NISM CERTIFICATION EXAMINATION WORK BOOK

III-A

Securities Intermediaries Compliance (Non-Fund)

NiSM NATIONAL INSTITUTE OF SECURITIES MARKETS
An Educational Initiative of SEBI

Workbook for

NISM-Series-III-A: Securities Intermediaries Compliance (Non-Fund) Certification Examination

National Institute of Securities Markets
www.nism.ac.in

This workbook has been developed to assist candidates in preparing for the National Institute of Securities Markets (NISM) Certification Examination for Securities Intermediaries Compliance, in particular for those intermediaries who do not involve in any fund-based activity and are registered with SEBI as either Stock Brokers, Depository Participants, Merchant Bankers, Underwriters, Bankers to the Issue, Debenture Trustees and Credit Rating Agencies.

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FOREWORD

NISM is a leading provider of high-end professional education, certifications, training and research in financial markets. NISM engages in capacity building among stakeholders in the securities markets through professional education, financial literacy, enhancing governance standards and fostering policy research. NISM works closely with all financial sector regulators in the area of financial education.

NISM Certification programs aim to enhance the quality and standards of professionals employed in various segments of the financial services sector. NISM's School for Certification of Intermediaries (SCI) develops and conducts certification examinations and Continuing Professional Education (CPE) programs that aim to ensure that professionals meet the defined minimum common knowledge benchmark for various critical market functions.

NISM certification examinations and educational programs cater to different segments of intermediaries focusing on varied product lines and functional areas. NISM Certifications have established knowledge benchmarks for various market products and functions such as Equities, Mutual Funds, Derivatives, Compliance, Operations, Advisory and Research.

NISM certification examinations and training programs provide a structured learning plan and career path to students and job aspirants who wish to make a professional career in the securities markets. Till March 2022, NISM has certified more than 15 lakh individuals through its Certification Examinations and CPE Programs.

NISM supports candidates by providing lucid and focused workbooks that assist them in understanding the subject and preparing for NISM Examinations. This book covers all important regulations related to the securities markets including, SEBI Act, SCRA, SCRR, PMLA, Insider Trading, FUTP etc. It also covers the regulations specific to Stock Brokers, Merchant Bankers, Debenture Trustees, Credit Rating Agencies, Bankers to an Issue. This book is a compendium of the important regulations, which the Compliance Officers working with various intermediaries in the securities markets refers to.

Dr. C.K.G. Nair
Director

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About NISM Certifications

The School for Certification of Intermediaries (SCI) at NISM is engaged in developing and administering Certification Examinations and CPE Programs for professionals employed in various segments of the Indian securities markets. These Certifications and CPE Programs are being developed and administered by NISM as mandated under Securities and Exchange Board of India (Certification of Associated Persons in the Securities Markets) Regulations, 2007.

The skills, expertise and ethics of professionals in the securities markets are crucial in providing effective intermediation to investors and in increasing investor confidence in market systems and processes. The School for Certification of Intermediaries (SCI) seeks to ensure that market intermediaries meet defined minimum common benchmark of required functional knowledge through Certification Examinations and Continuing Professional Education Programmes on Mutual Funds, Equities, Derivatives, Securities Operations, Compliance, Research Analysis, Investment Advice and many more. Certification creates quality market professionals and catalyzes greater investor participation in the markets. Certification also provides structured career paths to students and job aspirants in the securities markets.

About the Certification Examination for Securities Intermediaries Compliance (Non-Fund)

The examination seeks to create a common minimum knowledge benchmark for persons engaged in compliance function with any intermediary registered with SEBI as Stock Brokers, Depository Participants, Merchant Bankers, Underwriters, Bankers to the Issue, Debenture Trustees and Credit Rating Agencies.

The certification aims to enhance the quality of services as rendered by those engaged in compliance activities. It also aims at ensuring that the compliance officers are aware of the different regulations which govern the Securities Market.

Examination Objectives

This examination is broadly categorised into two parts. Part 'A' is generic in the sense that it gives the candidates a sense of the Financial and Regulatory Structure in India, the different Regulations which the intermediaries should be aware of and Part B specifically deals with the specific rules and regulations governing the Stock Brokers, Depository Participants, Merchant Bankers, Underwriters, Bankers to the Issue, Debenture Trustees and Credit Rating Agencies. On successful completion of the examination, the candidate should:

- Understand the financial structure in India; know the financial intermediaries and the types of products available in the Indian market.
- Understand the regulatory framework and the role of the various regulators in the financial system.
- Understand the importance of compliance activity and the scope and role of the compliance officer in the Indian securities market.
- Understand the various regulations and rules of the Indian securities market.
- Understand the importance of compliance with the rules and regulations and the penal actions initiated in case of any default or failure.

Assessment Structure

The examination consists of 100 questions of 1 mark each and should be completed in 2 hours. The passing score on the examination is 60%. There shall be a negative marking of 25% of the marks assigned to a question.

Examination Structure

The exam covers knowledge competencies related to the understanding of the financial structure in India and the importance of the different rules and regulations governing the Indian securities market.

How to register and take the examination

To find out more and register for the examination please visit *www.nism.ac.in*

Important

- Please note that the Test Centre workstations are equipped with either Microsoft Excel or OpenOffice Calc. Therefore, candidates are advised to be well versed with both of these softwares for computation of numericals.
- The sample questions and the examples discussed in the workbook are for reference purposes only. The level of difficulty may vary in the actual examination.

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PART A – UNDERSTANDING FINANCIAL STRUCTURE IN INDIA

CHAPTER 1: INTRODUCTION TO THE FINANCIAL SYSTEM

LEARNING OBJECTIVES:
After studying this chapter, you should know about the following components of financial system:

- Financial Market
- Financial Intermediaries
- Financial Securities

1.1 Financial System

The Financial System refers to the entire set of institutionalized arrangements by which funds are transferred from surplus units to deficit units at terms acceptable to both sides. Households as a sector represent the surplus unit, whereas corporations and governments collectively represent deficit units. An efficient financial system plays an important role in economic development and it consists of financial market, financial instruments and financial intermediaries. The role of the financial system is to gather or pool money from surplus units i.e., people and businesses that have more than they need currently and transmit or allocate those funds to deficit units i.e., those who can use them for investment. A larger flow of funds and efficient allocation of them leads to better economic output and welfare of the economy and society. In addition to this, the financial market should also function efficiently and at a minimal cost in cooperation with the other constituents of the financial system.

1.1.1 Financial Market

A Financial Market can be defined as the market in which financial assets such as equities, bonds, currencies and derivatives are created or transferred. It is a mechanism that allows traders to deal in financial securities, commodities, etc. at low costs which reflects the efficiency of the market.

Financial Market can be classified into different subtypes:

Money market is a market for financial assets that are close substitutes for money. It is a market for short term funds and instruments having a maturity period of one or less than one year. Money market provides short term debt financing and investment. The money market deals primarily in short-term debt securities and investments, such as banker's acceptances, Negotiable Certificates of Deposit (NCDs), repos and Treasury Bills (T-bills), call/notice money market, commercial papers.

Capital market is a market for securities, where business enterprises and government can raise long term funds. It is generally defined as a market in which money is provided for periods longer than a year. It can be sub classified into **Stock Market** which helps in raising funds through the issue of shares or stock and **Bond Market** which helps in raising funds through the issue of bonds.

Bonds in India are issued by Government (both State and Central), Corporates and Municipal Bodies. Capital Markets also provide the mechanism for subsequent trading of stocks and bonds.

Both the capital market and the money market have two interdependent and inseparable segments, *the primary market and the secondary market*. The primary market is used by issuers for raising fresh capital from the investors by making initial public offers or rights issues or offers for sale of equity or debt; on the other hand, the secondary market provides liquidity to these instruments, through trading and settlement on the stock exchanges. An active secondary market promotes the growth of the primary market and capital formation since the investors in the primary market are assured of a continuous market where they have an option to liquidate their investments. Thus, in the primary market, the issuer has direct contact with the investor, while in the secondary market, the dealings are between two investors and the issuer does not come into the picture.

The Forex market deals with the multicurrency requirements, which are met by the exchange of currencies. Depending on the applicable exchange rate, the transfer of funds takes place in this market. This is one of the most developed and integrated markets across the globe.

Credit market is a place where banks, Financial Institutions (FIs) and Non-Banking Financial Companies (NBFCs) provide short, medium and long-term loans to corporates and individuals.

Insurance market facilitates the transfer of various risks from individuals, business houses and bodies corporate to insurance companies.

1.2 Financial Intermediaries

A large variety and number of intermediaries provide intermediation services in the Indian securities market. They are the entities who are involved in the business of managing individual portfolios, executing orders, dealing in or distributing securities etc.

Merchant Bankers are entities that specialize in assisting companies to originate issues of securities. The range of assistance covers the following:

1. Advising the client on the timing of an issue
2. Advising the company on the selection of underwriters, brokers, bankers and others, e.g., drafting the prospectus and verifying the accuracy of the claims made therein interacting with regulators/exchanges

Bankers to Issues are scheduled banks that are engaged by companies to accept application money, allotment or call money, undertake refund of application money and pay dividend or interest warrants.

Registrars and Share Transfer Agents are persons registered under the SEBI (Registrars to an Issue and Share Transfer Agents) Regulations, 1993. They provide services relating to a public or

rights issue. It includes collating data on subscriptions to an issue, preparation of basis of allotment, crediting shares to the Demat accounts of the allottees etc.

Transfer Agents are persons that maintain record of holders of securities and deal with all matters connected with transfer or redemption of securities or incidental activities of a company so that it reflects changes in ownership of shares consequent upon trading and also handle dividend payouts and communications relating to other corporate actions.

Depositories are institutions that hold securities of investors in electronic (dematerialized) form, for a fee. The investors remain the beneficial owners of the securities. A Depository Participant (DP) is the registered agent of the Depository concerned and it is through the DP that an investor gets the services of the depository. It can be compared to a branch of a bank where individuals maintain their savings accounts. The DP interacts with the investor and furnishes the record pertaining to an investor's portfolio. The DP also facilitates the release of securities when sold, or the recording of securities when bought or obtained on allotment.

Stock Exchanges are an important constituent of the secondary market of Capital Market. Stock Exchange means a body of individuals or a body incorporated, under the Companies Act, to assist, regulate or control the business of buying, selling or dealing in securities.

Stock Brokers who are registered with SEBI provide different types of services which include the undertaking of secondary market transactions on behalf of their clients, that is, by executing buy or sell transactions communicated by investors. For their service, stock brokers earn a commission, commonly referred to as brokerage. Stock brokers also play a role in the marketing of new issues of securities by informing and advising investors of new issues.

Clearing House is the intermediary which performs two important functions: a) aggregating transactions over a trading period, netting the positions to determine the liabilities of members and ensures movement of funds and securities to meet respective liabilities; and b) guaranteeing those trades, in the event of default by either buyer or seller.

Portfolio Managers are individuals or firms that administer the portfolios of individuals or provide advice or direction to that effect, for a fee or a share in the profits or a combination of the two.

Mutual Funds are trusts that mobilize funds from investors by issuing units and undertake to invest the money in a manner consistent with the specified investment objective. The objective could be to maximize capital growth or to maximize current income or something similar. There are two types of investment schemes: open-end and closed-end. In the former, demand for units

is met by a fresh supply, so there is no limit on the number of units that can be issued. With closed-end funds, there is a limit on the number of units that can be issued and following issuance, units are traded in the secondary market. Closed-end funds have a specified maturity, unlike open-end funds.

Custodians are entities that hold securities or gold or gold-related instruments on behalf of institutional investors, e.g., mutual funds and insurance companies. Custodians maintain and reconcile the records relating to the assets held and also monitor corporate actions such as dividend payments or rights issues on behalf of their clients. In short, custodians are mainly into trade settlement, safekeeping, benefit collection, reporting and accounting. One point of distinction is that a Depository has the right to effect transfer of beneficial ownership while a custodian does not.

Warehouse means any premises (including any protected place) conforming to all the requirements including manpower specified by the Authority by regulations wherein the warehouse keeper takes custody of the goods deposited by the depositor and includes a place of storage of goods under controlled conditions of temperature and humidity.

Credit Rating Agency is a body corporate that is engaged in or proposes to be engaged in, the business of rating of securities offered by a company, including fixed deposits and credit facilities. Any person wanting to commence business as a credit rating agency should make an application to SEBI in the format prescribed by SEBI.

Debenture trustee means a trustee of a trust deed for securing any issue of debentures of a body corporate. An application by a debenture trustee for a grant of certificate to act as a debenture trustee shall be made to SEBI as per the prescribed format. According to Mutual Fund Regulations, trustee means the Board of Trustees or the Trustee Company who hold the property of the Mutual Fund in trust for the benefit of the unit holders. Similarly, with respect to the Alternate Investment Fund (AIF) Regulations, the Trustee is required to ensure certain compliances, for which it imposes relevant restrictions under the Fund Documents (for example, compliance with providing an exit mechanism to investors upon a material change in the PPM).

1.3 Financial Securities

According to the Securities Contracts (Regulation) Act, 1956, the term, “securities” encompasses:

a) shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or a pooled investment vehicle or other body corporate;

b) Derivative[1];
c) units or any other instrument issued by any collective investment scheme to the investors in such schemes;
d) security receipt as defined in section 2 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002;
e) units or any other instrument issued by any pooled investment vehicle;
f) any certificate or instrument (by whatever name called), issued to an investor by any issuer being a special purpose distinct entity which possesses any debt or receivable, including mortgage debt, assigned to such entity, and acknowledging beneficial interest of such investor in such debt or receivable, including mortgage debt, as the case maybe;
g) Government securities;
h) such other instruments as may be declared by the Central Government to be securities;
i) rights or interest in securities;

Stock means a type of security that signifies ownership in a corporation and represents a claim on part of the corporation's assets and earnings.

Equity shares represent an ownership interest in a company. The claim of equity shareholders on earnings and assets (in the event of liquidation) comes last and hence is residual in nature. Equity shareholders expect to benefit from dividends and price appreciation. They have both collective and individual rights such as the right to elect directors, the right to transfer shares, attend and vote at general meetings.

Preference shares are securities that have a preferential right to dividend and repayment of capital. These shares do not carry voting rights except when their rights are affected. These are hybrid securities as they combine features of both equity and debt. They bear dividends, similar to equities, which may or may not be paid, and offer no collateral as security. The preference shares have a finite life and the dividend is a stated per cent of par value, similar to debt securities.

Debentures are debt securities having a definite life during which they pay coupon, which is interest at a specified rate on the par value, at regular intervals, typically every six months. Bonds too are debt securities with similar features except that internationally the distinguishing feature of bonds is that they are secured by specific collateral. In India, long-term debt securities issued by the Government of India or State Government or partially by any one of them are called bonds.

[1] As per SCRA, derivative includes a security derived from a debt instrument, share, loan, whether secured or unsecured, risk instrument or contract for differences or any other form of security; a contract which derives its value from the prices, or index of prices, of underlying securities; commodity derivatives; and such other instruments as may be declared by the Central Government to be derivatives. *[Amended by the Finance Act 2015].*

Warrants are long-term call options issued by a company, which give the holder the right to buy equity shares from the company at a specified price known as the subscription price or exercise price. Warrants are separately tradable and their price behaviour is linked to that of the underlying equity share.

Derivatives are financial contracts that derive their values from underlying assets or groups of assets. Some common forms of derivatives instruments are as follows:

- **Options** are contracts that give the holder the right, but not the obligation, to buy or sell some underlying asset. For example, a call option on an equity share gives the holder the right to buy the underlying at a specific price known as the exercise price or strike price. On the other hand, a put option gives the holder the right to sell the underlying at a specific price. A call option would be bought if the buyer expects the price of the underlying to rise, while a put option will be bought if the buyer expects the price of the underlying to decline. The seller of the option is also known as the writer of the option. While the holder of the option is under no obligation to perform any action, it is the writer who is obligated to perform, that is, deliver securities on exercise of a call, or make payment on exercise of a put. For granting the privilege of either buying or selling a stock, the writer receives a payment known as premium. Options positions can be offset before expiration.
- **Futures** contracts guarantee delivery of a specific quantity of a specified asset on a specified future date, at the price currently quoted. If an investor anticipates the spot price on the delivery date to be higher than the quoted futures price today, then he or she may buy the contract hoping to make a profit. But, if an investor anticipates the spot price to be lower than today's quoted futures price, then the contract could be sold. Positions in futures contracts can be offset before the delivery date.

Index Derivatives: Futures contracts based on stock or financial index i.e., BSE Sensex or NSE Nifty 50 are known as Index Derivatives. The underlying asset of these derivatives are the stock market indices.

Exchange-traded derivative contracts are standardized in terms of the quantity, quality, time and place of delivery. They are transacted on an organised futures exchange.

Structured Products Structured products typically comprise bonds, equities, and derivatives as an underlying asset class. These products come either with Capital protection (full or partial principal return) or without capital protection features. Private banks, Wealth management firms, and NBFC (Non-Banking Financial Companies) offer structured products in India. It is typically suited for high net-worth investors who are looking for low risk and portfolio diversification for good returns

Alternate Investment Fund (AIF) AIF means any fund established or incorporated in India which is a privately pooled investment vehicle that collects funds from sophisticated investors, whether Indian or foreign, for investing it in accordance with a defined investment policy for the benefit of its investors. It is a form of a pooled-in vehicle for investing in real estate, private estate, private equity and hedge funds. AIF adds diversification to a portfolio and helps mitigate the risk.

ADR is an acronym for American Depository Receipt which is a security denominated in US Dollars, traded at US exchanges, representing a specific number of equity shares of a foreign company that are traded in the foreign country.

GDR is an acronym for Global Depository Receipt. It is an instrument denominated in foreign currency that allows foreign investors to invest in shares of foreign companies which are listed and traded in the foreign country. As an example, a Euro-denominated GDR issued by an Indian company will have a certain number of Rupee-denominated equity shares underlying it. The GDR may trade freely in the overseas security market where it is listed. A GDR holder may opt to liquidate the investment, in which case, the underlying shares will be released for sale by the custodian in India.

IDR is an acronym for Indian Depository Receipt. It is a Rupee-denominated security which is traded in Indian stock exchanges, representing a specific number of shares of a foreign company. An IDR offers Indian investors, access to foreign securities that are listed and traded at foreign exchanges. When security is termed fungible, it refers to the feature that allows an instrument to be replaced by another of a similar description, for instance, an ADR, vis-à-vis its underlying share.

Mutual Fund (MF) **units** represent the share of the investors/ unit holders in the assets of the scheme. The fund managers invest the money collected to try and achieve the specified investment objective.

Exchange-traded Funds (ETFs) are open-ended mutual funds that allow trading of their units throughout the day. This facility is in contrast to conventional mutual funds where buying and selling happen at the closing Net Asset Value (NAV) of the day or of the following day, depending on the precise time at which the investor placed the order. ETFs are passively managed investment options, while mutual funds are actively managed investment options.

Currency Derivatives (CDs) are contracts between buyers and sellers, whose values are derived from the underlying assets, i.e., the currency amounts. These are risk management tools in the forex and money markets. These may be options or futures or swaps, which offer investors the facility to lock in the rate at which they wish to buy or sell a particular currency. As an example,

an Indian exporter with Kuwaiti Dinar receipts who expects an appreciation of the Indian Rupee could buy a put option, to sell Dinar. In contrast, an Indian importer with Euro liability and expecting the foreign currency to appreciate could buy a call option on Euros. Alternatively, the Indian exporter could sell a futures contract in Kuwaiti Dinar and the Indian importer could buy a futures contract in Euros. Currency Swaps are agreements between parties that facilitate borrowing in foreign currencies at lower costs. For instance, a British firm may need Euros while a French firm may require Pounds Sterling. However, taking comparative advantage into account, it may be a better option for the British and French firms to raise funds in their respective currencies and then enter into a swap. The principals are also re-exchanged at maturity.

Interest-rate Derivatives are contracts that enable investors or borrowers to hedge against the risk of adverse interest-rate movement. These include interest-rate futures, interest-rate swaps, interest-rate options and Forward Rate Agreements (FRAs).

Interest-rate Futures are contracts in which the underlying asset is a debt security, for example, futures on Treasury Bills (T-Bills), Commercial Papers (CP) or Government Securities. An investor may trade in interest-rate futures with the objective of locking in a certain yield or borrowing rate. To illustrate, if a corporate treasurer apprehends a fall in interest rates by the time surplus funds are received, he could lock in the higher yield currently quoted by buying an interest-rate futures contract. On the other hand, if a banker fears a rise in interest rates by the time he enters the market to raise funds, he could lock in the lower rate currently quoted by selling an interest-rate futures contract.

Interest-rate Swaps are agreements between two or more parties to exchange the series of cash flows in the same currency over an agreed period of time. For instance, two prospective borrowers may have opposite views on the direction of interest rate movement in the future: ‘A’ expects rates to decline while ‘B’ thinks they will rise. On the basis of the comparative advantage enjoyed by one party, say, A, it may be beneficial for A to borrow fixed-rate and for B to borrow floating-rate and then for the two to enter into a swap. In an interest-rate swap, the principals are not exchanged.

Interest-rate Options is a derivative financial instrument. It can be caps or floors. A **cap** is bought to limit the interest rate to a specific ceiling on floating-rate borrowings, in the event that the benchmark rate starts rising. A **floor** is bought to earn a minimum rate of return on floating-rate investments, in the event that the benchmark rate begins to decline. Spread transactions and combinations involving multiple options to craft specific pay-out or receipt patterns are also possible.

Forward Rate Agreement (FRA) is a forward contract by which a borrower locks in a specified rate of interest for a pre-determined time period in the future. For example, assume that a company is planning to seek a six-month loan after three months. The company expects short-term rates to rise. So, it could buy a three-month FRA on six-month LIBOR at, say 7 % (using, LIBOR, that is, the London Inter-bank Offer Rate as the reference rate in the transaction). At the end of three months, if the six-month LIBOR is greater than 7 %, the bank which sold the FRA will pay the excess sum to the company. On the other hand, if the LIBOR turns out to be lower than 7 %, the company will pay the difference to the bank.

Securities Lending and Borrowing Scheme (SLB): Short Selling means selling a stock that the seller does not own at the time of the trade. Short selling can be done by borrowing the stock through Clearing Corporations of a stock exchange that are registered as Approved Intermediaries (AIs). Short selling can be done by retail as well as institutional investors. The Securities Lending and Borrowing mechanism allows short sellers to borrow securities for making delivery.

E-warehouse receipts: Warehouse receipt means an acknowledgement in writing or in the electronic form issued by a warehouse keeper or his duly authorised representative (including depository by whatever name called) of the receipt for storage of goods not owned by the warehouse keeper. E-warehouse receipts are negotiable warehouse receipts issued in electronic format.

REITs and InvITs

Real Estate Investment Trusts (REITs) and Infrastructure Investment Trusts (InvITs) are innovative vehicles that allow developers to monetise revenue-generating real estate and infrastructure assets while enabling investors or unit holders to invest in these assets without actually owning them. Such monetization benefits developers by allowing them to release capital for funding new infrastructure/real estate projects, and provides liquidity to investors or unit holders as the units of the trust are listed on exchanges. Apart from these, REITs and InvITs enjoy favourable tax treatment, including exemption from tax deduction at source for dividend distributed to REITs and InvITs.

Review Questions

1. Financial systems consist of banks, non-banks and _____.

   (a) Bullion Markets

   (b) Financial Markets

   (c) Money lenders

   (d) NGOs

2. Safekeeping and record-keeping of securities are done by _____.

   (a) Custodians

   (b) Venture Capital Funds

   (c) Brokers

   (d) Mutual Funds

3. Who amongst the following collates data on subscriptions regarding primary issuances?

   (a) Banks

   (b) Custodians

   (c) Venture Capital Funds

   (d) Registrars

4. As per the Securities Contract Regulation Act (SCRA), the term 'Security' excludes which of the following?

   (a) Shares

   (b) Bonds

   (c) Derivatives

   (d) Bullion

CHAPTER 2: REGULATORY FRAMEWORK - GENERAL VIEW

LEARNING OBJECTIVES:

After studying this chapter, you should know about:

- Financial Market Regulators and their role—SEBI, RBI, IRDAI, PFRDA
- Regulatory Bodies—ROC, EOW, FIU-India
- Securities Appellate Tribunal (SAT)
- Legislative framework governing the financial markets
- Bye-laws of stock exchanges
- Taxes on securities

2.1 Regulatory System

Regulation of the securities market is motivated by the need to safeguard the interests of investors. What is paramount is to ensure that investors make informed decisions on the basis of complete transparency and fairness in both primary and secondary market transactions. The basic objective of SEBI is to:

a. To protect the interest of investors in securities markets
b. To promote the development of securities markets
c. To regulate the securities markets

There are many other issues which warrant regulation. For example, deliberately engineered speculative activities in the stock market or insider trading are undesirable as they can hurt investors at large; companies and mutual funds issuing securities and units ought to furnish adequate disclosures on all relevant facts; stockbrokers ought to execute transactions most efficiently and also refrain from charging excessive brokerage. There can be instances of unethical activities which can be detrimental to investors in general such as insider trading, misusing the power of attorney given by investors to brokers, price manipulation, front running, etc.

There are various regulatory institutions that regulate different sectors of the financial system. For instance, the Securities and Exchange Board of India (SEBI) regulates the securities industry (Capital market), the Reserve Bank of India (RBI) regulates the banking sector, the Insurance Regulatory and Development Authority of India (IRDAI) regulates insurance companies, while the Pension Fund Regulatory and Development Authority (PFRDA) regulates the pension fund sector. Additionally, intermediaries representing some segment of the securities market may form a Self-Regulatory Organization (SRO). In order to obtain recognition as an SRO from SEBI, certain conditions have to be met as prescribed under the SEBI (Self-Regulatory Organizations)

Regulations, 2004. Ideally, an SRO will seek to uphold investors' interests by laying out and maintaining high ethical and professional standards of conduct and encouraging best practices among its members.

The ruling given by a regulator may be challenged by petitioning the prescribed authority. In the case of SEBI, for example, the appellate authority is the Securities Appellate Tribunal (SAT). Rulings of the SAT can be challenged in the Supreme Court of India. Importantly, no civil court shall entertain any suit or proceeding relating to a matter which an adjudicating officer appointed under the SEBI Act, or under a duly constituted SAT, is empowered under the said Act to decide upon. Further, no injunction can be granted by any court or any other authority with regard to any action taken or to be taken pursuant to any power conferred by the SEBI Act.

2.2 Financial Market Regulators

As already discussed in the above section, the role of a market regulator is to regulate markets, to ensure integrity and protect the interests of investors. The different regulators who regulate the activities of the different sectors in the financial market are as given below:

- Ministry of Finance (MOF)
- Ministry of Corporate Affairs (MCA)
- Securities and Exchange Board of India (SEBI) regulates the Securities, Commodities and Futures markets.
- Reserve Bank of India (RBI) is the authority to regulate and monitor the Banking sector.
- Insurance Regulatory and Development Authority of India (IRDAI) regulates the Insurance sector.
- Pension Fund Regulatory and Development Authority (PFRDA) regulates the pension fund sector.
- International Financial Services Centres Authority (IFSCA) is a unified authority for the development and regulation of financial products, financial services and financial institutions in the International Financial Services Centre (IFSC) in India.

