P2P") lending in India. In this regard, RBI has notified that P2P lending platforms would be treated as NBFCs, thereby bringing them under RBI's supervision. According to the master direction no P2P lending platform shall commence or carry on the business of a P2P lending without obtaining a certificate of registration. Every company seeking registration with RBI as a P2P lending platform shall have a net owned fund of not less than INR 20 million. Moreover, existing companies undertaking the business of P2P lending as on the date of effect of these directions, shall apply for registration as an NBFC to RBI within 3 months from the such date.

13. *RBI amends framework regulating financial services provided by banks*

RBI has introduced amendments to the framework regulating financial services offered by banks. RBI has now provided limits for investments made in deposit taking NBFCs, companies engaged in non-financial services, real estate investment trusts and infrastructure investment trusts, which have recently been introduced in the market.

Significantly, RBI has permitted limited investments in Category I and II Alternative Investment Funds ("**AIFs**"), while allowing investments in Category III AIF by banks through a subsidiary. Such a move will stimulate the AIF industry by providing for an additional source of domestic capital, while also providing banks an opportunity to improve their return on equity by taking an exposure to risk-adjusted superior return products.

Further, banks are required to adhere to, *inter alia,* the minimum prudential requirements and put in place effective risk control measures in order to become professional clearing members or to provide broking services through a separate subsidiary, in the commodity derivatives segment of stock exchanges.

14. RBI eases norms for issuance of masala bonds

RBI has removed rupee denominated bonds sold overseas, or "masala bonds", from under the limit prescribed for investments by FPIs in the corporate bonds. Previously, masala bonds were reckoned under both corporate debt and External Commercial Borrowings ("**ECB**") for FPI investment. With effect from October 3, 2017, masala bonds will now be counted only under the ECB category, where a borrower just needs to seek RBI's approval to sell these securities. Such a move will open up more space for FPIs to invest in corporate bonds, at compressed spreads, and will lead to better monitoring of the sources and purposes of the investments. With this now SEBI has lifted its previously imposed restriction on such masala bonds.

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SECURITIES AND EXCHANGE BOARD OF INDIA ("SEBI")

1. Imposition of regulatory fees on ODI subscribers

SEBI has amended the FPI regulatory framework, *inter alia*, directing all ODI subscribers to pay a "Regulatory Fee" of USD 1,000 once every three years. This additional cost has been justified by SEBI given that it is required to undertake continuous monitoring of the ODI route and as such, has had to install dedicated IT systems for efficient reporting. SEBI hopes that imposition of this fee will make the direct route more attractive and discourage ODI subscribers from using multiple issuers. However, it is feared that given the increase in compliance costs, entities may find it unviable to use the ODI route going forward and as a consequence, may wind down their Indian portfolio completely. Please read our detailed analysis here.

2. Supreme Court decides on 'non-intermediary front-running'

Front running, the practise of buying or selling securities ahead of a large order so as to benefit from the subsequent price move is a securities market malpractice in case of market intermediaries. So far, non-intermediaries were kept outside the purview of the prohibition on front running. However, recently the Supreme Court has brought more entities, including unregistered non-intermediaries within the definition of front-running. The Supreme Court has held that any person who provides non-public information about possible 'buy' or 'sell' of securities in advance of a substantial order and such movement results in unfair benefits for a third party, such person will he held liable for front running.

3. SEBI makes disclosure norms stricter for all listed banks

In a regulatory move to ensure transparency and complete disclosure to all investors, SEBI has mandated all listed banks to disclose cases of disparity in the figures published by it as against the gross NPAs and provisions assessed by RBI. Further, any default in the banking system (defaults on loan from financial institutions, banks, external commercial borrowing etc.) or in the capital markets (defaults on debt securities, foreign currency convertibles etc.) identified by the listed company has to be disclosed within one working day from the date of default.

4. Issuance of ODIs against derivatives

As a part of SEBI's efforts towards increasing transparency and accountability in the ODI space and encouraging direct investments through FPI route, it has prohibited FPIs from issuing ODIs with derivatives as the underlying instrument, except where the derivative positions have been taken for hedging equity shares held by the FPI, on a one-to-one basis. Accordingly, all existing ODIs where the underlying derivative positions are not for the purposes of hedging equity shares will have to be liquidated by the date of maturity of the ODI instrument or by December 31, 2020, whichever is earlier. In addition, the compliance officers also have an added responsibility to certify that the derivatives position, on which the ODI is being issued, is only for hedging the equity shares held by it, on a one to one basis.