We will discuss in brief the role of each regulator in the subsequent sections.

2.2.1 Role of Securities and Exchange Board of India (SEBI)

SEBI was established as a non-statutory body on April 12, 1988. It was established as a statutory body in the year 1992 and the provisions of the Securities and Exchange Board of India Act, 1992 (15 of 1992) came into effect on January 30, 1992. The preamble of SEBI describes the basic functions of the Securities and Exchange Board of India as "...*to protect the interests of investors*

in securities and to promote the development of, and to regulate, the securities market and for matters connected therewith or incidental thereto"

As per Section 11(2) of SEBI Act, SEBI is empowered under the various regulations of the SEBI Act to;

a) Regulate the business in stock exchanges and any other securities markets;
b) Register and regulate the working of stockbrokers, share transfer agents, bankers to an issue, trustees of trust deeds, registrars to an issue, merchant bankers, underwriters, portfolio managers, investment advisers and others associated with the securities market. SEBI's powers also extend to registering and regulating the working of depositories and depository participants, custodians of securities, foreign institutional investors, credit rating agencies, and others as may be specified by SEBI;
c) Register and regulate the working of venture capital funds and collective investment schemes including mutual funds;
d) Promote and regulate self-regulatory organisations;
e) Prohibit fraudulent and unfair trade practices relating to the securities market;
f) Promote investors' education and training of intermediaries in the securities market;
g) Prohibit insider trading in securities;
h) Regulate substantial acquisition of shares and takeover of companies;
i) Require disclosure of information, to undertake inspection, conduct inquiries and audits of stock exchanges, mutual funds, other persons associated with the securities market, intermediaries and SROs in the securities market. The requirement of disclosure of information can apply to any bank or any other authority or board or corporation established or constituted by or under any Central or State Act which, in the opinion of the Board, shall be relevant to any investigation or inquiry by the Board in respect of any transaction in securities;
j) Call for information from or furnish information to other authorities within India or abroad having functions similar to SEBI in matters relating to prevention or detection of violations in respect of securities laws;
k) Perform such functions and to exercise such powers under the Securities Contracts (Regulation) Act, 1956 as may be delegated to it by the Central Government;
l) Levy fees or other charges pursuant to the implementation of this regulation;
m) Conduct research for the above purposes;
n) Call from or furnish to such agencies specified by the Board, information as may be considered necessary for the discharge of its functions;
o) Performing such other functions as may be prescribed.

Some of the powers of SEBI as provided in the SEBI Act include:

Section 11(2A): The power to inspect any book, or register or other document or record of any listed public company or a public company which intends to get its securities listed at a recognized stock exchange if SEBI has reasonable grounds to assume that the concerned company has been indulging in insider trading or fraudulent and unfair trade practices relating to securities market.

Section 11(3): SEBI shall have the same powers as are vested in a civil court under the Code of Civil Procedure 1908, in respect of certain matters, such as the inspection of books and registers and summoning and enforcing the attendance of persons and examining them on oath.

Section 11(4) empowers SEBI to take the following actions if it is in the interest of investors or the Securities Market:

- suspend the trading of any security in a recognized stock exchange
- restrain persons from accessing the securities markets, and prohibiting any persons associated with securities market from buying, selling or dealing in securities
- suspend any office-bearer of any stock exchange or SRO from holding such position
- impound and retain the proceeds or securities relating to any transaction which is under investigation
- attach bank accounts or other property of any intermediary or any person associated with the securities market in any manner involved in violation of any of the provisions of the SEBI Act or the rules or regulations made thereunder, for upto 90 days.
- direct any intermediary or person associated with the securities market in any manner not to dispose off or alienate an asset constituting a part of any transaction which is under investigation

Section 11(5): The amount disgorged pursuant to direction issued under section 11B of the SEBI Act or section 12A of the Securities Contracts (Regulation) Act, 1956 or section 19 of +Depositories Act, 1996 or under a settlement made under section 15JB or section 23JA of the Securities Contracts (Regulation) Act, 1956 or section 19-IA of the Depositories Act, 1996, as the case may be, shall be credited to the Investor Protection and Education Fund established by SEBI and such amount shall be utilised by SEBI in accordance with the regulations of SEBI Act 1992.

Section 11A: SEBI is vested with the power to regulate or prohibit the issue of prospectus, offer document or advertisement which solicits money for the issue of securities.

Section 11A (1) empowers SEBI to specify regulations with respect to matters relating to the issue of capital, transfer of securities and other incidental matters as well as the manner in which such matters are required to be disclosed by the Companies. Apart from this, SEBI is empowered to issue general or special orders prohibiting any company from issuing the prospectus, any offer

document, or advertisement soliciting money from the public for the issue of securities and specify the conditions subject to which the prospectus or offer document or advertisement, if not prohibited, may be issued.

Section 11A (2) empowers SEBI to specify the requirements for listing and transfer of securities and matters incidental thereto.

Section 11B: SEBI has been vested with the powers to issue direction to any intermediary if after making an enquiry it is found that the investor's interest is at stake or action of the intermediary is obstructing the orderly development of the securities market. If need be, SEBI can also in the interest of the market/investors secure the proper management of any such intermediary or person against whom enquiry has been made. This power includes the power to direct any person who made a profit or averted loss by indulging in any transaction or activity in contravention of the provisions of this Act or regulations made thereunder, to disgorge an amount equivalent to the wrongful gain made or loss averted by such contravention. Apart from the above, SEBI also has the power to levy penalties after recording its reasons in writing.

Section 11C: In cases where SEBI has reasonable ground to believe that the transaction in securities are being dealt with in a manner detrimental to the investors or the securities market or that any intermediary or any person associated with the securities market has violated any of the provisions of the SEBI Act or the rules or the regulations made or directions issued by SEBI , at any time by order in writing may direct any person to investigate the affairs of such intermediary or person associated with the securities market and also report to SEBI such investigation.

We would be discussing the SEBI Act in greater detail in Unit 4 of this workbook.

2.2.2 Role of Reserve Bank of India (RBI)

Reserve Bank of India (RBI) is the central bank of the country vested with the responsibility of administering the monetary policy. Therefore, its key concern is to ensure the adequate growth of money supply in the economy so that economic growth and financial transactions are facilitated, but not so rapidly which may precipitate inflationary trends. This is borne out in its Preamble, in which the basic functions of the Bank are thus defined: *"…to regulate the issue of Bank Notes and the keeping of reserves with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage; to have a modern monetary policy framework to meet the challenge of an increasingly complex economy, to maintain price stability while keeping in mind the objective of growth*". In addition to the primary responsibility of administering India's monetary policy, RBI has other onerous responsibilities, such as financial supervision.

The main functions of RBI are:

1. **As the monetary authority**: to formulate, implement and monitor the monetary policy in a manner as to maintain price stability while ensuring an adequate flow of credit to productive sectors of the economy.
2. **As the regulator and supervisor of the financial system**: To prescribe broad parameters of banking operations within which Indian banking and financial system functions. The objective here is to maintain public confidence in the system, protect the interest of the people who have deposited money with the bank and facilitate cost-effective banking services to the public.
3. **As the manager of Foreign Exchange**: To administer the Foreign Exchange Management Act 1999, in a manner as to facilitate external trade and payment and promote orderly development and maintenance of the foreign exchange market in India.
4. **As the issuer of currency**: To issue currency and coins and to exchange or destroy the same when not fit for circulation. The objective that guides RBI here is to ensure the circulation of an adequate quantity of currency notes and coins of good quality.
5. **Developmental role**: To perform a wide range of promotional functions to support national objectives.
6. **Regulator and Supervisor of Payment and Settlement Systems:** It introduces and upgrades safe and efficient mode of payment systems in the country to meet the requirements of the public at large. The objective is to maintain public confidence in the payment and settlement system.
7. **Banking functions**:
    a) It acts as a banker to the Government and manages issuances of Central and State Government Securities.
    b) It acts as a banker to the banks by maintaining the banking accounts of all scheduled banks.

The general superintendence and direction of RBI's affairs are entrusted to a Central Board of Directors which is appointed by the Government of India. Further, each of the four regions in the country is served by a Local Board which advises the Central Board on local issues and represents territorial and economic interests of local co-operative and indigenous banks. The Local Boards also perform other functions as delegated by the Central Board.

RBI performs the important function of financial supervision under the guidance of the **Board for Financial Supervision (BFS)** which was constituted in 1994 as a committee of the Central Board of Directors. The primary objective of the BFS is to carry out consolidated supervision of the financial sector consisting of commercial banks, financial institutions and non-banking finance companies. The BFS oversees the functioning of the Department of Banking Supervision, the Department of Non-Banking Supervision and Financial Institutions Division

and issues directions on regulatory and supervisory issues. Some of the initiatives undertaken by the BFS are:

- Fine-tuning the supervisory processes adopted by the Bank for regulated entities;
- Introduction of off-site surveillance system to complement the on-site supervision of regulated entities;
- Strengthening the statutory audit processes of banks and enlarging the role of auditors in the supervisory process;
- Strengthening the internal defences within supervised institutions such as corporate governance, internal control and audit functions, management information and risk control systems, review of housekeeping in banks;
- Introduction of supervisory rating system for banks and financial institutions;
- Supervision of overseas operations of Indian banks, consolidated supervision of banks;
- Technical assistance programme for cooperative banks;
- Introduction of the scheme of Prompt Corrective Action Framework for weak banks;
- Guidance regarding fraud risk management framework in banks;
- Introduction of risk-based supervision of banks;
- Introduction of an enforcement framework in respect of banks;
- Establishment of a credit registry in respect of large borrowers of supervised institutions; and
- Setting up a subsidiary of RBI to take care of the IT requirements, including the cyber security needs of the Reserve Bank and its regulated entities, etc.

RBI's functions are governed by the Reserve Bank of India Act 1934, whereas the financial sector is governed by the Banking Regulation Act 1949.

2.2.3 Role of Insurance Regulatory and Development Authority of India (IRDAI)

The mission of the Insurance Regulatory and Development Authority of India (IRDA) is to regulate, promote and ensure orderly growth of the insurance sector, including the re-insurance business while ensuring the protection of the interests of insurance policyholders. IRDAI was constituted by an act of parliament and according to Section 4 of the IRDA Act 1999, the Authority comprises ten members who are all government appointees.

The powers and functions of the authority include the following:

1. Issuing a certificate of registration or renewing, modifying, withdrawing, suspending or cancelling such registration.
2. Protecting the interests of policyholders in matters relating to assignment of the policy, nomination by policyholders, insurable interest, settlement of insurance claim, surrender value of the policy and other clauses of insurance contracts.

3. Specifying the required qualifications, code of conduct and practical training for intermediaries including insurance intermediaries and agents.
4. Promoting efficiency in the conduct of insurance business
5. Promoting and regulating professional organisational connected with insurance and re-insurance business
6. Specifying the code of conduct for surveyors and loss assessors.
7. Seeking information, undertaking inspection, conducting inquiries and investigations including audit of the insurer, intermediaries and others.
8. To control and regulate the rates and terms and conditions that may be offered by insurers with regard to general insurance, which are not covered by the Tariff Advisory Committee.
9. Regulating the investment of funds by insurance companies.
10. Regulating maintenance of margin of solvency
11. Adjudication of disputes between insurers and intermediaries or insurance intermediaries
12. Supervising the functioning of the Tariff Advisory Committee
13. Specifying the percentage of premium income of the insurer to finance schemes for promoting and regulating professional organisations
14. Specifying the percentage of life insurance business and general insurance business to be undertaken by the insurer in the rural or social sector; and
15. Exercising such other powers as may be prescribed.

2.2.4 Role of Pension Fund Regulatory and Development Authority (PFRDA)

PFRDA was established on 18 September 2013 in accordance with the provisions of the Pension Fund Regulatory and Development Authority Act, 2013 with the following responsibilities: (a) To promote old age income security by establishing, developing and regulating pension funds, (b) To protect the interests of subscribers to schemes of pension funds and related matters. The PFRDA Act is applicable to (i) the National Pension System (NPS) and (ii) any other pension scheme not regulated by any other enactment.

The Preamble of the Pension Fund Regulatory & Development Authority Act, 2013 describes the basic functions of the PFRDA as –

"…. to promote old age income security by establishing, developing and regulating pension funds, to protect the interests of subscribers to schemes of pension funds and for matters connected therewith or incidental thereto."

PFRDA regulates National Pension System (NPS), subscribed by employees of Govt. of India, State Governments and by employees of private institutions/organizations & unorganized sectors.

The PFRDA is empowered under the various regulations of the PFRDA Act to:

- regulate, promote and ensure orderly growth of the National Pension System and pension schemes to which this Act applies

- protect the interests of subscribers of such Systems and schemes
- call for information from, undertaking inspection of, conducting inquiries and investigations including audit of, intermediaries and other entities or organisations connected with pension funds.

The National Pension System (NPS) is a defined contribution retirement savings scheme regulated by PFRDA. It offers a menu of investment choices and Fund Managers to its subscribers. NPS is mandatory for the new recruits to the Central Government, except the armed forces. NPS is also available for all the citizens of India on a voluntary basis. However, mandatory programmes under the Employees Provident Fund Organization (EPFO) and other special provident funds continue to operate according to the existing system, under the Employees Provident Fund (EPF) and Miscellaneous Provisions Act 1952 and other special acts governing these funds.

2.2.5 Role of International Financial Services Centres Authority (IFSCA)

IFSCA has been established on April 27, 2020 under the International Financial Services Centres Authority Act, 2019. It is headquartered at Gift City, Gandhinagar in Gujarat.

Before the establishment of IFSCA, the domestic financial regulators, namely RBI, SEBI, PFRDA and IRDA regulated business in IFSC. As the dynamic nature of business in the IFSCs requires a high degree of inter-regulatory coordination within the financial sector, the IFSCA has been established as a unified regulator with a holistic vision to promote ease of doing business in IFSC and provide a world-class regulatory environment.

The main objective of the IFSCA is to develop a strong global connection and focus on the needs of the Indian economy as well as serve as an international financial platform for the entire region and the global economy as a whole.

2.3 Other Agencies in the Financial Market

There are several government departments / agencies / organisations that also help in the regulation of the financial market such as the Ministry of Finance (MoF).

Ministry of Finance (MoF) governs the entire fiscal system of the Government of India. It centralizes around all the issues in India pertaining to the economy and finance. It also undertakes the task of mobilization of resources for execution of developmental programmes. Department of Economic Affairs (DEA), Department of Expenditure, Department of Revenue, Department of Financial Services etc. are the various departments that are headed by the MoF.

Department of Economic Affairs (DEA) is the nodal agency of the Central Government for formulating and monitoring India's economic policies having a bearing on domestic and

international aspects of economic management. The main function of the DEA is formulation and monitoring of macroeconomic policies relating to fiscal policy and public finance etc. as well as the functioning of the capital market including stock exchanges. Other responsibilities include the mobilization of external resources, foreign investments and monitoring foreign exchange resources including balance of payments, production of bank notes and coins of various denominations etc.

Department of Financial Services administers government policies relating to:

- Public sector banks
- Life insurance and general insurance
- Pension reforms
- Development Financial Institutions (DFIs) like National Bank for Agriculture and Rural Development (NABARD), Small Industries Development Bank of India (SIDBI), India Infrastructure Finance Company Ltd. (IIFCL), National Housing Bank (NHB), Export-Import Bank of India (EXIM Bank), Industrial Finance Corporation of India (IFCI).

Department of Investment and Public Asset Management oversees, among other things, all matters relating to the disinvestment of equity shares of Central Government from Central Public Sector undertakings. The department is also concerned with the financial policy relating to the utilization of proceeds of disinvestment.

The ***Ministry of Corporate Affairs*** is mainly concerned with the administration of the Companies Act, 1956/2013 and other allied acts, rules and regulations pertaining to the corporate sector. The Ministry is also responsible for administering the Competition Act 2002 which has replaced the Monopolies and Restrictive Trade Practices Act, 1969 (MRTP). The Ministry also supervises three professional bodies, viz., the Institute of Chartered Accountants of India (ICAI), the Institute of Company Secretaries of India (ICSI) and the Institute of Cost Accountants of India. The Ministry of Corporate Affairs is also vested with the responsibility of administering the Partnership Act, 1932, the Companies (Donations to National Funds) Act, 1951 and Societies Registration Act, 1980.

2.3.1 Registrar of Companies (ROC)

Pursuant to Section 396(1) of the Companies Act, 2013, the Central Government has appointed Registrars at different places to discharge the function of registration of companies as provided in Section 7. Registrar of Companies (ROC) covers the various States and Union Territories and are vested with the primary duty of registering companies created in the respective states and the Union Territories and ensuring that such companies comply with statutory requirements under the Act. These offices function as a registry of records, relating to the companies registered with them, which are available for inspection by members of the public on payment of the

prescribed fee. The Central Government exercises administrative control over these offices through the respective Regional Directors.

Functions of ROC

1) To take care of registration of a company in the country
2) To maintain a register of Companies/LLP by entering names of newly incorporated companies and removing the names of those which are stuck off.
3) To complete regulation and reporting of companies and their shareholders and directors.
4) To administer government reporting of several matters which includes the annual filing of numerous documents.
5) To foster and facilitate a business culture
6) To ask for supplementary information from any company when necessary. The registrar of companies can search for any company and demand to look into the accounts of the company with prior approval from the court.
7) To file a petition for winding up of a company with the discretion of the government

The ROC also undertakes other important duties, some of which are given below:
Under Section 81, the Registrar has to maintain a register containing particulars of all charges in respect of each company.

Under Section 83, the Registrar on being given evidence to his satisfaction with respect to any registered charge:

a) The debt for which the charge was created has been paid or satisfied wholly or partly, or
b) The part of the property or undertaking charged has been released from the charge or has ceased to form a part of the company's property or undertaking;

The Registrar may enter in the Register of Charges a memorandum of satisfaction in whole or in part or about the fact that a part of the property or undertaking has been released from the charge or no longer forms a part of the company's property or undertaking as the case may be, even if no intimation is received by him from the company.
Section 206 confers power on the Registrar to call for information or explanation. On perusing any document which a company is required to submit to him under the Act, if the Registrar determines that any information or explanation pertinent to the document is necessary, the Registrar may by written order call for information in writing from the company. If no information or explanation is forthcoming within the time specified, or if the information or explanation is inadequate, then the Registrar may demand that the company produce for inspection such books and papers as he deems necessary.

Section 209 spells out the power of the Registrar to seize documents and therefore, goes a step beyond Section 206, by which the Registrar may only demand the production of documents. If the Registrar has reasonable grounds to believe that books and papers of, or relating to, any company or body corporate or managing director or manager of such an entity may be destroyed, mutilated, altered, falsified or secreted, then the Registrar may make an application to a Magistrate having appropriate jurisdiction to obtain authority to search and seize the books and papers as he deems necessary.

Section 248 of Companies Act, 2013 confers powers on the Registrar to strike a defunct company off the register, after completing the formalities prescribed in the section.

2.3.2 National Company Law Tribunal (NCLT)

The Central Government has constituted National Company Law Tribunal (NCLT) under section 408 of the Companies Act, 2013 w.e.f. 01st June 2016.

In the first phase the Ministry of Corporate Affairs have set up eleven Benches, one Principal Bench at New Delhi and ten Benches at New Delhi, Ahmadabad, Allahabad, Bengaluru, Chandigarh, Chennai, Guwahati, Hyderabad, Kolkata and Mumbai. These Benches are headed by the President and 16 Judicial Members and 09 Technical Members at different locations. Subsequently, more members have joined and Benches at Cuttack, Jaipur, Kochi, Amravati, and Indore have been set up.

It is a quasi-judicial authority dealing with corporate disputes that are of civil nature arising under the Companies Act and Insolvency and Bankruptcy Code. The NCLT is a single judicial forum dealing with all disputes concerning the affairs of Indian companies.

2.3.3 Serious Fraud Investigation Office (SFIO)

The Government of India had set up a Committee on Corporate Governance under the Chairmanship of Shri Naresh Chandra, former Cabinet Secretary. The Naresh Chandra Committee, inter-alia, recommended setting up of Corporate Serious Fraud Office. Consequent to the recommendation of the Naresh Chandra Committee and in the backdrop of stock market scams as also the failure of non-banking companies resulting in huge financial loss to the public, the Cabinet in its meeting held on 9th January, 2003 decided to set up a Serious Fraud Investigation Office (SFIO).

As per the decisions of the Cabinet, the Central Government issued a resolution on 2nd July, 2003 constituting this organisation. In continuation of the aforesaid Resolution, charter of Serious Fraud Investigation Office was issued by the Government on 21st of August, 2003 which, inter

alia, stated that the responsibilities and functions of the SFIO will include, but not be limited to the following: -

a) The SFIO is expected to be a multi-disciplinary organisation consisting of experts in the field of accountancy, forensic auditing, law, information technology, investigation, company law, capital market and taxation for detecting and prosecuting or recommending for prosecution white-collar crimes/frauds.

b) The SFIO will normally take up for investigation only such cases, which are characterized by –

i) complexity and having inter-departmental and multi-disciplinary ramifications;
ii) substantial involvement of public interest to be judged by size, either in terms of monetary
iii) the possibility of investigation leading to or contributing towards a clear improvement in systems, laws or procedures.

c) The SFIO shall investigate serious cases of fraud received from the Department of Company Affairs. SFIO may also take up cases on its own, subject to para (d) below. The SFIO would make investigations under the provisions of the Companies Act, 2013 and would also forward the investigated reports on violations of the provisions of other acts to the concerned agencies for prosecution/appropriate action.

d) Whether or not an investigation should be taken up by the SFIO would be decided by the Director, SFIO who will be expected to record the reasons in writing. These decisions will be further subject to review by a coordination committee.

With a view to review the functioning of the SFIO and to make it more effective, the Central Government constituted an Expert Committee under the Chairmanship of Shri Vepa Kamesam formerly Deputy Governor, Reserve Bank of India. The committee deliberated upon various issues relating to the investigation of corporate fraud, based on the experience of SFIO and the recent developments in India and the global arena. In its report dated 29th April, 2009 the committee gave various recommendations to suggest statutory, administrative and organizational changes for improving the effectiveness and to ensure efficient discharge of duties by SFIO. The committee had carefully considered the views and opinions of different regulatory and investigative agencies and gave its recommendations to the Ministry in developing its proposals for legislative changes and institutional development towards dealing with corporate fraud effectively and also making SFIO an effective investigative and law enforcement agency.

Serious Fraud Investigation Office (SFIO) has been established through the Government of India vide Notification NO. S.O.2005(E) dated 21.07.2015. It is a multi-disciplinary organisation under the Ministry of Corporate Affairs, consisting of experts in the field of accountancy, forensic auditing, banking, law, information technology, investigation, company law, capital market and

taxation etc. for detecting and prosecuting or recommending for prosecution white-collar crimes/frauds.

SFIO is headed by a Director as Head of Department in the rank of Joint Secretary to the Government of India. The Director is assisted by Additional Directors, Joint Directors, Deputy Directors, Senior Assistant Directors, Assistant Directors Prosecutors and other secretarial staff. The headquarters of SFIO is in New Delhi, with five Regional Offices in Mumbai, New Delhi, Chennai, Hyderabad & Kolkata.

Investigation Procedure

(i) As per Section 212 (1) of the Companies Act, 2013, the Central Govt. may assign the investigation into the affairs of a company to the Serious Fraud Investigation Office –

(a) on receipt of report of the Registrar or Inspector under section 208;
(b) on intimation of a special resolution passed by a company requesting an investigation into its affairs;
(c) in public interest;
(d) on the request of any Department of Central Government or State Government

On receipt of such order from the Government, Director, SFIO may designate such number of Inspectors as he may consider necessary for the purpose of such investigation.

(ii) As per sub-section (3) of section 212 of Companies Act, 2013, the investigation into the affairs of a company shall be conducted in the manner and by following the procedure specified in Chapter XIV of Companies Act, 2013. The SFIO shall submit its report to the Central Government within the period specified in the order.

(iii) As per sub-section (4) of section 212 of Companies Act, 2013, the Director, SFIO shall cause the affairs of the company to be investigated by an investigating officer, who shall have the powers of the Inspector under section 217 of the Companies Act, 2013.

(iv) As per sub-section (5) of section 212 of Companies Act, 2013, it shall be the responsibility of the company, its officers and employees, who are or have been in the employment of the company to provide all information, explanation, documents and assistance to the investigating officer as he may require for conduct of business.

(v) As per sub-section (11) of section 212 of Companies Act, 2013, the Serious Fraud Investigation shall submit an interim report, if so directed by the Central Government.

(vi) As per sub-section (12) of section 212 of Companies Act, 2013, on completion of an investigation, the SFIO shall submit the Investigation Report to the Central Government.

The Computer Forensic and Data Mining Laboratory (CFDML) was set up in 2013 to provide support and service to the officers of SFIO in their investigations. The laboratory is equipped with state-of- the- art tools for Computer (Media) Forensics and has adopted a quality system based on internationally accepted standards in accordance with ISO/IEC 17025.

Mission statement - The CFDML is committed to provide
i) quality service of international standards to its customers by adopting procedures that are valid, reliable and sufficient for the intended purpose.
ii) technically valid results which fulfil statutory and regulatory requirements. iii) impartial and objective analysis in a time-bound manner and maintain a high level of integrity.

The CFDML has been notified as Examiner of Electronic Evidence u/s 79A of Information Technology Act, 2000 by the Ministry of Electronics and Information Technology (MeitY).

2.3.4 Economic Offences Wing (EOW)

The Economic Offences Wing (EOW) in the Central Bureau of Investigation was created in 1964 to deal with offences under various sections of the Indian Penal Code and notified underSpecial Acts mainly relating to serious frauds in banks, stock exchanges, financial institutions, joint-stock companies, public limited companies, misappropriation of public funds, criminal breach of trust, violation of Customs Act, counterfeiting of currency, narcotics, drug trafficking, arms peddling and offences relating to adulteration, black-marketing and others.

Following the securities and stock market scam of 1992, it was deemed desirable to strengthen and expand the EOW and accordingly, a full-fledged Economic Offences Division (EOD) was formed in 1994. The EOD has four zones of which one focuses exclusively on large and complicated security and bank frauds.

The areas currently covered by the EOD are:

1. Frauds relating to foreign trade
2. Banking frauds
3. Insurance frauds
4. Foreign exchange frauds
5. Frauds involving manipulation of share prices, insider trading and others
6. Smuggling of narcotics and psychotropic substances
7. Forgery of travel documents, identity papers and overseas job rackets
8. Counterfeit currency and fake Government stamps and paper

9. Smuggling of antiques, arts and treasures
10. Cybercrimes
11. Violation of Intellectual Property Rights, audio and video piracy and software piracy
12. Wildlife and environmental offences

State governments have also set up their EOWs to deal with commercial crimes, thefts of idols, bogus lottery tickets and other offences.

2.3.5 Financial Intelligence Unit - India (FIU-I)

Financial Intelligence Unit – India (FIU-IND) was set up by the Government of India vide O.M. dated 18th November 2004 as the central national agency responsible for receiving, processing, analyzing and disseminating information relating to suspect financial transactions. FIU-IND is also responsible for coordinating and strengthening efforts of national and international intelligence, investigation and enforcement agencies in pursuing the global efforts against money laundering and financing of terrorism. FIU-IND is an independent body reporting directly to the Economic Intelligence Council (EIC) headed by the finance minister.

The main function of FIU-IND is to receive cash/suspicious transaction reports, analyse them and, as appropriate, disseminate valuable financial information to intelligence/enforcement agencies and regulatory authorities. The functions of FIU-IND are:

- **Collection of Information:** Act as the central point for receiving Cash Transaction reports (CTRs), Non-Profit Organisation Transaction Report (NTRs), Cross Border Wire Transfer Reports (CBWTRs), Reports on Purchase or Sale of Immovable Property (IPRs) and Suspicious Transaction Reports (STRs) from various reporting entities.

- **Analysis of Information:** Analyze received information in order to uncover patterns of transactions suggesting suspicion of money laundering and related crimes.

- **Sharing of Information:** Share information with national intelligence/law enforcement agencies, national regulatory authorities and foreign Financial Intelligence Units.

- **Act as Central Repository:** Establish and maintain a national database on the basis of reports received from reporting entities.

- **Coordination:** Coordinate and strengthen the collection and sharing of financial intelligence through an effective national, regional and global network to combat money laundering and related crimes.

- **Research and Analysis:** Monitor and identify strategic key areas on money laundering trends, types and developments.

The value of information exchange at an international level in support of law enforcement efforts has proven itself to be highly significant. FIUs have the ability to exchange financial information that is helpful for following the financial trail in law enforcement investigations, including those related to terrorism, and uncovering criminal assets.

The Financial Action Task Force (FATF) is an inter-governmental body which sets standards and develops and promotes policies to combat money laundering and terrorist financing. The revised Forty Recommendations of FATF provide a complete set of counter-measures against money laundering covering the criminal justice system and law enforcement, the financial system and its regulation, and international co-operation. These Recommendations have been recognised, endorsed, or adopted by many international bodies as the international standards for combating money laundering.

Certain exclusive and concurrent powers under the Prevention of Money Laundering Act (PMLA) are conferred on the Director, FIU-IND. For instance, under Section 13(2) of the PMLA, the Director may impose a fine on any banking company, financial institution or intermediary for failing to comply with the obligations of maintenance of records or to furnish information or to verify the identities of clients. For the purposes of Section 13, the Director shall have the same powers as are vested in a civil court under the Court of Civil Procedure 1908, while trying a suit, such as discovery and inspection, compelling the production of records and so on. Under Section 66 of the PMLA, the Director or a specified authority may furnish or cause to be furnished, any information received or obtained, to any officer, authority or body, if it is deemed to be in the public interest.

2.3.6 Police Authorities

The police authorities are responsible for maintaining law and order and for enabling the enforcement of The Indian Penal Code (IPC) which contains laws on crimes of various kinds. The IPC has 511 sections, some of which contain detailed descriptions of certain crimes. In the context of the securities market, sections that have particular relevance are the ones relating to specific offences, such as:

a. Giving false evidence and offences against public justice (sections 191 to 229)
b. Offences against property (sections 378 to 462)
c. Offences relating to documents and property marks (sections 463 to 489E)
d. Attempts to commit offences (section 511)

To illustrate the relevance, some of the sections from the ones listed above are discussed as follows:

Section 192 relates to the fabrication of false evidence. For example: making a false entry in any book or record or electronic record; or, making a document or electronic recording containing a false statement intending that such circumstances, false entry or false statement may appear in evidence in a judicial proceeding or in a proceeding taken by law which may cause an erroneous opinion to be formed.

Section 403 relates to the dishonest misappropriation of property. The offence is committed when a person dishonestly misappropriates or converts to his own use any movable property.

Section 405 is about a criminal breach of trust. The offence is committed when a person who has been entrusted with property or dominion over property, dishonestly misappropriates it or converts it to his own use or disposes off that property in violation of any direction of law or legal contract or wilfully makes another person do so.

Offences relating to property, marks and documents include forgery (sections 463 and 465) and making a false document (section 464); further, if a clerk, officer or servant wilfully and with intent to defraud makes a false entry in, omits or alters or abets the omission or alteration of any material particular from or in any such book,electronic record, paper, writing, valuable security or account belonging to or in the possession of his employer, then it is an act of falsification of accounts, which is an offence under section 477A.

2.4 Appellate Authority

2.4.1 Role of Appellate Authority -Securities Appellate Tribunal (SAT)

The Securities Appellate Tribunal has been set up under the SEBI Act, which hears and disposes of the appeals of any person who has been aggrieved by any order of SEBI or of any adjudicating officer under the Act. This section elaborates on the different sections under the SEBI Act which discusses the establishment and the role of SAT. Section 15K (1) of the SEBI Act, 1992, empowers the Central Government to establish Securities Appellate Tribunal (SAT) to exercise jurisdiction, powers and authority under the said Act or any other law in force. SAT shall consist of a presiding officer and such other members, as may be determined by the Central Government. The qualification for appointment is that the person should be a sitting or retired- judge of the Supreme Court or Chief Justice of a High Court or a Judge of High Court for at least 7 years in the case of the Presiding Officer and is or has been a Judge of High Court for at least five years in case of a Judicial Member . There are specific requirements prescribed for a Technical Member.

SAT hears and disposes of appeals against orders passed by the Pension Fund Regulatory and Development Authority (PFRDA) under the PFRDA Act, 2013 and against orders passed by the Insurance Regulatory Development Authority of India (IRDAI) under the Insurance Act, 1938, the General Insurance Business (Nationalization) Act, 1972 and the Insurance Regulatory and Development Authority Act, 1999 and the Rules and Regulations framed thereunder.

Any person aggrieved by the following may appeal to the SAT, provided the aggrieved person had not granted his consent to the order against which the appeal is being made. The appeal must be filed within a period of 45 days from the date on which a copy of the order is received:

a. An order of SEBI made on or after the commencement of the Securities Laws (Second Amendment) Act, 1999, under the SEBI Act 1992, or related rules and regulations.
   OR
b. By an order made by an Adjudicating Officer under the Act.
   OR
c. By an order of the Insurance Regulatory and Development Authority or the Pension Fund Regulatory and Development Authority.

As per Section 15U (1), the SAT shall not be bound by the procedure laid down by the Code of Civil Procedure, 1908, but shall be guided by the principles of natural justice. Further, subject to other provisions of the SEBI Act, 1992, and rules, the SAT shall have powers to regulate its own procedure.

As per Section 15U (2), the SAT shall have, for discharging its functions, the same powers as are vested in a civil court under the Code of Civil Procedure, 1908, while trying a suit, in respect of the following matters:

a) Summoning and enforcing the attendance of any person and examining him on oath
b) Requiring the discovery and production of documents
c) Receiving evidence on affidavits
d) Issuing commissions for the examination of witnesses or documents
e) Reviewing its decisions
f) Dismissing an application for default or deciding it *ex-parte*
g) Setting aside any order of dismissal of any application for default or any order passed by it *ex-parte*
h) Any other matter which may be prescribed

According to Section 15U (3), every proceeding before the SAT shall be deemed to be a judicial proceeding and SAT shall be deemed to be a civil court.

Section 15U (4) states, where Benches are constituted, the Presiding Officer of the SAT may, from time to time, make provisions as to the distribution of the business of the SAT amongst the Benches and also provide for the matters which may be dealt with, by each Bench.

According to section 15U (5), on the application of any of the parties and after notice to the parties, and after hearing such of them as he may desire to be heard, or on his own motion without such notice, the Presiding Officer of the SAT may transfer any case pending before one Bench, for disposal, to any other Bench.

Section 15U (6) states that if a Bench of the SAT consisting of two members differ in opinion on any point, they shall state the point or points on which they differ, and make a reference to the Presiding Officer of the SAT who shall either hear the point or points himself or refer the case for hearing only on such point or points by one or more of the other members of the SAT and such point or points shall be decided according to the opinion of the majority of the members of the SAT who have heard the case, including those who first heard it.

Section 15V states that the appellant may either appear in person or authorize one or more chartered accountants or company secretaries or cost accountants or legal practitioners or any of its officers to present his or its case before the SAT.

Section 15W states that the provisions of the Limitation Act, 1963 shall apply to an appeal made to a SAT.

Section 15Y specifies that no civil court shall have jurisdiction to entertain any suit or proceeding in respect of any matter which SAT constituted under the SEBI Act is empowered to decide upon. Further, no injunction shall be granted by any court or authority in respect of any action taken or to be taken in pursuance of any power conferred by or under the SEBI Act.

Section 15Z states that any person aggrieved by any decision or order of the SAT may file an appeal to the Supreme Court within 60 days from the date of communication of the decision or order of the SAT to him, on any question of law arising out of the order.

2.5 Legislative Framework Governing the Financial Market

Understanding the financial market, intermediaries and the regulators are involved in efficient regulation of the system, in this section, we however try to take a look at the main rules and regulations pertaining to the securities market. The subsequent chapters in this workbook will delve deeper into each of the regulations as discussed hereunder.

2.5.1 SEBI Act, 1992

The SEBI Act, 1992 is an act to provide for the establishment of a Board to protect the interests of investors in securities and to promote the development of, and to regulate, the securities market and related matters. SEBI's regulatory ambit includes stock exchanges, stockbrokers, sub-brokers, share transfer agents, bankers to an issue, trustees of trust deeds, registrars to an issue, merchant bankers, underwriters, portfolio managers, investment advisers and other intermediaries associated with the securities market. Further, SEBI is the authority to regulate depositories, participants, custodians, foreign institutional investors, credit rating agencies, mutual funds and venture capital funds. SEBI is also vested with the responsibility of prohibiting fraudulent and unfair trade practices relating to the securities market, including insider trading.

2.5.2 Securities Contracts (Regulation) Act, 1956

The Securities Contracts (Regulation) Act, 1956 is a legislation designed to prevent undesirable transactions in securities by regulating the business of securities dealing and trading. In pursuance of its objects, the Act covers a variety of aspects, some of which are listed below:

1. Granting recognition to stock exchanges
2. Corporatization and demutualization of stock exchanges
3. The power of the Central Government to call for periodical returns from stock exchanges
4. The power of SEBI to make or amend bye-laws of recognized stock exchanges
5. The power of the Central Government (exercisable by SEBI also) to supersede the governing body of a recognized stock exchange
6. The power to suspend the business of recognized stock exchanges
7. The power to prohibit undesirable speculation

2.5.3 Securities Contracts (Regulation) Rules, 1957

Section 30 of the Securities Contracts (Regulation) Act, 1956 empowers the Central Government to make rules for the purpose of implementing the objects of the said Act. Pursuant to the same, the Securities Contracts (Regulation) Rules 1957 have been made. These rules contain specific information and directions on the following:

- Formalities to be completed including submission of application for recognition of a stock exchange
- Qualification norms for membership of a recognized stock exchange
- Mode of entering into contracts between members of a recognized stock exchange
- Obligation of the governing body to take disciplinary action against a member, if so, directed by the SEBI
- Audit of accounts of members

- Maintaining and preserving books of accounts and other documents by every recognized stock exchange and by every member
- Submission of the annual report and periodical returns by every recognized stock exchange
- Requirements with respect to the listing of securities on a recognized stock exchange
- Requirements with respect to the listing of units or any other instrument of a Collective Investment Scheme on a recognized stock exchange

2.5.4 SEBI (Prohibition of Insider Trading) Regulations, 2015

The SEBI (Prohibition of Insider Trading) Regulations, 2015 has come into force w.e.f. May 2015. Any trading done by an insider based on information that is not available in the public domain gives an undue advantage to insiders and affects market integrity. This is not in line with the principle of fair and equitable disclosure. In order to protect the integrity of the market, the SEBI (Prohibition of Insider Trading) Regulations have been put in place. The Regulations mainly provide for who are insiders, what is prohibited for them and the systemic provisions which need to be laid down and followed by listed companies as well as intermediaries to prevent insider trading.

The regulations define an "insider" as any person who is connected with a company or who is in possession of or as having access to unpublished price sensitive information in respect of securities of a company.

Since "generally available information" is defined, it is intended that anyone in possession of or having access to unpublished price sensitive information should be considered an "insider" regardless of how one came in possession of or had access to such information. Various circumstances are provided for such a person to demonstrate that he has not indulged in insider trading.

Connected person means any person who is or has during the six months prior to the concerned act been associated with a company, directly or indirectly, in any capacity including by reason of frequent communication with its officers or by being in any contractual, fiduciary or employment relationship or by being a director, officer or an employee of the company or holds any position including a professional or business relationship between himself and the company whether temporary or permanent, that allows such person, directly or indirectly, access to unpublished price sensitive information or is reasonably expected to allow such access.

Person is deemed to be a connected person if such person is:

(a) an immediate relative of connected persons specified in clause (i); or

(b) a holding company or associate company or a subsidiary company; or

(c) an intermediary as specified in section 12 of the SEBI Act or an employee or director thereof; or

(d) an investment company, trustee company, asset management company or an employee or director thereof; or

(e) an official of a stock exchange or clearing house or corporation; or

(f) a member of the board of trustees of a mutual fund or a member of the board of directors of the asset management company of a mutual fund or is an employee thereof; or

(g) a member of the board of directors or an employee, of a public financial institution as defined in section 2 (72) of the Companies Act, 2013; or

(h) an official or an employee of a self-regulatory organization recognised or authorized by the SEBI; or

(i) a banker of the company; or

(j) a concern, firm, trust, Hindu undivided family, company or association of persons wherein a director of a company or his immediate relative or banker of the company, has more than ten per cent of the holding or interest;

It is intended that a connected person is one who has a connection with the company that is expected to put him in possession of unpublished price sensitive information. Immediate relatives and other categories of persons specified above are also presumed to be connected persons but such a presumption is a deeming legal fiction and is rebuttable. This definition is also intended to bring into its ambit persons who may not seemingly occupy any position in a company but are in regular touch with the company and its officers and are involved in the know of the company's operations. It is intended to bring within its ambit those who would have access to or could access unpublished price sensitive information about any company or class of companies by virtue of any connection that would put them in possession of unpublished price sensitive information.

The Regulation also defines the term "generally available information" which means information that is accessible to the public on a non-discriminatory basis. It is intended to define what constitutes generally available information so that it is easier to crystallize and appreciate what unpublished price sensitive information is. Information published on the website of a stock exchange would ordinarily be considered generally available.

This Regulation is also applicable to Immediate Relative. Immediate relative is defined to include the spouse of a person, parents, sibling, child of such person or the spouse, any of whom is either dependent financially on such person, or consults such person in taking decisions relating to trading in securities. It is intended that the immediate relative of the "connected person" also becomes a connected person for purpose of these regulations.

2.5.5 SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003

The SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003 prohibit fraudulent, unfair and manipulative trade practices in securities. These regulations have been made in exercise of the powers conferred by section 30 of the SEBI Act, 1992.

Regulation 2(1) (c) defines fraud as inclusive of any act, expression, omission or concealment committed whether in a deceitful manner or not by a person or by any person with his connivance or by his agent while dealing in securities, in order to induce another person or his agent to deal in securities whether or not there is any wrongful gain or avoidance of any loss and shall include

a) A knowing misrepresentation of the truth or concealment of material fact in order that another person may act, to his detriment
b) A suggestion as to a fact which is not true, by one who does not believe it to be true
c) An active concealment of a fact by a person having knowledge or belief of the fact
d) A promise made without any intention of performing it
e) A representation, whether true or false, made in a reckless and careless manner
f) Any such act or omission as any other law specifically declares to be fraudulent
g) deceptive behaviour by a person depriving another of informed consent or full participation
h) false statement made without reasonable ground for believing it to be true
i) the act of an issuer of securities giving out misinformation that affects the market price of the security resulting in investors being effectively misled even though they did not rely on the statement itself or anything derived from it other than the market price

In this context, the term dealing in securities needs to be understood. It is defined as under:

"Dealing in securities" includes:

(i) an act of buying, selling or subscribing pursuant to any issue of any security or agreeing to buy, sell or subscribe to any issue of any security or otherwise transacting in any way in any security by any persons including as principal, agent, or intermediary referred to in the Act;

(ii) such acts which may be knowingly designed to influence the decision of investors in securities; and

(iii) any act of providing assistance to carry out the aforementioned acts.

Chapter II of the regulations prohibits certain dealings in securities covering buying, selling or issuance of securities. Further, it specifies instances of manipulative, fraudulent or unfair trade practice which includes the following:

a. Knowingly indulging in an act that creates a false or misleading appearance of trading in the securities market
b. Dealing in a security that is not intended to effect a transfer of beneficial ownership but to serve only as a device to inflate or depress or cause fluctuations in the price of such security for wrongful gain or avoidance of loss
c. Inducing any person to subscribe to an issue of the securities for fraudulently securing the minimum subscription to such issue of securities, by advancing or agreeing to advance any money to any other person or through any other means
d. Inducing any person for dealing in any securities for artificially inflating, depressing, maintaining or causing fluctuation in the price of securities through any means including by paying, offering or agreeing to pay or offer any money or money's worth, directly or indirectly, to any person
e. Any act or omission which is tantamount to a manipulation of the price of security including, influencing or manipulating the reference price or benchmark price of any securities
f. A person dealing in securities, knowingly publishing or causing to publish or reporting or causing to report any untrue information or information relating to securities, including financial results, financial statements, mergers and acquisitions, regulatory approvals which he does not believe to be true, prior to, or in the course of dealing in securities
g. Entering into a transaction in securities without the intention of performing it or without the intention of change of ownership of such security
h. Selling, dealing or pledging of stolen, counterfeit or fraudulently issued securities whether in the physical or dematerialized form:
i. However, if:
    a. the person selling, dealing in or pledging stolen, counterfeit or fraudulently issued securities was a holder in due course; or
    b. the stolen, counterfeit or fraudulently issued securities were previously traded on the market through a bonafide transaction,
    c. such selling, dealing or pledging of stolen, counterfeit or fraudulently issued securities shall not be considered as a manipulative, fraudulent, or unfair trade practice
j. disseminating information or advice through any media, whether physical or digital, which the disseminator knows to be false or misleading in a reckless or careless manner and which is designed to, or likely to influence the decision of investors dealing in securities;
k. A market participant entering into transactions on behalf of client without the knowledge of or instructions from client or mis-utilizing or diverting the funds or securities of the client held in a fiduciary capacity;

l. Circular transactions in respect of security entered into between persons including intermediaries to artificially provide a false appearance of trading in such security or to inflate, depress or cause fluctuations in the price of such security;
m. Fraudulent inducement of any person by a market participant to deal in securities with the objective of enhancing his brokerage or commission or income;
n. An intermediary predating or otherwise falsifying records including contract notes, client instructions, the balance of securities statement, client account statements
o. Any order in securities placed by a person, while directly or indirectly in possession of information that is not publicly available, regarding a substantial impending transaction in those securities, its underlying securities or its derivative;
p. Knowingly planting false or misleading news which may induce the sale or purchase of securities.
q. Mis-selling of securities or services relating to securities market; mis-selling means sale of securities or services relating to securities market by any person, directly or indirectly, by i) knowingly making a false or misleading statement or ii) knowingly concealing or omitting material facts or iii) knowingly concealing the associated risk or iv) not taking reasonable care to ensure the suitability of the securities or service to the buyer.
r. Illegal mobilization of funds by sponsoring or causing to be sponsored or carrying on or causing to be carried on any collective investment scheme by any person

Chapter III relates to the investigation of transactions of the nature described above. In particular, under regulation 8(1), it shall be the duty of every person who is under investigation:

a. To produce books, accounts, records and documents that may be required by the Investigating Authority and also to furnish statements and information that is sought.
b. To appear before the Investigating Authority personally when required to do so and to answer questions posed by the authority.

2.5.6 SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011

The SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, are spread over six chapters dealing with issues such as disclosures of shareholding and control, substantial acquisition of shares or voting rights, the procedure for an open offer, obligations of the acquirer, merchant banker and the target company and investigation and action by SEBI.

The regulations begin with an explanation of important terms such as “acquirer”, “acquisition” “control”, “a person acting in concert” “promoter”, “promoter group”, “wilful defaulter” and “fugitive economic offender”. Some of the regulations are discussed below, to illustrate the nature and scope of the regulations.

Regulation 3(1) – Public Announcement of an open offer

According to regulation 3(1), any acquirer who acquires shares or voting rights, which (taken together with shares or voting rights, if any held by him) would entitle him to exercise twenty-five per cent or more voting rights in a company, in any manner whatsoever, is required to make a public announcement of an open offer for acquiring shares of the target company.

Regulation 3(2) – Acquisition of additional shares or voting rights

Regulation 3(2) states that no acquirer who together with persons acting in concert with him, has acquired and holds in accordance with these regulations shares or voting rights in a target company entitling them to exercise twenty-five per cent or more of the voting rights in the target company but less than the maximum permissible non-public shareholding, shall acquire within any financial year additional shares or voting rights in such target company entitling them to exercise more than five per cent of the voting rights unless the acquirer makes a public announcement of an open offer for acquiring shares of such target company in accordance with these regulations.

In the case of a listed entity which has listed its specified securities on Innovators Growth Platform, the percentage would be 49% instead of 25%.

Regulation 4 – No control unless public announcement of an open offer is made

Regulation 4 states irrespective of acquisition or holding of shares or voting rights in a target company, no acquirer shall acquire, directly or indirectly, control over such target company unless the acquirer makes a public announcement of an open offer for acquiring shares of such target company in accordance with these regulations

Regulation 5(1) – Grounds for the indirect acquisition of share/voting rights/control

Regulation 5 (1) for the purposes of regulation 3 and regulation 4, acquisition of shares or voting rights in, or control over, any company or other entity, that would enable any person and persons acting in concert with him to exercise or direct the exercise of such percentage of voting rights in, or control over, a target company, the acquisition of which would otherwise attract the obligation to make a public announcement of an open offer for acquiring shares under these regulations, shall be considered as an indirect acquisition of shares or voting rights in, or control over the target company

Regulation 5(2) – Grounds for indirect acquisition considered as direct acquisition

Regulation 5(2) Notwithstanding anything contained in these regulations, in the case of an indirect acquisition attracting the provisions of sub-regulation (1) where,—

(a)the proportionate net asset value of the target company as a percentage of the consolidated net asset value of the entity or business being acquired

(b) the proportionate sales turnover of the target company as a percentage of the consolidated sales turnover of the entity or business being acquired; or

(c) the proportionate market capitalisation of the target company as a percentage of the enterprise value for the entity or business being acquired; is in excess of eighty per cent, based on the most recent audited annual financial statements, such indirect acquisition shall be regarded as a direct acquisition of the target company for all purposes of these regulations including without limitation, the obligations relating to timing, pricing and other compliance requirements for the open offer.[2]

Regulation 29(1) – Disclosure when 5% or more of shares/voting rights are acquired
Regulation 29(1) states that any acquirer who acquires shares or voting rights in a target company which taken together with shares or voting rights, if any, held by him and by persons acting in concert with him in such target company, aggregating to five per cent or more of the shares of such target company, shall disclose their aggregate shareholding and voting rights in such target company in such form as may be specified.

Regulation 29(2) – Transactions resulting in more than 2% change in shareholding/voting rights
Regulation 29(2) states: Any person, who together with persons acting in concert with him, holds shares or voting rights entitling them to five per cent or more of the shares or voting rights in a target company, shall disclose the number of shares or voting rights held and change in shareholding or voting rights, even if such change results in shareholding falling below five per cent, if there has been a change in such holdings from the last disclosure made under sub-regulation (1) or under this sub-regulation; and such change exceeds two per cent of total shareholding or voting rights in the target company, in such form as may be specified.
In the case of listed entity which has listed its specified securities on Innovators Growth Platform, any reference to “five per cent” shall be read as “ten per cent” and any reference to “two per cent” shall be read as “five per cent

Regulation 29(3) – Disclosure regarding acquisition/disposal of shares/voting rights in 2 days
Regulation 29(3) states: The disclosures required under sub-regulation (1) and sub-regulation (2) shall be made within two working days of the receipt of intimation of allotment of shares, or the acquisition or the disposal of shares or voting rights in the target company to, -
(a) every stock exchange where the shares of the target company are listed; and
(b) the target company at its registered office.

[2]Explanation—For the purposes of computing the percentage referred to in clause (c) of this sub-regulation, the market capitalisation of the target company shall be taken into account on the basis of the volume-weighted average market price of such shares on the stock exchange for a period of sixty trading days preceding the earlier of, the date on which the primary acquisition is contracted, and the date on which the intention or the decision to make the primary acquisition is announced in the public domain, as traded on the stock exchange where the maximum volume of trading in the shares of the target company are recorded during such period.

The other Regulations contain directions on various aspects of the public offer such as the appointment of a merchant banker, timing and content of the public announcement of the offer, submission of a letter of offer to SEBI and the offer price. Subsequent regulations deal with matters such as general obligations of the acquirer, merchant banker, BoD of the target company, provision of escrow to enable the acquirer to perform his obligations and substantial acquisition of shares in a financially weak company.

Regulation 32 empowers SEBI to issue directions or any other order such as:

a. Appointment of a merchant banker for the purpose of causing disinvestment of shares acquired in breach of the Takeover Regulations
b. Directing the transfer of any proceeds or securities to the Investor Protection and Education Fund established under the SEBI Act.
c. Directing the target company or depository not to give effect to the transfer of shares that have been acquired in violation of the Takeover Regulations.

2.5.7 Companies Act, 2013

The Companies Act, 2013 is legislation to consolidate and amend the law relating to companies and certain other associations.

The new Companies Act, 2013 is divided into 29 Chapters and 470 sections. All the sections have been notified as on date except Sections 129A, 393A and 418A.

The relevant Chapters are described briefly below:

Chapter III - Prospectus and Allotment of Securities

- Part I: Public Offer
- Part II: Private Placement
- Matters covered include the contents of a prospectus, its registration, shelf prospectus, red herring prospectus, civil and criminal liabilities for misstatements in the prospectus, allotment of securities by the company, Global depository receipt and offer or invitation for subscription of securities on private placement.

Section 24 of the Act which is part of this Chapter, states that the provisions contained in this Chapter, Chapter IV and section 127 shall be administered by SEBI if the company is listed or is proposing to get its securities listed on any recognised stock exchange.

Chapter IV Share Capital and Debentures: This Chapter describes the kinds of share capital, numbering and certificate of shares, voting rights, calls, dividend, issue of sweat equity shares,

issue and redemption of preference shares, debentures, buy-back of securities and alteration of capital.

Chapter VII Management and Administration: Matters dealt with herein include the registered office and name, the Register of Members and debenture holders, Annual Returns, meetings and proceedings.