5. ***ICDR and Takeover Code amended to ease rules for investors buying stake in distressed companies***

New investors acquiring shares in distressed companies through the Strategic Debt Restructuring ("**SDR**") scheme, in line with RBI guidelines, are now exempted from fulfilling the requirements of preferential issue and open offer under the aforementioned SEBI regulations. These relaxations for SDR in listed stressed companies have been available to the lenders and are now being extended to the investors with the intention of stepping up efforts to tackle the menace of bad loans.

6. ***Integration of equity and commodity derivatives licenses***

Pursuant to the SEBI-Forward Market Commission merger and as a consequent extension of SEBI's supervisory powers, SEBI has now permitted an equity segment broker or clearing member to deal in the commodity derivatives market without setting up a separate entity and vice-versa. In the event the integration of licenses lead to a change in control of the stock broker and clearing member, a prior approval from SEBI will be required. SEBI believes that this integration will synergise the trading and settlement mechanism, risk management, regulatory oversight and improve the economic efficiency and ease of doing business.

7. ***Stock exchanges and clearing corporations directed to frame new outsourcing policy***

SEBI has directed stock exchanges and clearing corporations to prepare a new outsourcing framework within 6 months, for appointing third-party vendors such as service providers and outsourced agencies. Certain core and critical operations such as daily operation of trading facilities, management of the market functioning, clearing, settlement and risk management and enforcement of stock exchanges and clearing corporation rules cannot be outsourced to third parties, with the exception of outsourcing operations to associate or group companies on an arm's length basis. SEBI has proposed this revision to improve risk management and safeguard the markets and investors from risks such as conflict of interest.

8. ***SAT recognises SEBI's power to lift the corporate veil***

In a landmark decision, the Securities Appellate Tribunal ("**SAT**") has recognised SEBI's power to lift the corporate veil in order to identify who controls a regulated entity. Here, SAT declared that Sahara Mutual Fund failed to fulfil the "fit and proper" criteria since the Promoter-Director of the sponsor has been declared not fit and proper for the securities market by the Hon'ble Supreme Court and SEBI. While upholding SEBI's order, SAT stated that SEBI Act empowers SEBI to take actions in the interest of protecting the interests of the investors and hence, lifting the corporate veil to the extent of identifying who controls a regulated entity cannot be faulted and without such a power SEBI will be a mute spectator to many of the corporate misdeeds which may jeopardize the interests of investors.

9. ***SAT overturns SEBI's decision on shell companies***

Pursuant to a Ministry of Corporate Affairs' ("**MCA**") direction, SEBI issued a communication to the three stock exchanges, Bombay Stock Exchange, National Stock Exchange and Metropolitan Stock Exchange directing them to restrict trading of 331 listed suspected shell companies. The list includes listed companies such as J Kumar Infraprojects, Parsvnath Developers and Prakash Industries. However, recently, SAT has overturned SEBI's decision on the ground that SEBI passed the impugned order without any investigation when there was no urgency. The lack of urgency was clearly illustrated by the fact that it took nearly two months for SEBI to comply with the MCA direction. Pursuant to the SAT order, SEBI has taken some corrective steps and ordered for a forensic audit of 3 listed companies which are suspected to be shell companies.

10. SEBI drops the proposal of adopting 'bright line' control test

SEBI has decided to continue with the practice of ascertaining acquisition of "control" as per the extant definition in the Takeover Regulations, 2011 on a case-to-case basis and as such, scrap the proposal of adopting a 'bright line test', which entailed reduced regulatory scrutiny and was also prone to abuse. According to Ministry of Corporate Affairs and few other stakeholders, the 'bright line test' was proposed as a different approach to defining control and also prescribed a list of protective rights which would not constitute as acquisition of control.

11. Category II AIFs exempted from the mandatory one-year lock-in

Pursuant to SEBI's board meeting held in June 21, 2017, SEBI has now exempted Category II AIFs from the requirement of pursuing a mandatory one-year lock-in of shares during an IPO, an exemption previously available only to Category I AIFs. This exemption is applicable prospectively to only red herring prospectuses registered with the Registrar of Companies, on or after July 31, 2017.

12. SEBI issues guidelines for issuance listing of debt securities on exchanges in IFSCs

SEBI recently allowed debt securities to get listed on stock exchanges at the International Financial Service Centres ("**IFSCs**")even if these are issued elsewhere, subject to following all necessary listing and corporate governance norms. However, if the debt security that is to be listed at the IFSC is issued outside the IFSC, the issuer must be a resident in a Financial Action Task Force member jurisdictions.

Debt securities that are issued in the IFSCs are mandatorily required to be listed on a stock exchange within the IFSC. SEBI has also directed the stock exchanges at the IFSCs to evolve a detailed framework prescribing the eligibility criteria and other requirements for issuance and listing of debt securities in IFSCs. This move will help the Gujarat International Finance Tec-City ("**GIFT**") to be a globally comparable financial centre in terms of debt market activities.