Chapter VIII Declaration and Payment of Dividend: Matters dealt with are declaration of dividend, unpaid dividend account, Investor Education and Protection Fund and punishment for failure to distribute dividend

Chapter XI Appointment and Qualifications of Directors: This Chapter deals with the Board of Directors, selection of independent directors' small shareholders' director, appointment, resignation and removal of directors etc.

Chapter XII Meetings of Board and its Powers: This Chapter describes in detail the requirements relating to meetings of the Board, quorum, passing of resolution by circulation, audit committee, powers of the Board and the restrictions thereto as well as loans and investments by company, related party transactions and the prohibition on insider trading of securities.

Chapter XIII Appointment and Remuneration of managerial personnel: Appointment of Managing Director, whole-time director or manager, overall maximum managerial remuneration, calculation of profits, recovery of remuneration in certain cases, central government or company to fix a limit with regard to remuneration, compensation for loss of office of managing or whole-time director or manager.

Chapter XIV Inspection, Inquiry and Investigation: Powers and procedure for inspection and investigation of companies by the inspector and Serious Fraud Investigation Office are described in this Chapter.

Chapter XV Compromises, Arrangements and Amalgamations: Power to enter into a compromise or make arrangements with creditors and members, Power of Tribunal to enforce compromise or arrangement, merger and amalgamation of certain companies, Power to acquire shares of shareholders dissenting from scheme or contract approved by the majority, Power of Central Government to provide for amalgamation of companies in the public interest.

Chapter XVI Prevention of Oppression and Management: Application to the tribunal for relief in case of oppression, powers of the tribunal, consequences of termination or modification of certain agreements, class action.

Chapter XXVII National Company Law Tribunal and Appellate Tribunal: This Chapter deals with the constitution of National Company Law Tribunal and the Appellate Tribunal, qualification of President and members of the tribunal, selection of members of the appellate tribunal, term of office, salary allowances and other terms and conditions of service of members, resignation of members, removal of members benches of tribunals, orders of tribunal, appeal from orders of tribunal, appeal to the supreme court, procedures before the appellate tribunal, power to punish for contempt, the civil court not to have jurisdiction,

Chapter XXVIII Special Courts: This Chapter deals with the Establishment of Special Courts, offences triable by Special courts, offences to be non-cognizable, compounding of certain offences, mediation and conciliation panel and procedures related thereto.

Chapter XXIX Miscellaneous: The punishment and penalty sections alike punishment for fraud, false statement, false evidence, in case of repeated default, for wrongful withholding of property, adjudication of penalties, delegation by Central Government and its power and functions, Power to exempt class or classes of companies from provisions of Act,

There are seven Schedules in the Companies Act, 2013.

2.5.8 Indian Contract Act, 1872

The Indian Contract Act came into force on 1 September 1872. It lays down general principles with regard to contracts and applies to the whole of India, except the state of Jammu & Kashmir.

The law of contracts represents the most important branch of mercantile law and rests at the foundation of trade and commerce. It is pervasive as it affects us in our daily lives, often without our realizing it. The main purpose of the law is to impart credibility about the fulfilment of obligations in mercantile transactions. The contracts become enforceable through the courts of law.

A contract primarily must satisfy two conditions;

1. There shall be an agreement; and
2. Such an agreement should be enforceable by law which creates legal obligations.

Hence, agreements that are enforceable by law are contracts. An agreement is enforceable by law when it fulfils certain conditions as laid down in section 10 of The Indian Contract Act, 1872. As per section 10 of the Indian Contract Act "*All agreements are contracts if they are made by the free consent of parties competent to contract, for a lawful consideration and with a lawful object and are not hereby expressly declared to be void. Nothing herein contained shall affect any*

law in force in India and not hereby expressly repealed by which any contract is required to be made in writing or the presence of witnesses, or any law relating to the registration of documents."

The sections of the Act relate to matters such as:

1. Essentials of a valid contract
2. Classification of contracts
3. Offer, acceptance and communication of offer, acceptance and revocation of either
4. Capacity of the parties to a contract
5. Free consent
6. Consideration
7. Legality of object and consideration
8. Performance of a contract
9. Remedies for breach of contract
10. Indemnity and guarantee
11. Bailment and pledge
12. Law of agency

A more detailed explanation on the essential elements of a contract is provided below.

- There must be at least two parties to a contract, with an offer by one and acceptance by the other. Such offer and acceptance must be legal.
- The parties to the agreement must intend to create legal relations between them. Mere social or domestic agreements do not constitute contracts.
- The agreement to be enforceable by law must be supported by valuable consideration. An agreement to perform for nothing in return is usually not enforceable. The consideration could be an act of abstinence or a promise to do or not to do something.
- The parties must be capable of entering into a valid contract, that is, they should have attained the age of majority, should be of sound mind and not be disqualified from contracting by any law.
- The consent of the parties must be free, that is, it should not have been caused by coercion, undue influence, fraud, misrepresentation or mistake.
- The object of the agreement must be lawful, which implies that it must not be illegal, immoral or against public policy. Any agreement with an unlawful object is void.
- The terms of the agreement must be definite and certain. A court will not enforce a contract that contains vague or illusory terms.
- The agreement must be capable of performance. An agreement to perform an impossible act is void.
- The agreement must not have been expressly declared to be void. Examples of such agreements are:
    1. An agreement in restraint of trade

2. An agreement in restraint of legal proceedings
3. An agreement having uncertain meaning

- The agreement may be oral or written. However, those agreements which are required to be written or even attested and registered must be in the prescribed form. Examples are mortgages of immovable property and negotiable instruments.

From the perspective of the securities market, the law of agency is especially important and it governs the relationship between an investor (principal) and a broker (agent). The function of a broker is to establish the privity of a contract between two parties to a transaction for which he earns a commission, i.e., brokerage. Accordingly, section 226 makes it clear that contracts entered into through an agent and the resulting obligations may be enforced in the same manner and will have the same legal consequences as if the contracts had been entered into and the acts performed by the principal in person.

Certain sections spell out the agent's duties for example:

Section 211 states that an agent is bound to conduct the business of his principal according to the directions given by the principal.

Section 212 makes it clear that an agent is bound to conduct the business of the agency skilfully (unless the principal is aware of his deficiencies) and with reasonable diligence.

Section 213 requires that an agent render proper accounts to his principal on demand.

Similarly, some regulations lay down the duties of the principal, as for instance, section 222 lays down that the principal is bound to indemnify the agent against the consequences of all lawful acts done by such agent in exercise of the authority conferred on him.

2.5.10 Prevention of Money-Laundering Act, 2002

Money laundering involves disguising financial assets so that they can be used without detection of the illegal activity that produced them. Through money laundering, the launderer transforms the monetary proceeds derived from criminal activity into funds with an apparently legal source.

The Prevention of Money-Laundering Act, 2002 (PMLA), is an act to prevent money-laundering and to provide for confiscation of property derived from, or involved in, money laundering and for related matters. Chapter II, section 3 describes the offence of money-laundering thus: Whoever directly or indirectly attempts to indulge, or knowingly assists or knowingly is a party or is involved, in any process or activity connected with the proceeds of crime and projecting it as untainted property shall be guilty of the offence of money-laundering.

The offences are classified under Part A, Part B and Part C of the Schedule. Under Part A, offences include counterfeiting currency notes under the Indian Penal Code to punishment for unlawful activities under the Unlawful Activities (Prevention) Act, 1967. Under Part B, offences are considered money laundering if the total value of such offences is Rs 30 lakh or more. Such offences include dishonestly receiving stolen property under the Indian Penal Code to breaching confidentiality and privacy under the Information Technology Act, 2000. Part C includes all offences under Part A and Part B (without the threshold) that has cross-border implications.

We will be discussing this Act in detail in Unit 9 of this workbook.

2.5.11 Foreign Exchange Management Act, 1999

The Foreign Exchange Management Act (FEMA), 1999, is an act to consolidate and amend the law relating to foreign exchange, external trade and payments for promoting the orderly development and maintenance of the foreign exchange market in India. As a consequence of this enactment, its predecessor, The Foreign Exchange Regulation Act (FERA), 1973 was repealed. FEMA extends to the whole of India and shall apply to all branches, offices and agencies outside India, owned or controlled by a person resident in India and also to any violation committed outside India by any person covered by FEMA. For illustrative purposes, some provisions of the Act are discussed below.

Section 3 states that except as provided in FEMA and allied rules and regulations or under permission of RBI, no person shall:

a) Deal in or transfer any foreign exchange or foreign security to any person not being an authorized person
b) Make any payment to or for the credit of any person resident outside India in any manner
c) Receive otherwise through an authorized person, any payment by order or on behalf of any person resident outside India in any manner
d) Enter into any financial transaction in India, as consideration for or in association with the acquisition or creation or transfer of a right to acquire any asset outside India by any person

Section 4 lays down that except as otherwise provided in FEMA, no person resident in India shall acquire, hold, own, possess or transfer any foreign exchange, foreign security or any immovable property situated outside India. Section 5 relates to Current Account transactions, while Section 6 pertains to Capital Account transactions.

Section 10 empowers RBI to authorize any person, on any application made to it, to deal in foreign exchange or foreign securities as an authorized dealer, money changer or offshore

banking unit or any other manner as it considers fit. Further, sub-section (5) stipulates that an authorized person shall, before undertaking any transaction in foreign exchange on behalf of any person, require that person to make such declaration and to give such information as will reasonably satisfy him that the transaction will not involve and is not meant to contravene or evade any provisions of the FEMA or any rule, regulation, notification, direction or order made under the legislation. If the person refuses to comply with any requirement or performs unsatisfactory compliance, the authorized person shall furnish written refusal to undertake the transaction and shall report the matter to RBI, if he has the reason to suspect that any violation or evasion is being contemplated by the person.

FEMA empowers the Central Government to appoint Adjudicating Authorities, Special Directors (Appeals) and an Appellate Tribunal. The latter two shall have for the purposes of discharging their functions under the Act, the same powers as are vested in a civil court under the Code of Civil Procedure, 1908 while trying a suit. Examples of some powers are:

a) Summoning and enforcing the attendance of any person and examining him on oath
b) Requiring the discovery and production of documents
c) Receiving evidence on affidavits
d) Subject to the provisions of regulations 123 and 124 of the Indian Evidence Act, 1872, requisitioning any public record or document or copy of such record or document from any office
e) Issuing commissions for the examination of witnesses or documents

Section 34 stipulates that no civil court shall have jurisdiction to entertain any suit or proceeding in respect of any matter which an Adjudicating Authority or the Appellate Tribunal or the Special Director (Appeals) is empowered under the FEMA to determine. Further, no injunction shall be granted by any court or other authority in respect of any action taken or to be taken in pursuance of any powers conferred by the Act. Section 35 pertains to appeal against any decision or order of the Appellate Tribunal, to the High Court.

2.5.12 Bye-Laws of Stock Exchanges[3]

Indian stock exchanges such as BSE, NSE, MCX, NCDEX, MSEI etc. frame their own Bye-Laws which are binding on all the trading members / brokers registered with the particular exchange. The bye-laws framed by the stock exchanges need to be approved by the SEBI and shall be in conformity with the provisions of the SC(R)A, 1956, SC(R)R, 1957 and the SEBI Act, 1992. The bye-laws lay down rules regarding the admission of trading members, listing requirements, fees, suspension of admission to the stock exchange, transaction and settlement, rights and liabilities

[3]Candidates may like to read the different provisions as given under the different bye-laws of the exchanges posted on the Exchange website.

of members, arbitration etc. It is the responsibility of the trading member or the compliance officer or any such person appointed by the trading member to ensure that all the different regulations of the bye-laws are adhered to.

2.5.12.1 Stamp duty[4]

Indian Stamp (Collection of Stamp-Duty through Stock Exchanges, Clearing Corporations and Depositories) Rules, 2019 has been issued by the Central Government to regulate the liability of instruments of transaction in stock exchanges and depositories to stamp duty. The responsibility for collection of stamp duty on transactions by the transferor of securities or issuance by the issuer in the depository system is the responsibility of the depository.

2.5.13 Taxes on Securities

2.5.13.1 Income-Tax Act, 1961

The Income-Tax Act, 1961, (as amended by the Finance Act, 2008) is an Act to consolidate and amend the law relating to income-tax and super-tax, and it extends to the whole of India. It came into force in April 1962. It consists of twenty-three chapters, but the ones that are of common interest are as follows:

Chapter I: Preliminary
Chapter II: Basis of charge
Chapter III: Incomes that do not form part of Total Income
Chapter IV: Computation of Total Income
Chapter V: Income of other persons included in assesses total income
Chapter VI: Aggregation of income and set off or carry forward of loss
Chapter VIA: Deductions to be made in computing total income
Chapter VIB: Restrictions on certain deductions in case of companies
Chapter VII: Incomes forming part of total income on which no income tax is payable
Chapter VIII: Rebates and Reliefs

Income Tax on Securities

Tax Deducted at Source (TDS) on Dividend

Financial securities (mostly shares, but also listed debentures and mutual funds) provide regular income in the form of dividend on shares and units of mutual funds, and interest on debt securities. Vide the Finance Act, 2020, dividend, in excess of Rs. 5000 in a financial year, is taxable in the hands of investors, effective from April 1, 2020. The applicable TDS on dividend is 10% for resident investors. However, if PAN is not available or is not submitted by the investor, the applicable TDS rate should be 20%. For non-resident Indians (NRIs), TDS should be at 20% of the

[4] The regulation would come into force w.e.f April 1, 2020.

dividend amount. The Finance Act, 2020 also provides for deduction of interest expense incurred to earn that dividend income. The deduction should not exceed 20% of the dividend income.

Capital Gains Tax

When securities, such as listed shares, listed debentures, mutual funds etc. are sold, it could result in gains or losses, depending on the cost of purchase (acquisition, including brokerage etc.). Such securities, if held for more than 12 months before the sale (called a transfer) could result in a Long-Term Capital Gain or Long-Term Capital Loss. If the holding period, however, is 12 months or less, the resultant Gain or Loss is called a Short-Term Capital Gain or Short-Term Capital Loss.

Tax on Short-Term and Long-Term Capital Gains

Tax Type	Condition	Tax applicable
Long-term capital gains tax	Except on sale of equity shares/ units of equity-oriented fund	20%
Long-term capital gains tax	On sale of Equity shares/ units of equity-oriented fund	10% on long-term capital gains in excess of Rs. 1 lakh, provided such transfer if subject to Securities Transaction Tax (STT).
Short-term capital gains tax	When securities transaction tax is not applicable	The short-term capital gain is added to investor's income and is taxed according to his applicable income tax slab.
Short-term capital gains tax	When securities transaction tax is applicable	15%.

Long Term Capital Losses can be set off only against Long Term Capital Gains, if there is any such income to be taxed. However, Short Term Capital Gains can be set off either against Short Term Capital Losses or Long-Term Capital Gains, if any. Losses (both Long and Short Term), if not set off in a year due to lack of offsetting income, can be carried forward for 8 assessment years.

The above provisions apply in respect of securities held as capital assets, not by persons regularly engaged in the business of buying and selling securities. For persons holding financial securities as a business asset (inventory or stock) for sale and filing Income Tax returns specifically under Business Profits, the losses and gains are computed under the income head 'Business Profits'.

2.5.13.2 Securities Transaction Tax (STT)

The Securities Transaction Tax (STT) was introduced by Chapter VII of The Finance (No. 2) Act, 2004. It is a tax applicable on the purchase or sale of equity shares, derivatives, equity-oriented funds and equity-oriented mutual funds. Examples of transactions done in a recognized stock exchange on which STT applies are as follows:

- Purchase or sale of equity shares and sale of units of equity-oriented mutual funds (delivery-based).
- Sale of equity shares and units of equity-oriented mutual funds (non-delivery-based).
- Sale of derivatives

The rate of STT differs based on the type of security traded and whether the transaction is a purchase or a sale. Taxable securities include equity, derivatives, unit of equity-oriented mutual funds etc. It also includes unlisted shares sold under an offer for sale to the public included in IPO and where such shares are subsequently listed in stock exchanges. STT is required to be collected by a recognised stock exchange or by the prescribed person in the case of every Mutual Fund or the lead merchant banker in the case of an initial public offer, and subsequently payable to the Government. Off-market transactions are out of the purview of STT.

2.5.13.3 Goods and Services Tax

Goods and Services Tax (GST) is an indirect tax that came into effect from July 2017. It replaced all other types of indirect taxes, once prevalent in India. GST is a comprehensive indirect tax that is levied on the supply of goods and services at every value addition stage.

Provisions of place of supply of service in case of stockbroking services are contained in section 12 (12) of IGST Act which states that the place of supply of banking and other financial services, including stock-broking services to any person shall be the location of the recipient of services on the records of the supplier of service. Provided that if the location of the recipient of service is not on the records of the supplier, the place of supply shall be the location of the supplier of services.

Section 2(85) of the CGST Act provides that the term ‘place of business includes:

- A place from where the business is ordinarily carried on and includes a warehouse, a godown or any other place where a taxable person stores his goods, supplies or receives goods or services or both; or

- A place where a taxable person maintains his books of account; or
- A place where a taxable person is engaged in business through an agent, by whatever name called.

GST would be applicable on the services provided by the stock-broker as given below:

1. Business of supplying the stock-broking service.
2. Interest/delayed payment charges charged for delay in the payment of brokerage.

As per section 2 (5) of CGST Act, 2017, the term "agent" means a person, including a factor, broker, commission agent, arhatia, del credere agent, an auctioneer or any other mercantile agent, by whatever name called, who carries on the business of supply or receipt of goods or services or both on behalf of another.

2.6 International Financial Services Centre (IFSC)

Financial Centre's that cater to customers outside their jurisdiction is referred to as international (IFSCs) or Offshore Financial Centres (OFCs). All these centres are 'international' in the sense that they deal with the flow of finance and financial products/services across borders. An IFSC is thus a jurisdiction that provides world-class financial services to non-residents and residents, to the extent permissible under the current regulations, in a currency other than the domestic currency (Indian rupee) of the location where the IFSC is located.

The Central Government may subject to the guidelines as may be framed by the Reserve Bank, the Securities and Exchange Board of India, the Insurance Regulatory and Development Authority and such other authority as it may deem fit, prescribe the requirement for setting up and terms and conditions of the operation of International Financial Services Centre.

IFSC at GIFT City, Gandhinagar is a deemed foreign territory dealing in foreign currency. The entities in IFSC are recognised as non-resident entities under the FEMA regulations and get benefits which include exemptions from security transaction tax (STT), commodity transaction tax, dividend distribution tax, capital gains waiver and no income tax. Stock exchanges operating in the GIFT IFSC are permitted to offer trading in securities in any currency other than the Indian rupees. The regulators namely the Reserve Bank of India (RBI), Securities & Exchange Board of India (SEBI), Insurance Regulatory & Development Authority of India (IRDAI) have issued regulations allowing Indian and foreign institutions to open their office in the IFSC.

As per the SEBI (IFSC) guidelines, 2015, the stock exchanges operating in IFSC were permitted to deal in the following types of securities and products in such securities in any currency other than the Indian rupee, with a specified trading lot size on their trading platform subject to prior approval of SEBI, viz.,

- Equity shares of a company incorporated outside India;

- Depository receipt(s);
- Debt securities issued by eligible issuers;
- Currency and interest rate derivatives;
- Index-based derivatives;
- And any other securities as may be specified by SEBI.

Currently, NSE and BSE both have exchanges at IFSC and offer various products for trading viz., Index derivatives, Stock Derivatives, Currency Derivatives, Commodity Derivatives and Debt Securities. Any intermediary permitted by SEBI for operating within the IFSC shall, for the purpose of enforcing compliance with regulatory requirements, appoint a senior management person as "Designated Officer".

SEBI in August 2020, said entities listing their debt securities in IFSC will now prepare their statement of accounts in accordance with International Financial Reporting Standards (IFRS) or US GAAP (Generally Accepted Accounting Principles) or Indian accounting standards (IND-AS) or accounting standards as applicable in the place of their incorporation and incorporate it in the relevant disclosure documents to be filed with the exchange. In case, an entity does not prepare its statement of accounts in accordance with IFRS/ US GAAP (Generally Accepted Accounting Principles) or Indian accounting standards (IND-AS) or as applicable in the place of their incorporation and incorporate it in the relevant disclosure documents to be filed with the exchange, it has to prepare a quantitative summary of significant differences between national accounting standards and IFRS and incorporate it in the relevant disclosure documents.

In September 2020, SEBI revised framework whereby any entity, being a company or a limited liability partnership (LLP) or any other similar structure recognised under the laws of its parent jurisdiction, desirous of operating in IFSC as an investment adviser (IA), may form a company or LLP to provide investment advisory services, An IA or parent entity will fulfil the net worth requirement, separately and independently, for each activity undertaken by it. An IA will ensure to conduct an annual audit in respect of compliance with investment adviser regulations and these guidelines from a chartered accountant from a company secretary. Further, IAs shall ensure to comply with the applicable guidelines issued by the relevant overseas regulator/ authority, while dealing with persons resident outside India and non-resident Indians seeking investment advisory services from them.

Review Questions

1. Unhealthy practice in the Securities Markets includes which of the following?
   (a) Disclosure
   (b) Transparency
   (c) Insider Trading
   (d) Surveillance

2. Which of the following has the responsibility of administering the monetary policy in India?
   (a) State Bank of India
   (b) Reserve Bank of India
   (c) Central Bank of India
   (d) All of the above

3. Which authority was set up with the primary responsibility of promoting old age income security by establishing, developing and regulating pension funds?
   (a) Association of Mutual Funds in India
   (b) Insurance and Regulatory Development Authority of India
   (c) Pension Fund Regulatory and Development Authority of India
   (d) Securities and Exchange Board of India

4. "The bye-laws of the stock exchanges are same across exchanges and need to be approved by SEBI". State whether True or False.
   (a) True
   (b) False

CHAPTER 3: INTRODUCTION TO COMPLIANCE

LEARNING OBJECTIVES:

After studying this chapter, you should know about:

- Appointment of compliance officer by stock brokers
- Role and Reporting structure of Compliance officer
- Appointment of compliance officer
- Responsibilities of compliance officers towards stakeholders
- Compliance requirements under the SEBI (Certification of Associated Persons in Securities Markets) Regulations, 2007

3.1 Compliance – Introduction

3.1.1 Meaning and Importance of Compliance function

In general, compliance means conforming to a rule, such as a specification, policy, standard or law. Specifically, in the context of the securities market, compliance however means a set of actions by which registered intermediaries in securities markets and issuer companies need to comply with the rules and regulations, notifications, guidelines and instructions issued by the Securities and Exchange Board of India (SEBI), the stock exchanges, depositories with whom the intermediary has taken membership, as well as policies laid down by the Board of Directors (BoD) of the Company and other competent authorities. The set of actions include maintenance of records, adoption of policies and procedures, preparation of reports, taking actions and making submissions to the competent authorities.

3.1.2 Compliance Officer

Compliance Officer (CO) is a person specifically designated by the regulated entity for monitoring compliance with the provisions of the SEBI Act, 1992, rules and regulations thereunder, notifications, guidelines and instructions issued by the SEBI or the Central Government and for redressal of investors' grievances. The compliance officer is also required to monitor the compliance of the rules, regulations and bye-laws of the concerned stock exchanges, or the Registrar of Companies, where applicable. In other words, the compliance officer is the first line regulator and all regulations require the appointment of COs.

Compliance as a function has been noted as one of the most important functions in the intermediaries across worldwide exchanges, commissions etc. International Organisation of Securities Commission (IOSCO) had come out with a discussion paper in 2005[5] on 'Compliance function at Market Intermediaries' in which they had defined compliance function as "*A function*

[5] http://www.iosco.org/library/pubdocs/pdf/IOSCOPD198.pdf

that, on an on-going basis, identifies, assesses, advises on, monitors and reports on a market intermediary's compliance with securities regulatory requirements, including whether there are appropriate supervisory procedures in place".

3.1.3 Appointment of CO

As per the SEBI (Stock Brokers) Regulations, 1992, a Compliance Officer is mandatorily required to be appointed. The relevant extracts of this regulation are given hereunder:

Regulation 18A

(1) Every stockbroker shall appoint a CO who shall be responsible for monitoring the compliance of the Act, rules and regulations, notifications, guidelines, instructions and so on, issued by SEBI or the Central Government and for redressal of investors' grievances.

(2) The Compliance Officer shall immediately and independently report to SEBI any non-compliance observed by him.

A Compliance Officer is required to be appointed as per the SEBI (Intermediaries) Regulations, 2008 dated 26th May 2008, the relevant extracts of which are given below:

Regulation 14

(1) An intermediary shall appoint a compliance officer for monitoring the compliance by it, of the requirements of the Act, rules, regulations, notifications, guidelines, circulars and orders made or issued by SEBI or the Central Government, or the rules, regulations and bye-laws of the concerned stock exchanges, or the SRO, where applicable:

Provided that the intermediary may not appoint a compliance officer if it is not carrying on the activity of the intermediary.

(2) The compliance officer shall report to the intermediary or its BoD, in writing, any material non-compliance by the intermediary.

3.1.4 Scope and Role of a Compliance Officer in the Indian Securities Market

The CO shall be responsible for monitoring the compliance with the SEBI Act, 1992, and more specifically with the rules and regulations, notifications, guidelines, orders passed and instructions issued by SEBI or the Central Government or the rules, regulations and bye-laws of the concerned stock exchanges, or the Self- Regulatory Organization (SROs), where applicable, by the concerned intermediary. The responsibility of the CO also extends to ensure redressal of investors' grievances.

The specific role of the CO as given under the SEBI (Stock Brokers) Regulations, 1992 and the SEBI (Intermediaries) Regulations, 2008 has been discussed in the above section.

Compliance looks into the different aspects of the culture and ethics of a market intermediary and is an important tool in managing the risk of legal or regulatory sanctions, financial loss, or loss to reputation resulting from the violation of regulatory requirements. The CO is responsible for monitoring the internal standards and policies put in place by the intermediary that also involves protecting the firm from any liability arising from false claims/abuses committed by its customers.

The CO is appointed by an entity or its Board of Directors (BoD) to comply with the SEBI Act and regulations, rules and so on. As such, the CO is required to report to the BoD of the Intermediary. However, where there is a non-compliance of the provisions of the SEBI Act or the allied regulations and rules, the CO is required to report to SEBI immediately and independently any non-compliance of the intermediary.

3.1.5 The Importance of Independence for COs

The gap between regulatory intent and compliance shall be minimal if there is a professional cadre of compliance officers in each organization of intermediaries. This is the rationale for the independent functioning of the CO, in any intermediary organization. CO shall participate in the preparation of policies and procedures so that the internal affairs of the intermediary are aligned with the regulatory objective rather than business expediency in case of conflict between the two.

This necessitates the level of reporting by the CO to the BoD/owners and SEBI and other competent authorities. It frees the CO from elaborate internal reporting procedures and protocol with the delays and inadequate attention to compliance matters.

RBI in September 2020 issued guidelines to Banks to set up an independent corporate compliance function headed by a designated chief compliance officer (CCO) selected through a suitable process with an appropriate ‘fit and proper’ selection criteria to effectively manage compliance risk. The CCO should be appointed for a minimum fixed period of three years in the rank of a general manager or not below two levels of the rank of CEO. A CCO "may be transferred/ removed before completion of the tenure only in exceptional circumstances with the explicit prior approval of the board after following a well-defined and transparent internal administrative procedure"

3.1.6 Reporting Responsibility of COs

It is the duty of the CO to immediately and independently report any non-compliance observed to the BoD of the intermediary and SEBI. The reporting responsibility can be classified into:

- *Mandatory reporting*: Periodic submission of reports as per provisions of regulations
- *Critical Reporting*: CO must immediately and independently report to SEBI and BoD any non-compliance observed. Coordination with the Regulators - The Compliance Officer is responsible for all the compliances under various laws. The coordination with the regulators under each law applicable to the entity is an important role of the Compliance Officer.

As given under Regulation 12 of the SEBI (Intermediaries) Regulations 2008, the intermediary is required to:

(1) Provide SEBI with a certificate of its compliance officer on the 1st April of each year certifying:

a) the compliance by the intermediary with all the obligations, responsibilities and the fulfilment of the eligibility criteria on a continuous basis under these regulations and the relevant regulations

b) that all disclosures made in Form A and under the relevant regulations are true and complete

(2) Prominently display a photocopy of the certificate at all its offices including branch offices.

(3) Prominently display the name and contact details of the compliance officer to whom a complaint may be made in the event of any investor grievance.

(4) Maintain books, accounts and records as specified in the relevant regulations.

3.2 Compliance Requirements under the SEBI (CAPSM) Regulations, 2007

The SEBI (Certification of Associated Persons in Securities Markets) (CAPSM) Regulations, 2007, Regulations 7 and 8, delegates the following powers and functions to the National Institute of Securities Markets (NISM):

(a) The functions of NISM in respect of certification for associated persons in the securities market shall include putting in place and implementing the certification process, procedure and policies.

(b) NISM in consultation with SEBI may lay down standards which may, (i) specify that all or any portion of such standards shall be applicable to all or any category of associated persons working or associated with all or any class of intermediaries in the securities market; (ii) specify that no associated person in any such class may be qualified to be employed or engaged or continued to be employed or engaged by an intermediary unless he is in compliance with such standards of examination, continuing professional education requirements and such other qualifications as NISM in consultation with SEBI may specify.

3.2.1 Obligation of Obtaining Certification

Regulation 3 of the SEBI (CAPSM) Regulations, 2007 provides that SEBI may by notification in the official gazette require such categories of associated persons to obtain the requisite certificate for engagement or employment with such classes of intermediaries and from such date, as may be specified in the notification ***provided*** that an associated person employed or engaged by an intermediary prior to the date specified by SEBI may continue to be employed or engaged by the intermediary if he obtains the certificate within two years from the said date.

An associated person on being employed or engaged by an intermediary on or after the date specified by SEBI shall obtain the certificate within one year from the date of being employed or engaged by the intermediary.

An associated person, who as on the date specified by SEBI, holds a certificate for a category as recognised by SEBI shall not be required to obtain a fresh certificate for the same category during the validity of such certificate.

3.2.2 Manner of Obtaining Certification

Regulation 4 of SEBI (CAPSM) Regulations, 2007 specifies the manner of obtaining the certificate the first time. These are further detailed below:

A Principal[6] may obtain the certificate in any of the following methods: -

(a) Passing the relevant certification examination, as may be specified by NISM.
(b) Successfully completing a related CPE Program[7], as may be specified by NISM.
(c) Delivering at least four sessions in a specific CPE program, as may be specified by NISM.

A person other than a principal, who has attained 50 years of age or who has 10 years of experience, may obtain the certificate by any of the following methods:

(a) Passing the relevant certification examination, as may be specified by NISM.
(b) Successfully completing a related CPE Program, as may be specified by NISM.

All other persons may obtain the certificate by the following method:

(a) Passing the relevant certification examination, as may be specified by NISM.

3.2.3 Validity Period of Certificate

The certificate given under regulation 3 of SEBI (CAPSM) Regulations, 2007 is valid for 3 years from the date of the grant of the certificate or revalidation as the case may be. Upon the expiry

[6]A Principal is a person who is actively engaged in the management of the intermediary's securities business including supervision, solicitation, conduct of business, and includes: a) Sole Proprietors, b) Managing Partners and c) Whole Time Directors
[7]The CPE Program is as per the new NISM communiqué Ref. No. NISM/Certification/ CPE General/2011/1 dated December 21, 2011.

of the validity of the certificate possessed by the associated person, the certificate shall be revalidated for 3 years provided the associated person successfully completes a programme of continuing professional education as specified by NISM.

Associated persons engaged in the activities[8] as mentioned in sub-regulation 4 of regulation 3 of the SEBI (CAPSM) shall continue to be so engaged only upon holding a valid certificate.

3.2.4 Continuing Professional Education Requirements

Upon expiry of the validity of the certificate possessed by an associated person, the certificate may get revalidated, provided the associated person successfully completes a programme of continuing professional education, as may be specified by NISM during 12 months preceding the date of expiry of the certificate, or by passing the relevant NISM Certification Examination before the expiry of the existing certificate[9].

The certificate will be revalidated for three years from the date of expiry of the existing certificate. Different categories of persons may get their certificate revalidated through different methods as follows:

A Principal may get his/her certificate revalidated by any of the following methods:

(a) Passing the relevant certification examination, as may be specified by NISM.
(b) Successfully completing a related CPE Program, as may be specified by NISM.
(c) Delivering at least four sessions in specific CPE program, as may be specified by NISM.

A person other than a principal, who has attained 50 years of age or who has 10 years of experience, may get the certificate revalidated by any of the following methods:

(a) Passing the relevant certification examination, as may be specified by NISM.
(b) Successfully completing a related CPE Program, as may be specified by NISM.

All other persons may get their certificate revalidated by any of the following methods:

(a) Passing the relevant certification examination, as may be specified by NISM.
(b) Successfully completing a related CPE Program, as may be specified by NISM.

Annexure 1 at the end of the workbook details the various SEBI mandated NISM certifications and the associated persons they are mandated for.

[8]Activity wherein the (a) the associated person as part of his work or operation deals or interacts with the investors, issuers or clients of intermediaries; (b) the associated person deals with assets or funds of investor or clients; (c) the associated person handles redressal of investor grievances; (d) the associated person is responsible for internal control or risk management; (e) the associated person is responsible for compliance of any rules or regulations; (f) the associated person is engaged in activities that have a bearing on operational risk of the intermediary.

[9]See NISM communiqué Ref. No. NISM/Certification/ CPE General/2011/1 dated December 21, 2011.

Review Questions

1. Primarily, compliance involves _____.

   (a) Conforming to a rule, policy, standard or law

   (b) Record keeping

   (c) Reporting

   (d) Preventing frauds

2. The SEBI (Intermediaries) Regulations, 2008, mandates the appointment of a Compliance Officer. State whether True or False?

   (a) True

   (b) False

3. Critical Reporting by Compliance officers include which of the following?

   (a) Money Laundering Activities

   (b) Submission of Books of Accounts

   (c) Sauda Book

   (d) All of the above

4. As per the SEBI (Certification of Associated Persons in Securities Markets) Regulations, 2007, a certificate is valid for a period of _____ from the date of grant of certificate or revalidation as the case may be.

   (a) 2 years

   (b) 5 years

   (c) 3 years

   (d) 7 years

CHAPTER 4: SECURITIES AND EXCHANGE BOARD OF INDIA ACT, 1992

LEARNING OBJECTIVES:

After studying this chapter, you should know about:

- Salient features of the SEBI Act, 1992
- Penalties applicable in case of violation of the SEBI Act provisions
- Cases when appeal can be made to Securities Appellate Tribunal (SAT) and Supreme Court
- Prohibition of Manipulative and Deceptive Devices, Insider Trading etc.

4.1 Salient Features of SEBI Act, 1992

The SEBI Act of 1992 was enacted "*to provide for the establishment of a Board to protect the interests of investors in securities and to promote the development of, and to regulate, the securities market and for matters connected therewith or incidental thereto*".

4.1.1 Powers and Functions of the SEBI

The SEBI Act in the broader sense performs the functions as stated in the above para, however, without any prejudice to the generality, the Act also provides for the following measures:

a. Regulating the business in stock exchanges and any other securities markets;
b. Registering and regulating the working of the stockbrokers, sub-brokers, share transfer agents, bankers to an issue, trustees of trust deeds, registrars to an issue, merchant bankers, underwriters, portfolio managers, investment advisers and such other intermediaries who may be associated with the securities manner in any manner. SEBI's powers also extend to registering and regulating the working of the depositories and its participants, custodians of securities, foreign institutional investors, credit rating agencies and such other intermediaries as notified by the SEBI;
c. Registering and regulating the working of Venture Capital Funds and other Collective Investment Schemes, including mutual funds;
d. Promoting and regulating self-regulatory organisations;
e. Prohibiting fraudulent and unfair trade practices relating to securities markets;
f. Promoting investors' education and training of intermediaries of securities markets;
g. Prohibiting insider trading in securities;
h. Regulating substantial acquisition of shares and take-over of companies;
i. Calling for information from, undertaking inspection, conducting inquiries and audits of the stock exchanges, mutual funds, other persons associated with the securities market, intermediaries and self-regulatory organisations in the securities market. SEBI also has

powers for calling for information and records from any person including any bank or any other authority or board or corporation established or constituted by or under any Central or State Act which, in the opinion of the Board, shall be relevant to any investigation or inquiry by the Board in respect of any transaction in securities;

j. calling for information from, or furnishing information to, other authorities, whether in India or outside India, having functions similar to those of the Board, in the matters relating to the prevention or detection of violations in respect of securities laws, subject to the provisions of other laws for the time being in force in this regard;
k. Performing such functions and exercising such powers under the provisions of the Securities Contracts (Regulation) Act, 1956 as may be delegated to SEBI by the Central Government;
l. Levying fees or other charges for carrying out the purposes of this section;
m. Conducting research for the above purposes;
n. Calling from or furnishing to any such agencies, as may be specified by SEBI, such information as may be considered necessary by it for the efficient discharge of its functions;
o. Performing such other functions as may be prescribed.

According to sub-section 3 of Section 11 of the SEBI Act, notwithstanding anything contained in any other law for the time being in force while exercising the powers, SEBI shall have the same powers as are vested in a civil court under the Code of Civil Procedure, while trying a suit in respect of the following matters;

i. The discovery and production of books of account and other documents, at such place and such time as may be specified by the SEBI;
ii. Summoning and enforcing the attendance of persons and examining them on oath;
iii. Inspection of any books, registers and other documents of any person;
iv. inspection of any book, or register, or other document or record of the company;
v. Issuing commissions for the examination of witnesses or documents.

According to sub-section 4 of Section 11 of the SEBI Act, SEBI by an order, for reasons to be recorded in writing, in the interest of investors or securities market can take the following measures either pending investigation or inquiry or completion of such investigation or inquiry

a) Suspend the trading of any security in a recognised stock exchange
b) Restrain persons from accessing the securities market and prohibit any person associated with the securities market to buy, sell or deal in securities
c) Suspend any office-bearer of any stock exchange or self-regulatory organisation from holding such position
d) Impound and retain the proceeds or securities in respect of any transaction which is under investigation

e) Attach for a period not exceeding 90 days bank account or other property of any intermediary or any person associated with the securities market in any manner involved in violation of any of the provisions of this Act, or the rules or the regulations made thereunder.

f) Direct any intermediary or any person associated with the securities market in any manner not to dispose of or alienate an asset forming part of any transaction which is under investigation.

The Section 11A of the SEBI Act states that without any prejudice to the provisions of the Companies Act 1956, SEBI may for the protection of investors, -

(a) Specify, by regulations –
   i. The matters relating to the issue of capital, transfer of securities and other matters incidental thereto; and
   ii. The manner in which such matters shall be disclosed by the Companies;

(b) By general or special orders –
   i. Prohibit any company from issuing prospectus, any offer document, or advertisement soliciting money from the public for the issue of securities;
   ii. Specify the conditions subject to which the prospectus, such as offer document or advertisement, if not prohibited, may be issued.

4.1.2 Penalties and Adjudication

SEBI Act empowers SEBI to impose penalties and initiate adjudication proceedings against intermediaries who default on the following grounds such as failure to furnish information, return etc. or failure by any person to enter into an agreement with clients etc. In this section we discuss the various clauses of sub-Sections 15[10], failing to comply with any of these will lead to penalties and adjudication proceedings.

Section	**Applicable to an intermediary when they fail to**	**Minimum Penalty**	**Maximum Penalty**
15A - Penalty for failure to furnish information, return etc	a) Furnish any document, return or report to SEBI or files false or incorrect or incomplete	not be less than one lakh rupees but may extend to one lakh rupees for each day during which such failure continues	one crore rupees

[10] Section 15 through its various sub-sections prescribes a minimum and maximum amount of penalty for violation(s). It also empowers the relevant authority to levy penalty on a per day basis (subject to maximum amount specified therein) till the default continues.

	information, return, report, books or other documents b) File any return or furnish any information, books or other documents within the time specified in the regulations or files false or incorrect or incomplete information, return, report, books or other documents c) Maintain books of account or records.		
Section 15B: Penalty for failure by any person to enter into an agreement with clients	to enter into an agreement with his/her client in violation of such a requirement under the SEBI Act, 1992	not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues	one crore rupees
Section 15C: Penalty for failure to redress investors' grievances (includes listed company)	to redress investors' grievances after having been directed in writing including by any means of electronic communication by SEBI to do so within a specified time period.	not be less than one lakh rupees but may extend to one lakh rupees for each day during which such failure continues	one crore rupees

Section 15D: Penalty for certain defaults in case of mutual funds	a) a person sponsors or carries on any collective investment scheme, including MFs, without obtaining the required certificate of registration b) to comply with the terms and conditions of the certificate of registration by a person registered with SEBI as a collective investment scheme including mutual funds c) to submit an application for listing of the collective investment scheme(s), by a person registered with SEBI as a collective investment scheme including mutual funds, in accordance with the regulations governing such listing d) to despatch unit certificates of any	not be less than one lakh rupees but may extend to one lakh rupees for each day during which such failure continues	one crore rupees

	scheme by a person registered with SEBI as a collective investment scheme including mutual funds, in accordance with the regulations governing such despatch e) to refund the application monies of investors by a person registered with SEBI as a collective investment scheme including mutual funds, within the period specified in the relevant regulations f) to invest the money collected by a person registered with SEBI as a collective investment scheme including mutual funds, in the manner or within the period specified in the relevant regulations		

Section 15E: Penalty for failure to observe rules and regulations by an asset management company (AMC)		to comply with any of the regulations that place restrictions on the activities of asset management companies.	not be less than one lakh rupees but may extend to one lakh rupees for each day during which such failure continues	one crore rupees
Section 15EA: Penalty for default in case of Alternative Investment Funds, Infrastructure Investment Trust and Real Estate Investment Trusts		to comply with the regulations made by the SEBI or comply with the directions issued by the SEBI	not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues	one crore rupees or three times the amount of gains made out of such failure, whichever is higher.
Section 15EB states the penalty for default in case of investment adviser and research analyst		to comply with the regulations made by the SEBI or directions issued by the SEBI, such as investment adviser or research analyst	not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues	one crore rupees
Section 15F: Penalty for default in case of stockbrokers	i. ii.	to issue contract notes in the form and manner specified by the stock exchange of which the broker is a member. To deliver any security or to make payment of the amount due to the investor in	not be less than one lakh rupees not be less than one lakh rupees	one crore rupees extend to one lakh rupees for each day during which such failure continues maximum of one crore rupees.

	the manner and within the period specified in the regulations. iii. Charging an amount of brokerage in excess of that specified in the regulations.	Not be less than one lakh rupees	Extend to five times the amount of brokerage charged in excess of the specified brokerage, whichever is higher.
<u>Section 15G: Penalty for insider trading</u>	a) When an insider acting on his/her behalf or behalf of another deals in securities of a body corporate listed on any stock exchange on the basis of any unpublished price-sensitive information b) When an insider communicates any unpublished price-sensitive information to any person, with or without his request for such information except as required in the ordinary course of business or under any law c) When an insider counsels or procures for any other person to	not be less than ten lakh rupees	extend to twenty-five crore rupees or three times the amount of profits made out of insider trading, whichever is higher.

	deal in any securities of any corporate body on the basis of unpublished price-sensitive information		
Section 15H: Penalty for non-disclosure of acquisition of shares and takeovers	(i) disclose the aggregate of his shareholding in the body corporate before he acquires any shares of that body corporate; or (ii) make a public announcement to acquire shares at a minimum price; or (iii) make a public offer by sending a letter of offer to the shareholders of the concerned company; or (iv) make payment of consideration to the shareholders who sold their shares pursuant to letter of offer.	not be less than ten lakh rupees	extend to twenty-five crore rupees or three times the amount of profits made out of such failure, whichever is higher.
Section 15HA: Penalty for fraudulent and unfair trade practices	for people indulging in fraudulent and unfair trade practices relating to securities	not be less than five lakh rupees	extend to twenty-five crore rupees or three times the amount of profits made out of such practices, whichever is higher.
Section 15HAA Penalty for alteration,		not be less than one lakh rupees	extend to ten crore rupees or three

destruction, etc., of records and failure to protect the electronic database of Board	(a) knowingly alters, destroys, mutilates, conceals, falsifies, or makes a false entry in any information, record, document (including electronic records), which is required under this Act or any rules or regulations made thereunder, so as to impede, obstruct, or influence the investigation, inquiry, audit, inspection or proper administration of any matter within the jurisdiction of the Board. Explanation.—For the purposes of this clause, a person shall be deemed to have altered, concealed or destroyed such information, record or document, in case he knowingly fails to immediately report the matter to the Board or fails to preserve the same till such information continues to be relevant to any investigation, inquiry, audit, inspection or proceeding, which may be initiated by the Board and conclusion thereof; (b) without being authorised to do so, access or tries to access,		times the amount of profits made out of such act, whichever is higher.

	or denies of access or modifies access parameters, to the regulatory data in the database; (c) without being authorised to do so, downloads, extracts, copies, or reproduces in any form the regulatory data maintained in the system database; (d) knowingly introduces any computer virus or other computer contaminant into the system database and brings out a trading halt; (e) without authorisation disrupts the functioning of system database; (f) knowingly damages, destroys, deletes, alters, diminishes in value or utility, or affects by any means, the regulatory data in the system database; or (g) knowingly provides any assistance to or causes any other person to do any of the acts specified above *Explanation.*—In this section, the expressions "computer contaminant", "computer virus" and		

	"damage" shall have the meanings respectively assigned to them under section 43 of the Information Technology Act, 2000.		
Section 15HB: Penalty for Contravention where no separate penalty has been provided	to comply with any provision of the SEBI Act, the rules or the regulations made or directions issued by SEBI thereunder, for which no separate penalty has been provided,	not be less than one lakh rupees	one crore rupees

To understand the various statutes of the Securities market, it is also essential to understand the Jurisdiction, Authority and Procedure adopted by the Appellate Tribunal. Appeal against any ruling of the capital market regulator is petitioned to the appellate tribunal set up for this purpose i.e., Securities Appellate Tribunal.

4.1.3 Appellate Tribunal

The Securities Appellate Tribunal (SAT) according to Section 15U is not bound by the procedure laid down by the Code of Civil Procedure, 1908, but shall be guided by the principles of natural justice and shall have the powers to regulate their own procedures including the places at which they have their sitting. The tribunal for the purpose of discharging its functions under this Act shall have the same powers as are vested in a civil court under the Code of Civil Procedure, 1908, while trying a suit, in respect of the following matters, namely:

- Summoning and enforcing the attendance of any person and examining him on oath;
- Requiring the discovery and production of documents;
- Receiving evidence on affidavits;
- Issuing commissions for the examination of witnesses or documents;
- Reviewing its decisions;
- Dismissing an application for default or deciding it *ex-parte;*
- Setting aside any order of dismissal of any application for default or any order passed by it *ex-parte*.
- Any other matter which may be prescribed

Any proceeding before the SAT shall be deemed to be a judicial proceeding within the meaning of provisions as given under the Indian Penal Code.

Section 15T: Appeal to Securities Appellate Tribunal

Section 15T of the SEBI Act gives the right to "Appeal to the SAT". It states that any person aggrieved by an order –

(i) Of the SEBI made, on and after the commencement of the Securities Laws (Second Amendment) Act, 1999, under the SEBI Act, or the rules and regulations made thereunder; or

(ii) Made by an adjudicating officer under the SEBI Act; or

(iii) Made by the Insurance Regulatory and Development Authority (IRDA) or the Pension Fund Regulatory and Development Authority (PFRDA)

may prefer an appeal to the SAT having jurisdiction in this matter. Every appeal should be filed within a period of 45 days from the date on which a copy of the order made by SEBI or the Adjudicating Officer or IRDA or PFRDA, as the case may be, is received by him in a specified form along with the fee as prescribed. The appeal filed before SAT shall be dealt with as expeditiously as possible and endeavour shall be made to dispose of the appeal finally within six months from the date of receipt of appeal.

Section 15Z: Appeal to Supreme Court

Any person aggrieved by any decision or order of the Securities Appellate Tribunal may file an appeal to the Supreme Court within 60 days from the date of communication of the decision or order of the SAT to him on any question of law arising out of such order.

4.1.4 Registration of Intermediaries

Section 12 of the SEBI Act vests SEBI with the power to issue the certificate of registration without which no stockbroker, sub-broker, share transfer agent, banker to an issue, trustee of trust deed, registrar to an issue, merchant banker, underwriter, portfolio manager, investment adviser or such other intermediary who may be associated with the securities market shall buy, sell or deal in securities. These intermediaries also require to comply with certain other provisions in certain other regulations while applying for certificate of registration such as a stockbroker applying to SEBI for a certificate of registration needs to apply as per the FORM A of the SEBI (Stock Brokers) Regulations 1992. These regulations would be discussed in length in the later sections of this workbook.

Section 12 also states that no person shall sponsor or cause to be sponsored or carry on or caused to be carried on any venture capital funds or collective investment schemes including mutual funds if the same does not obtain a certificate of registration from SEBI. Additionally, SEBI states that no person shall sponsor or cause to be sponsored or carry on or cause to be carried on the activitiy of an alternative investment fund or a business trust, unless a certificate of registration is granted by SEBI in accordance with the regulation made under the Income Tax Act, 1961.

The application for registration and the payment of such fees shall be in accordance with the provisions of the regulations. SEBI may however by order, suspend or cancel a certificate of registration as under the provisions in the regulations after giving the person concerned a reasonable opportunity of presenting his/her case.

4.1.5 Prohibition of Manipulative and Deceptive Devices, Insider Trading etc.

Section 12A of the SEBI Act prescribes that no person shall directly or indirectly -

a. Use or employ, in connection with the issue, purchase or sale of any securities, which are either listed or proposed to be listed on a recognised stock exchange, any manipulative or deceptive device or contrivance in contravention of the provisions of this Act or any rules made thereunder;
b. Employ any device, scheme or artifice to defraud in connection with the issue or dealing in securities which are listed or proposed to be listed on a recognised stock exchange;
c. Engage in any act, practice, course of business which operates or would operate as fraud or deceit upon any person, in connection with the issue, dealing in securities which are listed or proposed to be listed on a recognised stock exchange, in contravention of the provisions of this act or the rules or the regulations made thereunder;
d. Engage in insider trading;
e. Deal in securities while in possession of material or non-public information or communicate such material or non-public information to any other person, in a manner which is in contravention of the provisions of this Act or rules /regulations made hereunder;
f. Acquire control of any company or securities more than the percentage of the equity share capital of a company whose securities are listed or proposed to be listed on a recognised stock exchange in contravention of the regulations made under this Act.

As stated in Chapter 3, the designated compliance officer in each intermediary should ensure that the intermediary is functioning in compliance with the provisions of the various regulations (as discussed in this chapter) of the SEBI Act. Non-compliance with the rules and regulations laid down by SEBI will attract a penalty either monetary or suspension.

Review Questions

1. All of the following are the functions of SEBI under the SEBI Act, 1992, EXCEPT:

   (a) Regulating the business in other securities markets but not in stock exchanges

   (b) Promoting and regulating self-regulatory organisations

   (c) Regulating substantial acquisition of shares and take-over of companies

   (d) Prohibiting insider trading in securities

2. Can SEBI prohibit any company from issuing prospectus, any offer document, or advertisement soliciting money from the public for the issue of securities? State Yes or No.

   (a) Yes

   (b) No

3. Penalty may be payable by an intermediary under the SEBI Act if it fails to:

   (a) File any return or furnish any information, books or other documents within the time specified in the regulations

   (b) Maintain books of account or records

   (c) Both (a) & (b)

   (d) None of the above

4. Any intermediary can appeal to SAT if it has been aggrieved by any order passed by SEBI. State whether True or False.

   (a) True

   (b) False

CHAPTER 5: SECURITIES CONTRACTS (REGULATION) ACT, 1956 AND SECURITIES CONTRACTS (REGULATION) RULES, 1957

LEARNING OBJECTIVES:

After studying this chapter, you should know about:

- Key features of SCRA, 1956 and provisions such as call for periodical returns and contracts and options in securities
- Key features of Securities Contracts (Regulation) Rules, 1957 and provisions such as eligibility criteria for membership, contract between members, audit of members and book of accounts

5.1 Securities Contracts (Regulation) Act, 1956

As discussed in chapter 2 of this workbook, the Securities Contracts (Regulation) Act, 1956 provides for direct and indirect control of virtually all aspects of securities trading and the running of stock exchanges. This Act aims to prevent undesirable transactions in securities. It gives the Central Government the regulatory jurisdiction over (a) stock exchanges through a process of recognition and continued supervision, (b) contracts in securities, and (c) listing of securities on stock exchanges. The objective of SC(R)A is to prevent undesirable speculation and to regulate contracts and transactions in securities. A transaction in securities between two persons is essentially a contract. The law that specifically applies in the case of a securities contract is the SC(R)A.

In this chapter, we would be focused on the various sections and sub-sections of this Act related directly to the activities of the securities market and which is of importance from compliance point of view.

5.1.1 Call for Periodical Returns

Section 6(2) of SCRA requires every member of a recognized stock exchange to maintain and preserve for such periods not exceeding 5 years such books of accounts and other documents as the Central Government may prescribe after consultation with the concerned stock exchange, and such books of accounts and other documents shall be subject to inspection by SEBI.

Section 6(3) of SCRA provides that SEBI, in the interest of trade or the public interest, may by order in writing –

- Call upon any member of a recognized stock exchange to furnish in writing such information or explanation relating to the affairs of the member in relation to the stock exchange as SEBI may require; or

- Appoint person(s) to make inquiry into the affairs of any member of a stock exchange in relation to the stock exchange and submit a report of the same to SEBI or it may direct the governing body of the stock exchange to make the inquiry and submit its report to SEBI.