13. SEBI allows REITs and InvITs to raise funds via debt securities

In order to facilitate growth of Infrastructure Investment Trusts ("**InvITs**") and Real Estate investment Trust ("**REITs**"), SEBI in its Board meeting held on September 18, 2017, has allowed REITs and InvITs to raise debt capital by issuing debt securities and introduced the concept of Strategic Investor for REITs on similar lines as already present in case of InvITs. SEBI has also proposed to have further consultations with the stakeholders to allow REITs to invest in at least 50% stake in the underlying holding company. Similarly, it has also proposed to allow a holding company, with at least 50% stake, to invest in the underlying special purpose vehicle.

14. IFSC Guidelines amended to increase participation

To streamline the operations at the IFSC, SEBI has now permitted any recognised domestic or foreign stock exchanges, clearing corporations and foreign depositories to set up a subsidiary (minimum of 51% stake) at the IFSC to offer its services.If an eligible foreign investors ("**EFIs**") who is not registered with SEBI as an FPI, wanted to operate at an IFSC, the EFI had to request a bank which is allowed by RBI to operate at the IFSC to carry out a due diligence for the account opening process. To further streamline the operations at the IFSC, SEBI has now allowed, a trading member of a stock exchange at the IFSC (in addition to a bank which is allowed to operate in the IFSC) to carry out the due diligence for a non-registered EFI during the account opening process.

15. SEBI strengthens enforcement mechanism for arbitration awards

In order to deter securities' arbitration award debtors from defaulting, SEBI has asked stock exchanges to create a common database of all defaulting clients which will be accessible to members across the stock exchanges. It is relevant to note that a client may be identified as defaulter if the client does not pay the award amount to the member as directed in the applicable arbitration or appellate arbitration order and also does not appeal at the next level of redressal mechanism within the timelines prescribed by SEBI or the Arbitration and Conciliation Act, 1996.

16. *SEBI sets up Committee on Fair Market Conduct*

In recognition of the fact that securities market environment being dynamic, periodic review of regulations and surveillance mechanisms is of utmost importance, SEBI has constituted a committee on Fair Market Conduct. Terms of reference of the committee includes identification of opportunities for improvement in the insider trading regulation and fraudulent and unfair trade practices regulation. This committee also is required to suggest short term and medium term measures for improved surveillance of the markets as well as issues of algorithm based high frequency trades, harnessing of technology and analytics in surveillance.

17. *Informal guidance on SEBI Listing Regulations*

In light of listing regulations[5], SEBI issued an informal guidance on whether senior managers of Accelya Kale Solutions Limited ("**AKSL**") can sell securities of two offshore group companies to the group parent company, when a portion of the sale consideration was linked to the eventual sale price received for the group at the time of exit by the private equity fund which owned the group. In this regard, SEBI has clarified that the relevant provision of the listing regulations will not be attracted in the present case given that the consideration has been paid to the senior managers in connection with securities of an entity not listed in India.

18. *SEBI seeks to curb unauthorized trade practices by brokers*

SEBI in the past has taken several steps to tackle the menace of "unauthorized trades". Currently, the regulations for commodity derivative markets require members to execute the trade of clients only after keeping evidence of placing the order. However, there were no such requirements in equity, equity derivative and currency derivative markets. To further strengthen regulatory provisions against un-authorized trades and also to harmonies the requirements across markets, SEBI has decided that all brokers shall execute trades of clients only after keeping evidence of the client placing such order.

19. *SEBI allows FPIs to trade in commodity derivatives in IFSCs*

SEBI has allowed the stock exchanges operating at IFSCs to trade in commodity derivatives. After receiving representations from the exchanges operating at the GIFT IFSC and after consultations with Government of India and RBI, SEBI has allowed FPIs to participate in commodity derivatives contracts traded in stock exchanges in IFSCs.

20. *SEBI allows mutual funds to use Interest Rate Futures*

SEBI has recently reviewed norms on investment in derivatives by mutual funds. The regulator has now allowed Mutual Funds ("**MFs**") to use Interest Rate Futures ("**IRF**") contracts to hedge risks from volatility in interest rates. MFs may hedge the portfolio or part of the portfolio (including one or more securities) on weighted average modified duration basis by using IRFs.