Section 6(4) of SCRA provides that where an inquiry, as mentioned above, has been undertaken, every member of the concerned stock exchange shall be bound to produce before the inquiring authority all such books of accounts and other documents in its custody or power, which relates to or have bearing on the subject matter of such inquiry and shall also furnish such statement or information relating to the inquiry as the inquiring authority may require.

5.1.2 Contract as principal

Section 15 of SCRA provides that no member of a recognised stock exchange shall in respect of any securities enter into any contract as a principal with any person other than a member of a recognised stock exchange, unless he has secured the consent or authority of such person and discloses in the note, memorandum or agreement of sale or purchase that he is acting as a principal. However, a stockbroker may enter into a contract, as a principal with any other person only if written consent is received from such person within 3 days from the date of the contract and disclosure to this effect is made on the contract note. Section 18 excludes Spot contracts from the above requirement.

5.1.3 Penalties and Procedures

Sections 23 to 26 provide for the different penalties and procedures to be imposed upon any person /intermediary on non-compliance with any of the provisions given under the various rules and regulations governing the securities market in India.

Section 23 states that, inter alia, any person who,

(a) Without reasonable excuse (the burden of proving which shall be on him) fails to comply with any requisition made under sub-section (4) of section 6, or

(b) Enters into any contract in derivative in contravention of section 18A[11] or the rules made under section 30; or

(c) Not being a member of a recognised stock exchange or his agent authorised as such under the rules or bye-laws of such stock exchange or not being a dealer in securities licensed under section 17 wilfully represents to or induces any person to believe that contracts can be entered into or performed under this Act through him; shall without prejudice to any award of penalty by the adjudicating officer or the SEBI under the Act on conviction, be

[11] Section 18A states: Notwithstanding anything contained in any other law for the time being in force, contracts in derivatives shall be legal and valid if such contracts are (a) traded on a recognized stock exchange, and (b) settled on the clearing house of the recognised stock exchange, in accordance with the rules and bye-laws of such stock exchange.

punishable with imprisonment for a term which may extend to ten years or with a fine which may extend to Rs. 25 crore or with both.

Section 23A of SCRA provides that any person, who is required under the SCRA or SCRR –

- to furnish any information, document, books, returns or report to the recognized stock exchange or to the Board, fails to furnish the same within the specified time therefore in the listing agreement or conditions or bye-laws of the recoganised stock exchange or the Act or rules made thereunder, or who furnishes false, incorrect or incomplete information, document, books, return or report, shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees for each such failure.
- to maintain books of account or records as per the listing agreements, conditions or bye-laws of a recognised stock exchange, fails to maintain the same, shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees.

Section 23B of SCRA provides that if any person fails to enter into an agreement with his client, who are required to enter as per the Act,he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees.

Section 23C of SCRA provides that if any stockbroker or sub-broker or a company whose securities are listed or proposed to be listed in a recognised stock exchange fails to redress the grievances of any investor after having been directed by SEBI or Stock Exchange, in writing, to do so within the stipulated time, he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees.

Section 23D of SCRA provides that if a registered stockbroker fails to segregate securities or monies of client(s) from its own securities or funds or uses the securities or monies of client(s) for self or any other client(s), he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one crore rupees.

Section 23E of SCRA provides that if a company or any person managing collective investment scheme or mutual fund or Real estate investment trust or Infrastructure investment trust or alternative investment fund, fails to comply with the listing conditions or delisting conditions or grounds or commits a breach thereof, it or he shall be liable to a penalty which shall not be less than five lakh rupees but which may extend to twenty-five crore rupees.

Section 23JA of SCRA provides for application in writing to the SEBI proposing for settlement of proceedings initiated or to be initiated for the alleged defaults. The SEBI after taking into consideration the nature, gravity and impact of defaults, may agree to the proposal for settlement, on payment of such sum by the defaulter or on such other terms as may be determined by SEBI. No appeal lies against any order passed under this section. Further, all settlement amounts excluding the disgorgement amount and legal costs realised are credited to the Consolidated Fund of India.

Section 23JB of SCRA states the procedure to be followed by the Recovery Officer of SEBI in case of non-payment of the penalty imposed under this Act by the adjudicating officer for refund of monies or compliance of disgorgement order issued under Section 12A. Recovery can be made in any one or more modes

i. attachment and sale of persons movable property
ii. attachment of person's bank accounts
iii. attachment and sale of person's immovable property
iv. arrest of the person and his detention in prison
v. appointing a receiver for the management of the person's movable and immovable properties

Section 23JC states that where a person dies, his legal representative shall be liable to pay any sum which the deceased would have been liable to pay, if he had not died, in the like manner and to the same extent as the deceased. However, the legal representative is liable only in case the penalty is imposed before the death of the deceased person.

Section 23L states that any person aggrieved by the order or decision of recognised stock exchange or adjudicating officer or any order made by SEBI may prefer an appeal before Securities Appellate Tribunal within forty-five days from decision of order is received by the appellant.

Sections 26A to 26E have been introduced in the SCRA with respect to the establishment of Special Courts. The provisions state that the Central Government may establish or designate as many Special Courts as may be necessary. It also prescribes the rules for the constitution of the Court as well as the offences triable by the Special Courts, Appeal and Revision, Application of Code to proceedings before Special Court etc.

Case 5.1: SEBI vs Vedika Securities

Facts of the case :

1) SEBI conducted an inspection of books of accounts of Vedika Securities Ltd (member of BSE and NSE) to verify segregation of client's funds and securities
2) Show cause notice was issued by adjudicating officer communicating alleged violations viz., Vedika was transferring funds from client account to settlement account routed through its own self -account.

Findings of the case :

1)SEBI noted that clients funds were mixed with own/borrowed funds by Vedika. As said practise was continuous, it could not be ascertained whether, on a particular day, funds of the client having credit balance were being used to meet the obligation of another client (s) having a debit balance

2)Vedika has not maintained proper segregation of client funds and own funds and violated SEBI circular no. SMD/SEBI/CIR/93/23321 dated November 18, 1993.

3)Adjudicating officer opined this to be a fit case to levy monetary penalty under section 15HB of SEBI Act and Section 23D of SCRA read with Regulation 26 (xiii), (xv) and (xvi) of SEBI Stock Broker Regulations.

Order:

After considering factors mentioned in Section 23J of SCRA and in terms of power conferred under section 15-I of SEBI Act and Section 23-I of SCRA, a penalty of Rs 1 lakh was levied on Vedika Securities

Case 5.2: SEBI vs Ashok Shivlal Rupani Enterprise International Limited (directors of Sainand Commercial Ltd)

Facts of the case:

Board of the Sainand Commercial Ltd (company) in its meeting held in July 2010 recommended for change in management and the proposal was moved through postal ballot. However, no corporate announcement was made by the company to the stock exchange regarding the board meeting and recommendation of change of management. Violation of regulation of 30(4) of SEBI (Listing Obligations and Disclosure Requirements) Regulations 2015 read with clause 36 of listing agreement read with section 21 and section 24 of SCRA, 1956.

Findings of the case:

a) SEBI noted that from documents on record, it was the responsibility of all directors to ensure all the legal and procedural compliances are done by the company. Ashok Shivlal Rupani and Naresh Shivlal Rupani failed to submit any documentary evidence regarding public announcement to the Exchanges. The submission of Uttam Ravji Gada …… that he relied on

other director's assurance that all necessary compliances have been carried out and hence not liable was not accepted by SEBI

b) The recommendation of the Board of Directors in regard to change in management of the company is very vital information. Not only the shareholders but the entire market needs to be made aware of such change. It is essential that corporate announcement is made, which the company did not make, all directors at the relevant time are liable for non-compliance. Hence penalized under section 23A(a) of SCRA

Order:

In view of charges established under provisions of SCRA, SEBI in 2018 levied a monetary penalty under section 23A(a) of SCRA of Rs 2 lakhs each on all three, namely Ashok Shivlal Rupani, Naresh Shivlal Rupani and Uttam Ravji Gada who were the directors of the company for the alleged violation.

5.2 Securities Contracts (Regulation) Rules, 1957

In exercise of the powers conferred by section 30 of the SCRA, the Central Government has made the Securities Contracts (Regulation) Rules, 1957. In this section, we discuss those rules formed under the SCRR which are of importance from a compliance point of view.

5.2.1 Eligibility criteria for membership of a recognized stock exchange

Rule 8 of SCRR specifies the rules relating to the admission of members of the stock exchange. No person is eligible to become a member if he

a. is less than 21 years of age;
b. is not a citizen of India provided that the governing body may in suitable cases relax this condition with the prior approval of SEBI;
c. has been adjudged bankrupt or receiving the order in bankruptcy has been made against him or has been proved to be insolvent even though he has obtained his final discharge;
d. has compounded with his creditors unless he has paid sixteen annas in the rupee;
e. has been convicted of an offence involving fraud or dishonesty;
f. is engaged as principal or employee in any business other than that of securities or commodity derivatives except as a broker or agent not involving any personal financial liability unless he undertakes on admission to sever his connection with such business:
g. has been at any time expelled or declared a defaulter by any other stock exchange;
h. has been previously refused admission to membership unless a period of one year has elapsed since the date of such rejection.

No person eligible for admission as a member under the above-mentioned rule shall be admitted as a member unless he:

(a) has worked for not less than two years as a partner with, or an authorised assistant or authorised clerk or remisier or apprentice to, a member; or

(b) agrees to work for a minimum period of two years as a partner or representative member with another member and to enter into bargains on the floor of the stock exchange and not in his name but the name of such other member; or

(c) succeeds to the established business of a deceased or retiring member who is his father, uncle, brother or any other person who is, in the opinion of the governing body, a close relative:

Provided that, the rules of the stock exchange may authorise the governing body to waive compliance with any of the foregoing conditions if the person seeking admission is in respect of means, position, integrity, knowledge and experience of business in securities, considered by the governing body to be otherwise qualified for membership.

5.2.2 Contracts between members

Rule 9 of the SCRR requires all contracts entered into between members of a recognized stock exchange to be confirmed in writing and to be enforced in accordance with the rules and bye-laws of the stock exchange of which they are members.

5.2.3 Audit of accounts of members.

As per Rule 12, every member shall get his accounts audited by a chartered accountant whenever such audit is required by SEBI.

Case 5.3: SEBI Settlement order in respect of Polson Limited

Facts of the case:

a) SEBI passed an interim order in June 2013 with respect to 105 listed companies who did not comply with minimum public shareholding (MPS) stipulated under Rule 19(2)(b) and 19A of SCRR, 1957. Polson Ltd was one of 105 companies.

b) On the basis of the submission made by the company, SEBI in June 2016 passed an order confirming directions issued vide interim order against the company, its director/promoter. In the said order it was noted that the company continued to be non-compliant with MPS requirements and thereby continued to breach Rule 19A of SCRR.

c) Polson in November 2017 informed SEBI that they have fulfilled MPS by selling 11, 200 equity shares owned by the promoters of the company, using the “Offer for sale” mechanism.

Findings of the case:

a) BSE confirmed to SEBI in January 2018 that the company is in compliance with the public shareholding requirement of 25% mandated in Rule 19A of SCRR as a continuous listing requirement for listed companies.

Order:

a) SEBI revoke the directions issued in the interim order against the company and its directors and promoters.

b) Mandate of MPS was applicable since 2010. Company has delayed the compliance with MPS for 4 years and has not provided any justification for delayed compliance, SEBI may consider initiating any action as deemed fit.

Settlement order

a) Show cause notice (SCN) was issued in May 2018 why an enquiry should not be held against it and penalty not imposed under section 23E of SCRA

b) Pending adjudication proceedings commenced by aforesaid SCN, the company filed a settlement application in June 2018 proposing to settle the proceedings without admitting or denying the finding of the fact.

c) SEBI Whole-time member agreed on the recommendation of High-powered Committee for a settlement amount of Rs 6.80 lakhs which was duly remitted by the company.

5.2.3 Books of account

Under Rule 15(1) every member of a recognized stock exchange is required to maintain and preserve the following books of account and documents for 5 years:

- Register of transactions (*Sauda book*).
- Clients' ledger.
- General ledger.
- Journals.
- Cashbook.
- Bank pass-book.
- Documents register showing full particulars of shares and securities received and delivered.

Rule 15(2) requires every member of a recognized stock exchange to maintain and preserve the following documents for a period of 2 years:

- Member's contract books showing details of all contracts entered into by the member with other members of the same exchange or counterfoils or duplicates of memos of confirmation issued to such other members.
- Counterfoils or duplicates of contract notes issued to clients.
- Written consent of clients in respect of contracts entered into as principals.

Review Questions

1. As per SCRR, the trading members of the stock exchanges are required to maintain the counterfoils or duplicates of contract notes issued to clients for how many years?

   (a) 3

   (b) 5

   (c) 2

   (d) 7

2. Members of the stock exchanges are required to preserve which of the following documents as per the SCRA?

   (a) Networth certificate

   (b) Books and accounts and other documents for a specific period of time

   (c) Registration certificate

   (d) All of the above

3. SCRA provides for a provision that a stockbroker of a recognised stock exchange can enter into a contract in securities with another stockbroker after obtaining his consent. State whether True or False.

   (a) True

   (b) False

4. Manner in which the derivatives contracts and other contracts should be dealt in the securities market are prescribed in which of the following?

   (a) Public Debt Act

   (b) Depositories Act

   (c) Companies Act

   (d) SCRA, 1956

CHAPTER 6: SEBI (INTERMEDIARIES) REGULATIONS, 2008

LEARNING OBJECTIVES:

After studying this chapter, you should know about the:

- Obligations of Intermediaries
- Inspection and other disciplinary proceedings for intermediaries
- Actions in case of default by members
- Code of conduct for intermediaries

6.1 Introduction

The SEBI (Intermediaries) Regulations, 2008 were notified in the official gazette on 26th May 2008. These regulations have 6 chapters and 4 schedules. In this chapter, we have summarized and discussed some of them. Candidates, however, are advised to go through the regulation in detail for better understanding.

The Regulations defines Intermediaries as a person mentioned in sub-sections 12 of the Act and includes asset management company in relation to SEBI (Mutual Fund) Regulations 1996, a clearing member of a clearing corporation or clearing house, foreign portfolio investor, trading member of derivatives segment or currency derivatives segment of stock exchange but does not include foreign venture capital investor, mutual fund, collective investment scheme and venture capital fund.

6.2 General Obligations of Intermediaries

The SEBI (Intermediaries) Regulations, 2008 prescribes that

(1) An intermediary shall provide the Board with a certificate of its compliance officer on the 1st April of each year certifying the compliance by the intermediary with all the obligations, responsibilities and the fulfilment of the eligibility criteria on a continuous basis under these regulations and the relevant regulations;

(2) Each intermediary shall prominently display a photocopy of the certificate at all its offices including branch offices.

(3) The intermediary shall also prominently display the name and contact details of the compliance officer to whom a complaint may be made in the event of any investor grievance.

(4) The intermediary shall maintain such books, accounts and records as specified in the relevant regulations.

(5) The intermediary shall make endeavours to redress investor grievances promptly but not later than forty-five days of receipt thereof and when called upon by the Board to do so it shall redress the grievances of investors within the time specified by the SEBI.

(6) The intermediary shall maintain records regarding investor grievances received by it and redressal of such grievances.

(7) The intermediary shall at the end of each quarter of a Financial Year ending on 31st March upload information about the number of investor grievances received, redressed and those remaining unresolved beyond three months of the receipt thereof by the intermediary on the website specified by SEBI.

6.2.1 Appointment of Compliance Officer

As already stated in chapter 3, an intermediary is required to appoint a compliance officer for monitoring the compliance by it of the requirements of the Act, rules, regulations, notifications, guidelines, circulars and orders made or issued by SEBI, or the Central Government, or the rules and regulations and bye-laws of the concerned stock exchanges or the SRO, where applicable. The compliance officer shall report to the intermediary or its board of directors in writing, of any material non-compliance by the intermediary.

6.2.2. Code of Conduct

An intermediary and its directors, officers, employees and key management personnel shall continuously abide by the code of conduct specified in the Schedule III of SEBI (Intermediaries) Regulations.

6.3 Inspection and Disciplinary Proceedings

6.3.1 Obligation of the intermediary on Inspection

Under regulation 19 of the SEBI (Intermediaries) Regulations, 2008

1. It shall be the duty of every director, proprietor, partner, trustee, officer, employee and any agent of an intermediary which is being inspected, to produce to the inspecting authority such books, accounts, records including telephone records and electronic records and documents in his custody or control and furnish to the inspecting authority with such statements and information relating to its activities within such time as the inspecting authority may require.
2. The intermediary shall allow the inspecting authority to have reasonable access to the premises occupied by such intermediary or by any other person on its behalf and also

extend reasonable facility for examining any books, records including telephone records and electronic records and documents in the possession of the intermediary or any such other person and also provide copies of documents or other material which in the opinion of the inspecting authority are relevant for the purposes of the inspection.

6.4 Action in Case of Default and Manner of Suspension and Cancellation of Certificate

- Where any intermediary fails to comply with any of the conditions of registration or contravenes any of the provisions of the securities laws (i.e. SEBI Act or SCRA or Depository Act or rules and regulations made thereunder) or directions, instructions or circulars issued thereunder. the Executive Director may, at his discretion,appoint a bench of 3 officers (not below the rank of Division Chief) as the designated authority to enquire into and to make recommendations as to the action to be taken. No officer who has conducted an investigation or inspection in respect of the alleged violation can be appointed as a designated authority.
- The designated authority shall issue a show-cause notice to a person against whom an enquiry has been initiated, to show cause as to why the action, as contemplated against such person, should not be recommended.
- The show-cause notice shall specify the period (not exceeding 21 days) within which a written reply should be submitted along with documentary evidence, if any, in support of such written reply. Every show cause notice shall specify the contravention alleged to have been committed indicating the provisions of the securities laws or the direction or the order of the SEBI which are alleged to have been contravened. Also, there shall be annexed to the notice copies of documents relied upon by SEBI along with the extracts of relevant portions of the reports containing the findings arrived at in an inquiry, investigation or inspection, if any.
- The designated authority may grant a request for inspection of documents.
- The designated authority shall grant an opportunity of personal hearing and issue or cause to issue a notice scheduling a date for hearing.

If the noticee does not reply to the show-cause notice or fails to appear on the scheduled date of hearing and the designated authority is satisfied that sufficient opportunity has been given to the noticee, the designated authority may conclude the proceedings after recording the reasons for doing so, on the basis of the material available on record.

6.4.1 Recommendation of Action

After considering material available on record and the reply, the designated authority may by way of a report, recommend the following measures:

(i) Disposing of the proceedings without adverse action
(ii) Cancellation of certificate of registration;
(iii) Suspension of certificate of registration for a specified period;
(iv) Prohibition of the noticee from taking up any new assignment or contract or launch a new scheme for such period as may be specified;

(v) Debarment of an officer of the noticee from being employed or associated with any registered intermediary or other person associated with the securities market for such period as may be specified;

(vi) Debarment a branch or an office of the noticee from carrying out activities for such period as may be specified;

(vii) Issuance of a regulatory censure to the noticee.

The designated authority shall endeavour to submit the report within 120 from the date of receipt of reply to the notice or date of personal hearing whichever is later.

6.4.2 Order

Regulation 27 specifies on receipt of the report containing measures by the designated authority, the competent authority shall cause to forward a copy of the report submitted by the designated authority and call upon the noticee to make a submission as to why measures recommended by the designated authority should not be taken. The noticee shall submit not exceeding twenty-one days from date of service, written submission along with documentary evidence if any, in support of the written submission.

After considering the submission of the noticee, the competent authority may if deemed fit, for records to be recorded it in writing, remit the matter to the designated authority to enquire afresh or to further enquire afresh or to further enquire and resubmit the report.

The competent authority may grant an opportunity of personal hearing where the designated authority has recommended cancellation of certificate of registration or the competent authority is of the prima facie view that it is a fit case for cancellation of certificate of registration. After considering the facts and circumstances of the case, material on record and the written submission, if any, the competent authority shall endeavour to pass an appropriate order within 120 days from the date of submission or personal hearing, whichever is later.

6.4.3 Common Order

The competent authority may pass a common order in respect of a number of noticees where the subject matter in question is substantially the same or similar in nature.

6.4.4 Special Procedure for action on expulsion from membership of the stock exchange (s) or clearing corporation(s) or termination of all the depository participant agreements with depository (ies)

(i) On receipt of intimation from all the stock exchange(s) or clearing corporation(s) of which the stock-broker or clearing member, as the case may be, was a member, that such stockbroker or clearing member, has been expelled from its membership, SEBI may issue a notice to such stockbroker or clearing member calling upon the noticee to make its submission(s), if any, within a period not exceeding twenty-one days from the date of service thereof, through a written reply, along with documentary evidence, as to why the certificate of registration, granted under the Act or the regulations made thereunder, should not be cancelled.

(ii)On receipt of intimation from all the depositories where the participant was admitted, that the depository participant agreement has been terminated by the depository(ies), SEBI may issue a notice to such participant calling upon the noticee to make its submission(s), if any, within a period not exceeding twenty-one days from the date of service thereof, through a written reply, along with documentary evidence, as to why the certificate of registration, granted under the Act or the regulations made thereunder, should not be cancelled.

(iii)No opportunity of personal hearing shall be granted while disposing of the proceedings under this regulation.

(iv) After considering the facts and circumstances of the case, material on record and the written submissions, if any, SEBI shall endeavour to pass an order within twenty days from the date of receipt of written submissions.

(v) SEBI may, while passing such order, impose such conditions upon the person as it deems fit to protect the interest of the investors or its clients or the securities market.

(vi) SEBI may require the person concerned to satisfy the factors as it deems fit, including but not limited to the following :
(a) the arrangements made by the person for maintenance and preservation of records and other documents required to be maintained under the relevant regulations;
(b) redressal of investor grievances;
(c) transfer of records, funds or securities of its clients;
(d) the arrangements made by it for ensuring continuity of service to the clients;
(e) defaults or pending action, if any.

(vii)On and from the date of cancellation of the certificate, the person concerned shall-
(a) return the certificate of registration so cancelled to SEBIand shall not represent itself to be a holder of the certificate for carrying out the activity for which such certificate had been granted;
(b) cease to carry on any activity in respect of which the certificate had been granted;

(c) transfer its activities to another person holding a valid certificate of registration to carry on such activity and allow its clients or investors to withdraw or transfer their securities or funds held in its custody or to withdraw any assignment given to it, without any additional cost to such client or investor;
(d) make provisions as regards liability incurred or assumed by it;
(e) take such other action including the action relating to any record(s) or document(s) and securities or money of the investors that may be in custody or control of such person, within the time period and in the manner, as may be required under the relevant regulations or as may be directed by the Board while passing order under this Chapter or otherwise.

(viii) A copy of the order passed under this regulation shall be sent to the noticee and also uploaded on the website of the Board.

(ix)The intimation of the cancellation of the certificate of registration shall be sent to the stock exchange(s) or the clearing corporation(s) or the depository (ies), as the case may be.

6.4.5 Surrender of certificate of registration

An intermediary may surrender the certificate of registration by making a request to the SEBI. SEBI, while disposing such request, may require the intermediary to satisfy SEBI as to the factors it deems fit, including but not limited to the following:

i. the arrangements made by the person for maintenance and preservation of records and other documents required to be maintained under the relevant regulations;
ii. redressal of investor grievances;
iii. transfer of records, funds or securities of its clients;
iv. the arrangements made by it for ensuring continuity of service to the clients;
v. defaults or pending action, if any.

While accepting the surrender, SEBI may also impose such conditions upon the intermediary as it deems fit for protection of the investors or its clients or the securities market and such intermediary shall comply with such conditions.

6.4.6 Effect of debarment, suspension, cancellation or surrender

On and from the date of debarment or suspension of the certificate, the concerned person shall

a) not undertake any new assignment or contract or launch any new scheme and during the period of such debarment or suspension it shall cease to carry on any activity in respect of which certificate had been granted;
b) allow its clients or investors to withdraw or transfer their securities or funds held in its custody or withdraw any assignment given to it, without any additional cost to such client or investor;

c) make provisions as regards liability incurred or assumed by it;
d) take such other action including the action relating to any records or documents and securities or money of the investors that may be in custody or control of such person, within the time period and in the manner, as may be required under the relevant regulations or as may be directed by SEBI while passing the order.

On and from the date of surrender or cancellation of the certificate, the concerned person shall

i. return the certificate of registration so cancelled to SEBI and shall not represent itself to be a holder of the certificate for carrying out the activity for which such certificate had been granted;
ii. cease to carry on any activity in respect of which the certificate had been granted;
iii. transfer its activities to another person holding a valid certificate of registration to carry on such activity and allow its clients or investors to withdraw or transfer their securities or funds held in its custody or to withdraw any assignment given to it, without any additional cost to such client or investor;
iv. make provisions as regards liability incurred or assumed by it;
v. take such other action including the action relating to any records or documents and securities or money of the investors that may be in custody or control of such person, within the time period and in the manner, as may be required under the relevant regulations or as may be directed by SEBI while passing orders.

Regulation 34 states the manner of service of notice and order publication. It states that any notice issued or order passed under these regulations may be served -

i. by hand delivery to the concerned person or duly authorized agent or
ii. by delivery at address available on the records of SEBI and addressed to that person or his duly authorised agent, by registered post acknowledgement due or by speed post or by such courier service or by electronic mail service or by any other means of transmission which affords a record of delivery or
iii. in case of stock broker or a sub-broker or a depository participant through the concerned stock exchange or depository respectively; and
iv. if it cannot be served as per clause (i), (ii) and (iii) by affixing the same on the door or some other conspicuous part of the premises in which such person resides or is known to have last resided or carries on business or is known to have last carried on business or personally works for gain or is known to have last personally worked for gain

Further, every order passed shall be put on the website of SEBI.

6.4.6 Directions

Without prejudice to any order under the securities laws and the directions, guidelines and circulars issued thereunder, SEBI may, in the interest of the securities market, in the interest of

the investors or for the purpose of securing the proper management of any intermediary, issue necessary direction including but not limited to any or all of the following -

a) directing the intermediary or other persons associated with securities market to refund any money or securities collected from the investors under any scheme or otherwise, with or without interest;
b) directing the intermediary or other persons associated with securities market not to access the capital market or not to deal in securities for a particular period or not to associate with any intermediary or with any capital market-related activity;
c) directing the recognized stock exchange concerned not to permit trading in the securities or units issued by a mutual fund or collective investment scheme;
d) directing the recognized stock exchange concerned to suspend trading in the securities or units issued by a mutual fund or collective investment scheme;
e) any other direction which SEBI may deem fit and proper in the circumstances of the case.

Provided that before issuing any directions, SEBI shall give a reasonable opportunity of being heard to the persons concerned. In case of any interim direction, SEBI shall give a reasonable opportunity of hearing to the persons concerned after passing the direction, without any undue delay.

6.5 Code of Conduct

An intermediary and its directors, officers, employees and key management personnel shall continuously abide by the code of conduct specified in SEBI (Intermediaries) Regulations, 2008. Some aspects of the Code of Conduct are discussed below:

I. *Investors/Clients -* Every intermediary shall make all efforts to protect the interests of investors and shall render the best possible advice to its clients having regard to the client's needs and the environments and his own professional skills

II. *High Standards of Service*: An intermediary shall ensure that it and its key management personnel, employees, contractors and agents shall in the conduct of their business, observe high standards of integrity, dignity, ethics and professionalism and all professional dealings shall be affected in a prompt, effective and efficient manner.

III. *Conflict of Interest*: An intermediary shall avoid conflict of interest and make adequate disclosure of his interest and shall put in place a mechanism to resolve any conflict-of-interest situation that may arise in the conduct of its business or where any conflict of interest arises, shall take reasonable steps to resolve the same in an equitable manner.

IV. *Compliance and Corporate Governance*:

An intermediary shall ensure that good corporate policies and corporate governance is in place. It shall ensure that they do not engage in any fraudulent and manipulative transactions in the securities listed on the stock exchanges. It shall also ensure that they do not indulge in any unfair competition which is likely to harm the interests of the other intermediaries or the investors.

An intermediary shall take adequate and necessary steps to ensure that continuity in data and record-keeping is maintained and that the data and records are not lost or destroyed. It shall also ensure that for electronic records and data, up-to-date backup is always available with it. It shall not be a party to or instrumental in or indulge in:

(a) Creation of a false market for securities listed or proposed to be listed on any stock exchange in India;

(b) Price rigging or manipulation of prices of securities listed or proposed to be listed on any stock exchange in India; or

(c) Passing of any unpublished price sensitive information in respect of securities which are listed or proposed to be listed on any stock exchange to any person or intermediary; or

(d) Any activity for distorting market equilibrium or which may affect the smooth functioning of the market or for personal gain.

An intermediary need to maintain an appropriate level of knowledge and competency and abide by the provisions of any Act, regulations, circulars and guidelines of the Central Government, the Reserve Bank of India (RBI), SEBI, the stock exchanges or any other applicable statutory or self-regulatory or other body as the case may be and as may be applicable to the intermediary in respect of the business carried on by such intermediary.

Case 6.1: SEBI v/s Vrise Securities Pvt Ltd

Facts of the case:

a) Vrise is a member of BSE and NSE. Basis an email received by SEBI alleging dabba trading activities by one Mr Jatin Mehta by using terminals allotted by Vrise, SEBI directed BSE and NSE to conduct surprise inspection to find any possible illegal trading by Vrise.

b) During an onsite inspection on June 11, 2014, NSE Exchange officials observed that Jatin was operating the terminal of Vrise. The location of the said terminal was not reported to Exchange by Vrise . The inspection team visited the premises on June 12, 2014, however, Jatin being an employee of Vrise refused to accept the inspection letter and denied access to inspection officials to enter the premises. Subsequently, the location was closed on September 2014 when BSE officials reached the premises.

c) As per NSE records Jatin was a CTCL dealer for Opera House (pin code 400004) premise however was operating the terminal from Borivali (pin code 400092).

d) Vrise by not uploading CTCL terminals had violated various circulars issued by the Exchanges. Further Vrise by not cooperating with the Exchange officials for conducting inspection and failing to exercise control over its branch had violated Exchange regulations.

e) Enquiry proceedings were initiated against Vrise under SEBI (intermediaries) Regulation for alleged violation. The Designated authority (DA) based on the submissions found Vrise in violation of regulations and circulars and recommended that Vrise be prohibited from registering new fresh clients for a period of one year.

d) Show Cause Notice (SCN) was issued in January 2019 calling upon Vrise as to why action recommended by DA or penalty should not be imposed

Findings of the case:

a) Vrise operated pro-account from the trading terminal which was not located from its functional corporate office and which was not uploaded to Exchange as mandated in various circulars.

b) It is established that Vrise failed to extend co-operation to NSE inspecting officials during the course of the inspection and failed to exercise control over branch operations.

Order:

a) The above-mentioned violations by Vrise amounts to violation of Regulation 27 of Brokers Regulation which makes Vrise liable for action under Chapter V of Intermediaries Regulation.

b) Well settled principle of law that multiple proceedings for the same set of violations and hence contention of Vrise that it is a one-off incident, NSE has already penalised for the same violation, they have taken corrective steps does not have any merit.

c) Power conferred under section 19 of SEBI Act, 1992 read with regulation 28(2) of SEBI (Intermediaries Regulation), 2008 the adjudicating officer prohibited Vrise from registering new fresh clients for a period of 6 months from the date of order i.e., January 08, 2020.

Review Questions

1. SEBI in the interest of the securities market may direct an intermediary to refund the money or securities collected from the investors with or without interest. State whether True or False.

   (a) True

   (b) False

2. If an applicant is not found to be a 'fit and proper person' can he get registration certificate under SEBI (Intermediaries) Regulations 2008?

   (a) Yes

   (b) No

3. All the employees, directors etc. of the intermediary need to strictly adhere to the Code of Conduct as prescribed in the SEBI Regulations. State Whether True or False.

   (a) True

   (b) False

4. Can a common order be passed in respect of a number of noticees where the subject matter in question is substantially the same or similar in nature?

   (a) Yes

   (b) No

CHAPTER 7: SEBI (PROHIBITION OF INSIDER TRADING) REGULATIONS, 2015

LEARNING OBJECTIVES:

After studying this chapter, you should know about:

- Prohibition on dealing, communication or counselling in securities when in possession of insider information
- Disclosures and internal procedure for prevention of insider trading
- Code of conduct for prevention of insider trading
- Preservation of Price Sensitive Information
- Trading plan
- Reporting requirements for transaction in securities

7.1 Introduction to the Insider Trading Regulations

Any dealing/trading done by an insider based on information which is not available in the public domain gives an undue advantage to insiders and affects market integrity. This is not in line with the principle of fair and equitable markets. In order to protect the integrity of the market, the SEBI (Prohibition of Insider Trading) Regulations have been put in place. These regulations aim to put in place a framework for the prohibition of insider trading in securities and to strengthen the legal framework. The Regulations mainly provide for who can be insiders, what is prohibited for them and the systemic provisions/ fair conduct policy which needs to be laid down and followed by listed companies as well as intermediaries.

Who are Insiders?

The regulations define "insider" as any person who is a connected person or in possession of or having access to unpublished price sensitive information.

Connected person means:

(i) any person who is or has during the six months prior to the concerned act been associated with a company, directly or indirectly, in any capacity including by reason of frequent communication with its officers or by being in any contractual, fiduciary or employment relationship or by being a director, officer or an employee of the company or holds any position including a professional or business relationship between himself and the company whether temporary or permanent, that allows such person, directly or indirectly, access to unpublished price sensitive information or is reasonably expected to allow such access.

(ii) Without prejudice to the generality of the foregoing, the persons falling within the following categories shall be deemed to be connected persons unless the contrary is established, -

(a) an immediate relative of connected persons specified in clause (i); or
(b) a holding company or associate company or a subsidiary company; or
(c) an intermediary as specified in section 12 of the Act or an employee or director thereof; or
(d) an investment company, trustee company, asset management company or an employee or director thereof; or
(e) an official of a stock exchange or clearing house or corporation; or
(f) a member of the board of trustees of a mutual fund or a member of the board of directors of the asset management company of a mutual fund or is an employee thereof; or
(g) a member of the board of directors or an employee, of a public financial institution as defined in section 2 (72) of the Companies Act, 2013; or
(h) an official or an employee of a self-regulatory organization recognized or authorized by the SEBI; or
(i) a banker of the company; or
(j) a concern, firm, trust, Hindu undivided family, company or association of persons wherein a director of a company or his immediate relative or banker of the company, has more than ten per cent of the holding or interest;

It is intended that a connected person is one who has a connection with the company that is expected to put him in possession of unpublished price sensitive information. Immediate relatives and other categories of persons specified above are also presumed to be connected persons but such a presumption is a deeming legal fiction and is rebuttable. This definition is also intended to bring into its ambit persons who may not seemingly occupy any position in a company but are in regular touch with the company and its officers and are involved in the know of the company's operations. It is intended to bring within its ambit those who would have access to or could access unpublished price sensitive information about any company or class of companies by virtue of any connection that would put them in possession of unpublished price sensitive information.

Regulation 2(c) defines the term 'compliance officer'. It states that "compliance officer" means any senior officer, designated so and reporting to the board of directors or head of the organization in case the board is not there, who is financially literate and is capable of appreciating requirements for legal and regulatory compliance under these regulations and who shall be responsible for compliance of policies, procedures, maintenance of records, monitoring adherence to the rules for the preservation of unpublished price sensitive information, monitoring of trades and the implementation of the codes specified in these regulations under

the overall supervision of the board of directors of the listed company or the head of an organization, as the case may be. For the purpose of this regulation, “financially literate” shall mean a person who has the ability to read and understand basic financial statements i.e., balance sheet, profit and loss account, and statement of cash flows;

Regulation 2(e) defines the term "generally available information" means information that is accessible to the public on a non-discriminatory basis. It is intended to define what constitutes generally available information so that it is easier to crystallize and appreciate what unpublished price sensitive information is. Information published on the website of a stock exchange would ordinarily be considered generally available.

Regulation 2(f) defines the term ‘immediate relative’ as a spouse of a person and includes parent, sibling, and child of such person or of the spouse, any of whom is either dependent financially on such person or consults such person in taking decisions relating to trading in securities.

Since “generally available information” is defined, it is intended that anyone in possession of or having access to unpublished price sensitive information should be considered an “insider” regardless of how one came in possession of or had access to such information. Various circumstances are provided for such a person to demonstrate that he has not indulged in insider trading. Therefore, this definition is intended to bring within its reach any person who is in receipt of or has access to unpublished price sensitive information. *The onus of showing that a certain person was in possession of or had access to unpublished price sensitive information at the time of trading would, therefore, be on the person levelling the charge after which the person who has traded when in possession of or having access to unpublished price sensitive information may demonstrate that he was not in such possession or that he has not traded or he could not access or that his trading when in possession of such information was squarely covered by the exonerating circumstances.*

Regulation 2(n) defines unpublished price sensitive information as any information, relating to a company or its securities, directly or indirectly, that is not generally available which upon becoming generally available, is likely to materially affect the price of the securities and shall, ordinarily including but not restricted to, information relating to the following: –

(i) financial results;
(ii) dividends;
(iii) change in capital structure;
(iv) mergers, de-mergers, acquisitions, delisting, disposals and expansion of business and such other transactions;
(v) changes in key managerial personnel;

What is prohibited under SEBI (Prohibition of Insider Trading) Regulations?

Regulation 3(1) states that an insider shall not communicate, provide, or allow access to any unpublished price sensitive information, relating to a company or securities listed or proposed to be listed, to any person including other insiders except where such communication is in furtherance of legitimate purposes, the performance of duties or discharge of legal obligations. This provision is intended to cast an obligation on all insiders who are essentially persons in possession of unpublished price sensitive information to handle such information with care and to deal with the information with them when transacting their business strictly on a need-to-know basis. It is also intended to ensure that organisations develop practices based on "need-to-know" principles for treatment of confidential information in their possession.

Regulation 3(2) states that no person shall procure from or cause the communication by any insider of unpublished price sensitive information, relating to a company or securities listed or proposed to be listed, except in furtherance of legitimate purposes, the performance of duties or discharge of legal obligations. This provision is intended to impose a prohibition on unlawfully procuring possession of unpublished price sensitive information. Inducement and procurement of unpublished price sensitive information not in furtherance of one's legitimate duties and discharge of obligations would be illegal under this provision.

Regulation 3(2A) states that the board of directors of a listed company shall make a policy for the determination of "legitimate purposes" as a part of "Codes of Fair Disclosure and Conduct" formulated under regulation 8. The term "legitimate purpose" shall include sharing of unpublished price sensitive information in the ordinary course of business by an insider with partners, collaborators, lenders, customers, suppliers, merchant bankers, legal advisors, auditors, insolvency professionals or other advisors or consultants, provided that such sharing has not been carried out to evade or circumvent the prohibitions of these regulations.

Regulation 3(2B) states that any person in receipt of unpublished price sensitive information pursuant to a "legitimate purpose" shall be considered an "insider" for purposes of these regulations and due notice shall be given to such persons to maintain the confidentiality of such unpublished price sensitive information in compliance with these regulations.

Regulation 3(3) further states that unpublished price sensitive information may be communicated, provided, allowed access to or procured, in connection with transactions that would:

(i) entail an obligation to make an open offer under the takeover regulations where the board of directors of the listed company is of informed opinion that the sharing of such information is in the best interests of the company;

(ii) not attract the obligation to make an open offer under the takeover regulations but where the board of directors of the listed company is of informed opinion that the sharing of such information is in the best interests of the company and the information that constitute unpublished price sensitive information is disseminated to be made generally available at least two trading days prior to the proposed transaction being effected in such form as the board of directors may determine to be adequate and fair to cover all relevant and material facts.

For this purpose, Regulation 3(4) states that the board of directors shall require the parties to execute agreements to contract confidentiality and non-disclosure obligations on the part of such parties and such parties shall keep information so received confidential, except for the purpose of sub-regulation (3), and shall not otherwise trade in securities of the company when in possession of unpublished price sensitive information.

Regulation 3(5) states that the board of directors or head(s) of the organization of every person required to handle unpublished price sensitive information shall ensure that a structured digital database is maintained containing the nature of unpublished price sensitive information and the names of such persons who have shared the information and also the names of such persons with whom information is shared under this regulation along with the Permanent Account Number (PAN) or any other identifier authorized by law where PAN is not available. Such databases shall not be outsourced and shall be maintained internally with adequate internal controls and checks such as time stamping and audit trails to ensure non-tampering of the database. Regulation 3(6) specifies that a structured digital database is required to be preserved for not less than 8 years after completion of the transaction and in the event of any investigation or enforcement proceedings, relevant information in the structured digital database shall be preserved till the completion of proceedings.

As per Regulation 4, no insider shall trade in securities that are listed or proposed to be listed on a stock exchange when in possession of unpublished price sensitive information. When a person who has traded in securities has been in possession of unpublished price sensitive information, his trades would be presumed to have been motivated by the knowledge and awareness of such information in his possession. However, the insider may prove his innocence by demonstrating the circumstances including the following:

(i) The transaction is an off-market *inter-se* transfer between insiders who were in possession of the same unpublished price sensitive information without being in breach of regulation 3 and

both parties had made a conscious and informed trade decision. However, such unpublished price sensitive information was not obtained under sub-regulation (3) of regulation 3 of these regulations. It is further stated that such off-market trades shall be reported by the insiders to the company within two working days. Every company shall notify the particulars of such trades to the stock exchange on which the securities are listed within two trading days from receipt of the disclosure or from becoming aware of such information.

(ii) The transaction was carried out through the block deal window mechanism between persons who were in possession of the unpublished price sensitive information without being in breach of regulation 3 and both parties had made a conscious and informed trade decision;
Provided that such unpublished price sensitive information was not obtained by either person under sub-regulation (3) of regulation 3 of these regulations.

(iii) The transaction in question was carried out pursuant to a statutory or regulatory obligation to carry out a bona fide transaction.

(iv) The transaction in question was undertaken pursuant to the exercise of stock options in respect of which the exercise price was pre-determined in compliance with applicable regulations.

(v) in the case of non-individual insiders: –

(a) the individuals who were in possession of such unpublished price sensitive information were different from the individuals taking trading decisions and such decision-making individuals were not in possession of such unpublished price sensitive information when they took the decision to trade; and

(b) appropriate and adequate arrangements were in place to ensure that these regulations are not violated and no unpublished price sensitive information was communicated by the individuals possessing the information to the individuals taking trading decisions and there is no evidence of such arrangements having been breached;

(vi) the trades were pursuant to a trading plan set up in accordance with regulation 5.

Regulation 5 deals with "Trading Plans" which can be formulated by an insider and the procedure-related thereto. It states as under:

(1) An insider shall be entitled to formulate a "Trading Plan" and present it to the compliance officer for approval and public disclosure pursuant to which trades may be carried out on his behalf in accordance with such plan.

(2) Such Trading Plan shall:

i. not entail commencement of trading on behalf of the insider earlier than six months from the public disclosure of the plan;

ii. not entail trading for the period between the twentieth trading day prior to the last day of any financial period for which results are required to be announced by the issuer of the securities and the second trading day after the disclosure of such financial results;

iii. entail trading for a period of not less than twelve months;

iv. not entail overlap of any period for which another trading plan is already in existence;

v. set out either the value of trades to be effected or the number of securities to be traded along with the nature of the trade and the intervals at, or dates on which such trades shall be effected;

vi. does not entail trading in securities for market abuse.

(3) The compliance officer shall review the Trading Plan to assess whether the plan would have any potential for violation of these regulations and shall be entitled to seek such express undertakings as may be necessary to enable such assessment and to approve and monitor the implementation of the plan. However, pre-clearance of trades shall not be required for a trade executed as per an approved trading plan. It is further stated that trading window norms and restrictions on contra trade shall not be applicable for trades carried out in accordance with an approved trading plan.

(4) The Trading Plan once approved shall be irrevocable and the insider shall mandatorily have to implement the plan, without being entitled to either deviate from it or to execute any trade in the securities outside the scope of the trading plan.

However, the implementation of the Trading Plan shall not be commenced if any unpublished price sensitive information in possession of the insider at the time of formulation of the plan has not become generally available at the time of the commencement of implementation and in such event, the compliance officer shall confirm that the commencement ought to be deferred until such unpublished price sensitive information becomes generally available information so as to avoid a violation of sub-regulation (1) of regulation 4.

(5) Upon approval of the Trading Plan, the compliance officer shall notify the plan to the stock exchanges on which the securities are listed.

Information to SEBI by Informants

Regulation 7A to 7K deals with this aspect of Informant. 'Informant' means an individual(s), who voluntarily submits to the SEBI a Voluntary Information Disclosure Form relating to an alleged violation of insider trading laws that has occurred, is occurring or has a reasonable belief that it is about to occur, in a manner provided under these regulations, regardless of whether such individual(s) satisfies the requirements, procedures and conditions to qualify for a reward;

Regulation 7B specifies the procedure for submission of original information to the SEBI. On receipt of such information, SEBI is required to examine the same and initiate necessary action as per Regulation 7C. Regulation 7D discusses the eligibility of an informant for a reward for such

information and regulation 7E specifies the process for determination of the amount of reward. The procedures for application/rejection of claim for reward are specified in 7F and 7G respectively. Regulation 7H specifies the requirements with respect to informant confidentiality.

Regulation 7I specifies the requirements to be followed for protection against retaliation and victimization of informants. Regulation 7I (1) states that every person required to have a Code of Conduct under these regulations shall ensure that such a Code of Conduct provides for suitable protection against any discharge, termination, demotion, suspension, threats, harassment, directly or indirectly or discrimination against any employee who files a Voluntary Information Disclosure Form, irrespective of whether the information is considered or rejected by the SEBI or he or she is eligible for a Reward under these regulations, by reason of:

(i) filing a Voluntary Information Disclosure Form under these regulations;

(ii) testifying in, participating in, or otherwise assisting or aiding the Board in any investigation, inquiry, audit, examination or proceeding instituted or about to be instituted for an alleged violation of insider trading laws or in any manner aiding the enforcement action taken by the Board; or

(iii) breaching any confidentiality agreement or provisions of any terms and conditions of employment or engagement solely to prevent any employee from cooperating with the Board in any manner.

For the purpose of this Chapter, "employee" means any individual who during employment may become privy to information relating to violation of insider trading laws and files a Voluntary Information Disclosure Form under these regulations and is a director, partner, regular or contractual employee, but does not include an advocate.

Nothing in this regulation shall require the employee to establish that,

(i) the Board has taken up any enforcement action in furtherance of information provided by such person; or

(ii) the information provided fulfils the criteria of being considered as Original Information under these regulations.

Nothing in these regulations shall prohibit any Informant who believes that he or she has been subject to retaliation or victimisation by his or her employer, from approaching the competent court or tribunal for appropriate relief.

Notwithstanding anything contained above, any employer who violates this chapter may be liable for penalty, debarment, suspension, and/or criminal prosecution by the Board, as the case may be. However, nothing in these regulations will require the Board to direct reinstatement or compensation by an employer.

Nothing in these regulations shall diminish the rights and privileges of or remedies available to any Informant under any other law in force.

Regulation 7J deals with void agreements which states that (1) any term in an agreement (oral or written) or Code of Conduct, is void in so far as it purports to preclude any person, other than an advocate, from submitting to the Board information relating to the violation of the securities laws that has occurred, is occurring or has a reasonable belief that it would occur.

(2) No person shall by way of any threat or act impede an individual from communicating with the Board, including enforcing or threatening to enforce, a confidentiality agreement (other than agreements related to legal representations of a client and communications thereunder) with respect to such communications.

No employer shall require an employee to notify him of any Voluntary Information Disclosure Form filed with the Board or to seek its prior permission or consent or guidance of any person engaged by the employer before or after such filing.

Code of Fair Disclosure

Regulation 8(1) specifies that the board of directors of every company, whose securities are listed on a stock exchange, shall formulate and publish on its official website, a code of practices and procedures for fair disclosure of unpublished price sensitive information that it would follow in order to adhere to each of the principles set out in Schedule A to these regulations, without diluting the provisions of these regulations in any manner.

Regulation 8(2) states that every such code of practices and procedures for fair disclosure of unpublished price sensitive information and every amendment thereto shall be promptly intimated to the stock exchanges where the securities are listed.

7.2 Code of Conduct

As per Regulation 9(1), the board of directors of every listed company and the board of directors or head(s) of the organisation of every intermediary shall ensure that the chief executive officer or managing director shall formulate a code of conduct with their approval to regulate, monitor and report trading by its designated persons and immediate relatives of designated persons towards achieving compliance with these regulations, adopting the minimum standards set out in Schedule B (in case of a listed company) and Schedule C (in case of an intermediary) to these regulations, without diluting the provisions of these regulations in any manner. It is clarified that intermediary, which are listed, would be required to formulate a code of conduct to regulate, monitor and report trading by their designated persons, by adopting the minimum standards set

out in Schedule B with respect to trading in their securities and Schedule C with respect to trading in other securities

Regulation 9(2) states that the board of directors or head(s) of the organisation, of every other person who is required to handle unpublished price sensitive information in the course of business operations, shall formulate a code of conduct to regulate, monitor and report trading by their designated persons and immediate relative of designated persons towards achieving compliance with these regulations, adopting the minimum standards set out in Schedule C to these regulations, without diluting the provisions of these regulations in any manner. Professional firms such as auditors, accountancy firms, law firms, analysts, insolvency professional entities, consultants, banks etc., assisting or advising listed companies shall be collectively referred to as fiduciaries for the purpose of these regulations.

Regulation 9(3) specifies that every listed company, intermediary and other persons formulating a code of conduct shall identify and designate a compliance officer to administer the code of conduct and other requirements under these regulations.

Regulation 9(4) states that for the purpose of sub-regulation (1) and (2), the board of directors or such other analogous authority shall in consultation with the compliance officer specify the designated persons to be covered by the code of conduct on the basis of their role and function in the organisation and the access that such role and function would provide to unpublished price sensitive information in addition to seniority and professional designation and shall include: -
(i) Employees of such listed company, intermediary or fiduciary designated on the basis of their functional role or access to unpublished price sensitive information in the organization by their board of directors or analogous body;
(ii) Employees of material subsidiaries of such listed companies designated on the basis of their functional role or access to unpublished price sensitive information in the organization by their board of directors;
(iii) All promoters of listed companies and promoters who are individuals or investment companies for intermediaries or fiduciaries;
(iv) Chief Executive Officer and employees up to two levels below Chief Executive Officer of such listed company, intermediary, fiduciary and its material subsidiaries irrespective of their functional role in the company or ability to have access to unpublished price sensitive information;
(v) Any support staff of a listed company, intermediary or fiduciary such as IT staff or secretarial staff who have access to unpublished price sensitive information.

Regulation 9A deals with the institutional mechanism for the prevention of insider trading. Regulation 9A (1) states that the Chief Executive Officer, Managing Director or such other

analogous person of a listed company, intermediary or fiduciary shall put in place an adequate and effective system of internal controls to ensure compliance with the requirements given in these regulations to prevent insider trading.

Regulation 9 A (2) specifies that the internal controls shall include the following:

(a) all employees who have access to unpublished price sensitive information are identified as a designated person;

(b) all the unpublished price sensitive information shall be identified and its confidentiality shall be maintained as per the requirements of these regulations;

(c) adequate restrictions shall be placed on communication or procurement of unpublished price sensitive information as required by these regulations;

(d) lists of all employees and other persons with whom unpublished price sensitive information is shared shall be maintained and confidentiality agreements shall be signed or notice shall be served to all such employees and persons;

(e) all other relevant requirements specified under these regulations shall be complied with;

(f) periodic process review to evaluate the effectiveness of such internal controls.

Regulation 9A (3) states that the board of directors of every listed company and the board of directors or head(s) of the organisation of intermediaries and fiduciaries shall ensure that the Chief Executive Officer or the Managing Director or such other analogous person ensures compliance with regulation 9 and sub-regulations (1) and (2) of this regulation.

Regulation 9 A (4) states that the Audit Committee of a listed company or other analogous body for intermediary or fiduciary shall review compliance with the provisions of these regulations at least once in a financial year and shall verify that the systems for internal control are adequate and are operating effectively.

As per Regulation 9 A(5), every listed company shall formulate written policies and procedures for inquiry in case of leak of unpublished price sensitive information or suspected leak of unpublished price sensitive information, which shall be approved by board of directors of the company and accordingly initiate appropriate inquiries on becoming aware of leak of unpublished price sensitive information or suspected leak of unpublished price sensitive information and inform the Board promptly of such leaks, inquiries and results of such inquiries.

As per Regulation 9 A (6), the listed company shall have a whistle-blower policy and make employees aware of such policy to enable employees to report instances of leaks of unpublished price sensitive information.

Regulation 9 A (7) specifies that if an inquiry has been initiated by a listed company in case of leak of unpublished price sensitive information or suspected leak of unpublished price sensitive information, the relevant intermediaries and fiduciaries shall co-operate with the listed company in connection with such inquiry conducted by a listed company.

Sechedule A of the egulations 8 have prescribed the Principles of Fair Disclosure for purposes of Code of Practices and Procedures for Fair Disclosure of Unpublished Price Sensitive Information as under:

- Prompt public disclosure of unpublished price sensitive information that would impact price discovery no sooner than credible and concrete information comes into being in order to make such information generally available.
- Uniform and universal dissemination of unpublished price sensitive information to avoid selective disclosure.
- Designation of a senior officer as a chief investor relations officer to deal with dissemination of information and disclosure of unpublished price sensitive information.
- Prompt dissemination of unpublished price sensitive information that gets disclosed selectively, inadvertently or otherwise to make such information generally available.
- Appropriate and fair response to queries on news reports and requests for verification of market rumours by regulatory authorities.
- Ensuring that information shared with analysts and research personnel is not unpublished price sensitive information.
- Developing best practices to make transcripts or records of proceedings of meetings with analysts and other investor relations conferences on the official website to ensure official confirmation and documentation of disclosures made.
- Handling of all unpublished price sensitive information on a need-to-know basis.