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INSURANCE REGULATORY AND DEVELOPMENT AUTHORITY ("IRDA")

1. *Insurers to follow RBI's pricing rules in case of put or call options in joint-venture agreements*

Pursuant to RBI allowing the inclusion of optionality clauses (put and call options) in contracts, vide its notification dated November 12, 2013, insurers had sought clarity from IRDAI as to whether the existing contracts with optionality clauses, entered into prior to the above RBI notification, were in compliance with the foreign exchange laws. In this regard, IRDAI has advised all insurers who have joint venture agreements with foreign entities incorporating optionality clauses (put and call options) therein to ensure that they are in compliance with the Foreign Exchange Management Act, 1999 and

[5] The listing regulation states that promoters or shareholders of a listed company cannot enter into any agreement with any shareholder or any other third party with regard to compensation or profit sharing in connection with dealings in the securities of such listed entity, unless the approval of the board and the public shareholders have been obtained

the applicable rules and regulation, including those regarding pricing.

2. *IRDAI proposes amendments to regulations regarding reward/commission paid to insurance agents/intermediaries.*

IRDAI has released a draft of the second amendment in relation to regulations pertaining to payment of commission, remuneration or reward to insurance agent or insurance intermediaries where it is *inter alia*, proposed to regulate the rewards for life insurance business for an insurance marketing firm separately under IRDAI's Insurance Marketing Firm Regulations, 2015. Further, IRDAI has sought to clarify that the commission payable to insurance intermediaries in the health insurance business is to be taken as 'Nil', unless otherwise specified in the Government Health Scheme.

In the context of motor insurance, IRDAI has also permitted insurance intermediaries to charge a commission on the third party insurance portion of the Motor (Comprehensive) policy equal to the commission chargeable for stand-alone motor insurance policies for third party insurance. IRDAI has also proposed that, in order to improve insurance coverage of two wheelers, slightly higher commissions be paid to insurance intermediaries for this category of automotive vehicles.

3. *Insurers to create a Debenture Redemption Reserve when issuing debentures*

In relation to the IRDAI (Other Forms of Capital) Regulations, 2015, IRDAI has clarified that insurers which have raised capital by issue of debentures, shall create a Debenture Redemption Reserve of 25% of the value of outstanding debentures in terms of the Companies Act, 2013, to protect investors against the possibility of default by the company and the same shall not considered as a liability for the purpose of computation of solvency margin and ratio.

4. *Aadhaar sufficient for insurance KYC*

With the objective of simplifying KYC processes required to be undertaken by insurers in order to on-board new clients, IRDAI has clarified that Aadhaar-based electronic-know your customer (e -KYC) process would be sufficient for the purpose of customer verification. While customers were previously required to submit PAN card, an address proof and a cancelled cheque to satisfy KYC requirements for buying insurance products, insurer now can authenticate an individual's details from the Aadhar database in accordance with the regulations specified by the Unique Identification Authority of India, and additional documents need not be provided by the customer. However, IRDAI has clarified that the e-KYC process can only happen with the customer's consent.

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ABOUT CYRIL AMARCHAND MANGALDAS

Cyril Amarchand Mangaldas or the Firm was founded in May 2015 to continue the legacy of the 100-year old Amarchand & Mangaldas & Suresh A. Shroff & Co., whose pre-eminence, experience and reputation of almost a century has been unparalleled in the Indian legal fraternity. Set up on the foundation of our glorious legal tradition and the outstanding legal practice built by Mr. Suresh A. Shroff, the Firm under the leadership of Mr. Cyril Suresh Shroff, along with its partners and associates, has come together to restructure and design a new blue print for the future.

With a long and illustrious history that began in 1917, the Firm is the largest full-service law firm in India, with over 625 lawyers, including 100 partners, and offices in India's key business centres at Mumbai, New Delhi, Bengaluru, Hyderabad, Ahmedabad and Chennai. The Firm advises a large, varied client base that includes domestic and foreign commercial enterprises, financial institutions, private equity funds, venture capital funds, start-ups and governmental and regulatory bodies. The Firm prides itself in having a strong value system that keeps its clients as the central focus. Building on the strength of this value system, the Firm has fostered a collaborative work culture and adopts a pragmatic and solution-oriented approach to problem solving. Today, the Firm is recognised globally as a trusted adviser which consistently delivers quality, capability and commitment to its clients.

FINANCIAL REGULATORY PRACTICE

The Financial Regulatory Practice is a focused advisory team, dedicated to providing end to end solution to financial institutions doing business in India. Our knowledge of the Indian regulatory regime for financial institutions, as well as our credibility with key regulators puts us in a unique position to advise such clients on all aspects of their business, from entry strategies to expansion, ongoing compliance, transactional advisory (both greenfield and brownfield) as well as regulatory representations.

DISCLAIMER

Should you have any queries in relation to any of the issues set out herein or on other areas of law, please feel free to contact us at the following coordinates:

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