Schedule B has also prescribed the minimum standards for the Code of Conduct for listed companies to regulate, monitor and report trading by designated persons as under:

1. The compliance officer shall report to the board of directors and in particular, shall provide reports to the Chairman of the Audit Committee, if any, or to the Chairman of the board of directors at such frequency as may be stipulated by the board of directors but not less than once in a year.
2. All information shall be handled within the organisation on a need-to-know basis and no unpublished price sensitive information shall be communicated to any person except in furtherance of legitimate purposes, the performance of duties or discharge of legal

obligations. The code of conduct shall contain norms for appropriate Chinese Walls procedures and processes for permitting any designated person to "cross the wall".

3. Designated Persons and immediate relatives of designated persons in the organisation shall be governed by an internal code of conduct governing dealing in securities

4. (1) Designated persons may execute trades subject to compliance with these regulations. Towards this end, a notional trading window shall be used as an instrument of monitoring trading by the designated persons. The trading window shall be closed when the compliance officer determines that a designated person or class of designated persons can reasonably be expected to have possession of unpublished price sensitive information. Such closure shall be imposed in relation to such securities to which such unpublished price sensitive information relates. Designated persons and their immediate relatives shall not trade in securities when the trading window is closed.

   (2) Trading restriction period shall be made applicable from the end of every quarter till 48 hours after the declaration of financial results. The gap between clearance of accounts by the audit committee and board meeting should be as narrow as possible and preferably on the same day to avoid leakage of material information.

   (3) The trading window restrictions mentioned in sub-clause (1) shall not apply in respect of –

   (a) transactions specified in clauses (i) to (iv) and (vi) of the proviso to sub-regulation (1) of regulation 4 and in respect of a pledge of shares for a bonafide purpose such as raising of funds, subject to pre-clearance by the compliance officer and compliance with the respective regulations made by the Board;

   (b) transactions which are undertaken in accordance with respective regulations made by the Board such as acquisition by conversion of warrants or debentures, subscribing to rights issue, further public issue, preferential allotment or tendering of shares in a buy-back offer, open offer, delisting offer or transactions which are undertaken through such other mechanism as may be specified by the Board from time to time.

5. The timing for re-opening of the trading window shall be determined by the compliance officer taking into account various factors including the unpublished price sensitive information in question becoming generally available and being capable of assimilation by the market, which in any event shall not be earlier than forty-eight hours after the information becomes generally available

6. When the trading window is open, trading by designated persons shall be subject to pre-clearance by the compliance officer, if the value of the proposed trades is above such thresholds as the board of directors may stipulate.

7. Prior to approving any trades, the compliance officer shall be entitled to seek declarations to the effect that the applicant for pre-clearance is not in possession of any unpublished price

sensitive information. He shall also have regard to whether any such declaration is reasonably capable of being rendered inaccurate.

8. The code of conduct shall specify any reasonable timeframe, which in any event shall not be more than seven trading days, within which trades that have been pre-cleared have to be executed by the designated person, failing which fresh pre-clearance would be needed for the trades to be executed.

9. The code of conduct shall specify the period, which in any event shall not be less than six months, within which a designated person who is permitted to trade shall not execute a contra trade. The compliance officer may be empowered to grant relaxation from strict application of such restriction for reasons to be recorded in writing provided that such relaxation does not violate these regulations. Should a contra trade be executed, inadvertently or otherwise, in violation of such a restriction, the profits from such trade shall be liable to be disgorged for remittance to the Board for credit to the Investor Protection and Education Fund administered by the Board under the Act. However, this shall not be applicable for trades pursuant to the exercise of stock options.

10. The code of conduct shall stipulate such formats as the board of directors deems necessary for making applications for pre-clearance, reporting of trades executed, reporting of decisions not to trade after securing pre-clearance and for reporting level of holdings in securities at such intervals as may be determined as being necessary to monitor compliance with these regulations.

11. Without prejudice to the power of the Board under the Act, the code of conduct shall stipulate the sanctions and disciplinary actions, including a wage freeze, suspension recovery, clawback etc., that may be imposed, by the listed company required to formulate a code of conduct under sub-regulation (1) of regulation 9, for the contravention of the code of conduct. Any amount collected under this clause shall be remitted to the Board for credit to the Investor Protection and Education Fund administered by the Board under the Act.

12. The code of conduct shall specify that in case it is observed by the listed company required to formulate a code of conduct under sub-regulation (1) of regulation 9, that there has been a violation of these regulations it shall promptly inform the stock exchange(s) where the concerned securities are traded, in such form and such manner as may be specified by the Board from time to time.

13. Designated persons shall be required to disclose names and Permanent Account Number or any other identifier authorized by law of the following persons to the company on an annual basis and as and when the information changes:

    a) immediate relatives

    b) persons with whom such designated person(s) shares a material financial relationship

c) Phone, mobile and cell numbers which are used by them

In addition, the names of educational institutions from which designated persons have graduated and the names of their past employers shall also be disclosed on a one-time basis.

The term "material financial relationship" shall mean a relationship in which one person is a recipient of any kind of payment such as by way of a loan or gift from a designated person during the immediately preceding twelve months, equivalent to at least 25% of the annual income of such designated person but shall exclude relationships in which the payment is based on arm's length transactions

14. Listed entities shall have a process for how and when people are brought 'inside' on sensitive transactions. Individuals should be made aware of the duties and responsibilities attached to the receipt of Inside Information, and the liability that attaches to misuse or unwarranted use of such information

Schedule C specifies the minimum standards for code of conduct for intermediaries and fiduciaries to regulate, monitor and report trading by Designated Persons. The details are given below:

1. The compliance officer shall report to the board of directors or head(s) of the organisation (or committee constituted in this regard) and in particular, shall provide reports to the Chairman of the Audit Committee or other analogous body, if any, or to the Chairman of the board of directors or head(s) of the organisation at such frequency as may be stipulated by the board of directors or head(s) of the organization but not less than once in a year.
2. All information shall be handled within the organisation on a need-to-know basis and no unpublished price sensitive information shall be communicated to any person except in furtherance of legitimate purposes, the performance of duties or discharge of legal obligations. The code of conduct shall contain norms for appropriate Chinese Wall procedures, and processes for permitting any designated person to "cross the wall".
3. Designated persons and immediate relatives of designated persons in the organisation shall be governed by an internal code of conduct governing dealing in securities.
4. Designated persons may execute trades subject to compliance with these regulations. Trading by designated persons shall be subject to pre-clearance by the compliance officer(s) if the value of the proposed trades is above such thresholds as the board of directors or head(s) of the organisation may stipulate.
5. The compliance officer shall confidentially maintain a list of such securities as a "restricted list" which shall be used as the basis for approving or rejecting applications for pre-clearance of trades.

6. Prior to approving any trades, the compliance officer shall seek declarations to the effect that the applicant for pre-clearance is not in possession of any unpublished price sensitive information. He shall also have regard to whether any such declaration is reasonably capable of being rendered inaccurate.

7. The code of conduct shall specify any reasonable timeframe, which in any event shall not be more than seven trading days, within which trades that have been pre-cleared have to be executed by the designated person, failing which fresh pre-clearance would be needed for the trades to be executed.

8. The code of conduct shall specify the period, which in any event shall not be less than six months, within which a designated person who is a connected person of the listed company and is permitted to trade in the securities of such listed company, shall not execute a contra trade. In case of dealing in the units of mutual funds, the code of conduct shall specify the period, which in any event shall not be less than two months, within which a Designated Person who is a connected person of the mutual fund/asset management company/trustees and is permitted to trade in the units of such mutual fund, shall not execute a contra trade. The compliance officer may be empowered to grant relaxation from strict application of such restriction for reasons to be recorded in writing provided that such relaxation does not violate these regulations. Should a contra trade be executed, inadvertently or otherwise, in violation of such a restriction, the profits from such trade shall be liable to be disgorged for remittance to the Board for credit to the Investor Protection and Education Fund administered by the Board under the Act. Provided that this shall not be applicable for trades pursuant to the exercise of stock options.

9. The code of conduct shall stipulate such formats as the board of directors or head(s) of the organisation (or committee constituted in this regard) deems necessary for making applications for pre-clearance, reporting of trades executed, reporting of decisions not to trade after securing pre-clearance, and for reporting level of holdings in securities at such intervals as may be determined as being necessary to monitor compliance with these regulations.

10. Without prejudice to the power of the Board under the Act, the code of conduct shall stipulate the sanctions and disciplinary actions, including a wage freeze, suspension, recovery, clawback etc., that may be imposed, by the intermediary or fiduciary required to formulate a code of conduct under sub-regulation (1) and sub-regulation (2) of regulation 9, for the contravention of the code of conduct. Any amount collected under this clause shall be remitted to the Board for credit to the Investor Protection and Education Fund administered by the Board under the Act.

11. The code of conduct shall specify that in case it is observed by the intermediary or fiduciary required to formulate a code of conduct under sub-regulation (1) or sub-regulation (2) of regulation 9, respectively, that there has been a violation of these regulations, such

intermediary or fiduciary shall promptly inform the stock exchange(s) where the concerned securities are traded, in such form and such manner as may be specified by the Board from time to time. Section 11 (A) states that in case of dealing in the units of mutual funds, the code of conduct shall specify that in case it is observed by the intermediary or fiduciary required to formulate a code of conduct under sub-regulation (2) of regulation 5F, that there has been a violation of these regulations, such intermediary or fiduciary shall promptly inform the same to the stock exchange(s) in such form and such manner as may be specified by the Board from time to time.

12. All designated persons shall be required to disclose the name and Permanent Account Number or any other identifier authorized by law of the following to the intermediary or fiduciary on an annual basis and as and when the information changes:

    a) immediate relatives

    b) persons with whom such designated person(s) shares a material financial relationship

    c) Phone, mobile, and cell numbers which are used by them

In addition, names of educational institutions from which designated persons have graduated and names of their past employers shall also be disclosed on a one-time basis.

Explanation – the term "material financial relationship" shall mean a relationship in which one person is a recipient of any kind of payment such as by way of a loan or gift from a designated person during the immediately preceding twelve months, equivalent to at least 25% of the annual income of such designated person but shall exclude relationships in which the payment is based on arm's length transactions.

13. Intermediaries and fiduciaries shall have a process for how and when people are brought 'inside' on sensitive transactions. Individuals should be made aware of the duties and responsibilities attached to the receipt of Inside Information, and the liability that attaches to misuse or unwarranted use of such information.

7.3 Role of Compliance Officer

The Compliance Officer is required to maintain all the documents as required under these Regulations. The Compliance Officer is required to frame a code of fair disclosure and conduct in line with the model code specified under Schedule A. Apart from this, the intermediaries, which are listed, would be required to formulate a code of conduct to regulate, monitor and report trading by their designated persons, by adopting the minimum standards set out in Schedule B with respect to trading in their own securities and in Schedule C with respect to trading in other securities. Every listed company, intermediary and other persons formulating a code of conduct shall identify and designate a compliance officer to administer the code of conduct and other requirements under these regulations. The board of directors or such other analogous authority shall in consultation with the compliance officer specify the designated

persons to be covered by the code of conduct on the basis of their role and function in the organisation and the access that such role and function would provide to unpublished price sensitive information in addition to seniority and professional designation. Every compliance specified in the Regulations is normally the responsibility of the Compliance Officer.

Case 7.1: SEBI order in the matter of trading in shares of Palred Technologies Limited

Facts of the case :

a) SEBI conducted an investigation into the scrip of Palred Technologies Ltd (PLT) for the period Sep 18, 2012 to November 30, 2013 to ascertain a possible violation of provision of SEBI Act, 1992

b) SEBI vide order dated February 4, 2016 as an interim measure, impounded the alleged gains under Section 11(4)(d) of the SEBI Act

c) PTL made a corporate announcement of slump sale on August 10, 2013 of its software solutions business to Kewill group and a one-time special dividend post the closure of sale transaction on October 14, 2013.

Both these information's being price sensitive information, it was alleged in the investigation report that Palem Reddy, the Chairman and Managing Director (MD) of PTL, employees of PTL, past employees of PTL and certain other entities known to Palem Reddy traded during the unpublished price sensitive information (UPSI) period that preceded the actual announcement to the public, Palem Reddy, acquired shares from the beginning of discussions till the signing of a non-binding offer between the Company and the buyers and stopped trading thereafter. Moreover, it was alleged that he communicated directly or indirectly the UPSI to other Noticees, who began trading in PTL shares beginning from June 2013 onwards and bought 4,25,615 shares till the announcement on August 10, 2013. Show cause notice (SCN) had two parts

Show cause notice – UPSI	Period of UPSI
UPSI I- UPSI in respect of Slump sale of software solution business to Kewill group	UPSI, I came into existence on September 18, 2012, when the non-disclosure agreement ('NDA') was executed, and continued till the decision of the slump sale of the business was announced by the Company on August 10, 2013
UPSI II -UPSI in respect of Declaration of Interim Dividend of Rs. 29 per share and reduction of 50% of the capital of the Company by paying a value of Rs. 29 per share	UPSI II came into existence on September 12, 2013 and continued till October 14, 2013.

Since NDA signified only the commencement of the due diligence process, there was every possibility of the deal being scrapped anytime during the due diligence process. Therefore, UPSI I emanated on September 18, 2012 is not correct. UPSI, I came into existence on May 9, 2013 and continued till August 10, 2013 when the non-binding offer was given by the buyers.

Preliminary decision of capital reduction was taken on September 12, 2013, but the actual quantum of reduction was discussed and approved by the Board of Directors on October 13, 2013 Based on this, investigations concluded that the UPSI-II came into existence on October 4, 2013 and continued till October 14, 2013

Palem Srikanth Reddy cannot be held to have violated Regulation 3(i) of SEBI (Prohibition of Insider Trading) Regulations, 1992, as he has not traded using inside information.

As regards P. Soujanya Reddy, considering her financial capacity and the pattern of her trading in the scrip of PTL, where she purchased only 17,500 shares worth little over 2 lakhs, it cannot be said that the acquisition is on account of UPSI –I. She had not traded during UPSI II.

As regards Ameen Khwaja, Noorjahan A. Khwaja, Ashik Ali Khwaja, Rozina Hirani Khwaja, Shefali Ameen Khwaja and Shahid Khwaja - Ameen Khwaja is a promoter director of Pal Premium Online Media Pvt Ltd, (POMPL) with Palem S. Reddy who was also a promoter-director of POMPL. POMPL was rendering professional services related to IT to PTL. As Palem Reddy and Ameen Khwaja were co-promoters and co-directors of POMPL, I am of the view that there existed a business relationship between the two promoters and by extending services of POMPL to PTL, Ameen Khwaja can also be stated to have had a business relationship with the company because the service contract between the two companies would be a reflection of the understanding exchanged between these two promoters. In this case, one cannot distinguish between the company and its promoter because the very identity of POMPL for availing services has arisen out of the connection that existed between the two promoters. Thus, in the facts and circumstances of the case, it can be reasonably presumed that the UPSI regarding Slump sale was passed on to the Khwaja group by none other than Palem S. Reddy

Further, members of the Khwaja family, by virtue of their relationship with Ameen Khwaja squarely fall with the definition of “deemed connected” under the PIT Regulations, 1992.

The overall pattern of trading of the Khwaja group in PTL, wherein a short period of two and half months, the group invested more than Forty-Nine Lakh rupees for 3,24,001 shares of PTL along with the connection of Ameen Khwaja with Palem Reddy confirms the distinct likelihood of the trades being based on the communication of UPSI-I relating to the scrip. Quantum of trades

carried out by Khwaja group entities during a short period without any justification/rational etc. invest in a relatively illiquid scrip, for the first time by four members, it is reasonable to draw the inference that the Khwaja group had received the UPSI regarding the Slump sale.

Ameen Khwaja has violated Sections 12A(d) and 12A(e) of SEBI Act, 1992 and Regulation 3(ii) of SEBI (PIT) Regulations, 1992 read with regulation 12 of SEBI (PIT) Regulations, 2015, and Noorjahan A. Khwaja, Ashik Ali Khwaja, Rozina Hirani Khwaja, Shefali Ameen Khwaja and Shahid Khwaja have violated Sections 12A(d) and 12A(e) of SEBI Act, 1992 and Regulations 3(i) and 3(ii) of SEBI (PIT) Regulations, 1992 read with regulation 12 of SEBI (PIT) Regulations, 2015.

As regards Kukati Parvathi -degrees of relationship with Palem are not so proximate for me to consider her to be one amongst the persons to whom Palem Reddy could be reasonably expected to have passed on the UPSI. Kukati Parvathi had not violated Regulation 3(i) and 3(ii) of SEBI (Prohibition of Insider Trading) Regulations, 1992 and Section 12A(d) and 12A(e) of SEBI Act, 1992 read with regulation 12 of SEBI (Prohibition of Insider Trading) Regulations, 2015.

As regards Pirani Aziz - the kind of transactions carried out by Pirani i.e., trading in the scrip of PTL just before UPSI, opening Demat account just one day prior to trading in PTL, the volume of trade in PTL and no significant transaction before and after the purchase of PTL shares till March 2015, show that he had the information regarding UPSI. on Facebook, Pirani and Ameen Khwaja are not direct friends and they are connected through Mutual friends. Although facebook-connection backed by trading patterns raises a cloud of suspicion, this by itself is not sufficient to hold someone guilty of a serious violation like Insider Trading. Pirani cannot be held to have violated Regulation 3(i) and 3(ii) of SEBI (Prohibition of Insider Trading) Regulations, 1992 and Section 12A(d) and 12A(e) of SEBI Act, 1992 read with regulation 12 of SEBI (Prohibition of Insider Trading) Regulations, 2015.

As regards Karna Reddy - Purchase of PTL shares coupled with the fact that he was working in the finance department of PTL and the fact that he started purchasing scrip of only PTL and that too, only after May 2013, during the UPSI period is sufficient to draw a conclusion that he had traded on the basis of UPSI. Therefore, in my view, Karna Reddy has violated Section 12A(d) and 12A(e) of SEBI Act, 1992 and Regulation 3(i) of SEBI (PIT) Regulations, 1992 read with regulation 12 of SEBI (PIT) Regulations, 2015

As regards Mohan Krishna Reddy - Mohan Krishna Reddy is an independent director and he purchased 9,300 shares in the month of September 2013. The remaining 11,600 shares were purchased on November 1, 2013 (10,000 shares) and November 6, 2013 (1,600 shares). The agenda for the board meeting of October 14, 2013 was may circulated on October 7, 2013. Thus, there is nothing on record to show that Mohan Krishna Reddy had awareness and knowledge

about the exact payment of dividends prior to October 7, 2013 when the board agenda was circulated. Mohan K Reddy cannot be held to have violated Regulation 3(i) and 3(ii) of SEBI (Prohibition of Insider Trading) Regulations, 1992 and Section 12A(d) and 12A(e) of SEBI Act, 1992 read with regulation 12 of SEBI (Prohibition of Insider Trading) Regulations, 2015.

As regards Prakash Lohia, Umashankar S. and Raja Lakshmi Srivaiguntam - both Umashankar and Prakash Lohia resigned from PTL in January 2010 and April 2011 respectively. nothing on record like constant telephonic connection, email exchanges, fund movement etc. to show that Umashankar and Prakash Lohia were in constant connection with Palem Reddy. Umashankar, Rajalakshmi and Prakash Lohia had not violated Regulation 3(i) and 3(ii) of SEBI (Prohibition of Insider Trading) Regulations, 1992 and Section 12A(d) and 12A(e) of SEBI Act, 1992 read with regulation 12 of SEBI (Prohibition of Insider Trading) Regulations, 2015

Order:

1) Palem Srikanth Reddy, Ameen Khwaja, Noorjahan A. Khwaja, Ashik Ali Khwaja, Rozina Hirani Khwaja, Shefali Ameen Khwaja, Shahid Khwaja, and Karna Ramanjula Reddy

   a) shall be restrained from accessing the securities market and further prohibited from buying, selling or otherwise dealing in securities, directly or indirectly for a period of three years, and

   b) shall not associate with any listed company in the capacity of a director or otherwise for a period of three years. The above persons may liquidate their existing holdings, except PTL, during the said debarment/restraint period of 3 years

2) Noorjahan A. Khwaja, Ashik Ali Khwaja, Rozina Hirani Khwaja, Shefali Ameen Khwaja, Shahid Khwaja and Karna Ramanjula Reddy–shall individually disgorge the amounts indicated in the order

Case 7.2: SAT Order - Shruti Vora vs. SEBI

Facts of the case:

a) In the month of November 2017 certain articles were published in newspapers wherein it was alleged that the quarterly financial results of several companies were in circulation in certain WhatsApp groups before its official disclosure by respective companies.

b) SEBI carried out search and seizure operations of 26 entities and about 190 devices were seized for investigation. Around 12 companies' earnings and financial information got

leaked in WhatsApp messages. In the SAT order dealings of 6 companies viz., Bajaj Auto Ltd, Bata India Ltd., Ambuja Cements, Asian Paints Ltd, Wipro Ltd and Mindtree Ltd.

c) SEBI vide its order dated June 4, 2020, imposed a penalty of Rs 15 lakhs on Ms Shruti Vishal Vora in terms of the provisions of Section 15G of the SEBI Act, 1992 for the violation of Sections 12 A (d) & 12 A (e) of SEBI Act 1992 and Regulation 3 (1) of SEBI (Prohibition of Insider Trading) Regulations, 2015.

Findings and Reasoning:

a) Despite great efforts by SEBI to find out the source of information, no information could be recovered.

b) Out of the number of messages mined from devices, only in present six cases message matched with the exact figure of financial results.

c) Adjudicating officer (AO) failed to appreciate that WhatsApp message may have originated in a brokerage house or from platforms of Bloomberg which are in public domain. Further, there were numerous other messages of similar nature received and forwarded which did not match with the financial result

d) Definition of 'unpublished price sensitive information and 'insider' would show that generally, available information would not be unpublished price sensitive information.

e) Respondent (SEBI) failed to prove any preponderance of probabilities that the impugned messages were unpublished price sensitive information, that the appellant knew that it was unpublished price sensitive information and with the said knowledge they or any of them had passed the said information to other parties.

Order:

All appeals are allowed without any order as to costs. Impugned orders in all the appeals are set aside.

Case 7.3: SAT Order - Piramal Enterprises Limited vs. SEBI

Facts of the case:

Appellant is the company M/s. Piramal Enterprises Limited (hereinafter referred to as "PEL") and its directors.

Appellant No. 1 Shri Ajay G. Piramal was the Chairman,

Appellant No. 2 Dr Swati A. Piramal and

Appellant No. 3 Ms Nandini Piramal were Directors of the PEL at the relevant time.

It is held in the impugned order that Abbott approached the PEL with an offer to acquire its Domestic Healthcare Business on January 18, 2010. During February-May 2010 due diligence was carried out by the PEL on the offer. On May 10, 2010, Shri Ajay Piramal, Chairman of the Board individually informed other Board Members regarding the proposed transactions. On May 20, 2010 the Chairman of the PEL informed other Board Members that the meeting of the Audit Committee and the Board of Directors of the PEL will be held on May 21, 2010 and accordingly these meetings were held on May 21, 2010 wherein some of the Board Members joined telephonically. In this meeting, the Board of Directors approved the acceptance of the offer from Abbott for a consideration of 3.72 billion USD and a corporate announcement was made by the PEL at 11:59 AM to both BSE Limited and National Stock Exchange of India Limited. These facts are undisputed.

An investigation was done by SEBI into possible violation of PIT Regulations, 1992 and possible violations of Clause 49 of the Listing Agreement etc. by the PEL. During the investigation, vide letter dated January 21, 2011 the PEL informed SEBI that, in addition to the appellants Shri Anand Piramal, Shri Rajesh Laddha and Prof. Nitin Nohria were privy to the decision at every stage in the matter of sale of its domestic healthcare business to Abbott. Shri Anand Piramal is the son of the Chairman and Managing Director, Appellant No. 1 and 2 in Appeal No. 467 of 2016. Further, Shri Anand Piramal is neither a Board Member nor holds any position in the PEL. Shri Rajesh Laddha was an Executive Director and Chief Operating Officer of the PEL. He held a position of Senior Management but not a Member/Director in the Board of Directors. Prof. Nohria was a consultant. A show-cause notice dated February 24, 2016 was issued by SEBI and subsequently, a personal hearing and inspection of documents etc. were granted.

The parties informed SAT that Shri N. Santhanam, Compliance Officer who has also been held guilty for not closing the trading window, filed an appeal before this Tribunal during the pendency of which the matter was settled with SEBI under the SEBI (Settlement of Administrative and Civil Proceedings) Regulations, 2014.

There are basically two charges against the appellants:

i) Disclosing the information relating to the proposed transaction or Business Transfer Agreement ("BTA" for short) to entities who were not required to know about the transaction and thereby violating the relevant Clauses of the Model Code for listed Companies under PIT Regulations, 1992.

ii) Failure to close the trading window and thereby violating the relevant Clauses of the Model Code for listed Companies under PIT Regulations, 1992.

Findings and Reasoning:

SAT stated as under:

We find merit in the submission made by the learned senior counsel for the appellants that the information relating to the sale of the healthcare division of the PEL was given to Shri Anand Piramal and others only on a 'need to know' basis as is provided under Regulation 12(3) of the PIT Regulations, 1992 read with Regulation 12 of PIT Regulations, 2015. It is an undisputed fact that Shri Anand Piramal is a promoter of the appellant PEL and the same has been disclosed to the stock exchanges on various occasions. Moreover, he is a "deemed to be connected person" under 2(h)(viii) of PIT Regulations, 1992. Being a promoter holding about 2% of the equity capital of the PEL he had to give an undertaking relating to multiple Clauses in the BTA like non-compete provision for 8 years. Hence, he had to know in advance the decision relating to selling part of the PEL. There is no charge that Shri Anand Piramal indulged in insider trading when he was in a possession of this information. The charge is only that the information was shared with him by the appellants. Since as a promoter and as a "person is deemed to be a connected person" the information was shared with him only on a "need to know" basis which is as provided under PIT Regulations 1992. In the light of this the penalty imposed for the alleged violation of Clauses 3.2.1 and 3.2.3(f) of the Model Code of Conduct and 1.1, 1.2 and 12(3) and of PIT Regulations, 1992 is not sustainable.

As far as the second charge is concerned that the trading window was not closed at the relevant time, we find that admittedly the trading window was not closed at any point of time. The contention that the trigger came in only when the Board approved the BTA on May 21, 2010 cannot be accepted. It is on record that the said information was disclosed by the Chairman of the PEL to other Board Directors on May 10, 2010. According to the regulations the trading window had to remain closed for 24 hours further to the disclosure to the stock exchange but at no point of time, the trading window was closed.

The argument that only the Compliance Officer is responsible for the closure of the trading window since the Board of Directors has an overall responsibility only cannot be accepted. The sale of a division of a company is not a routine matter like the adoption of annual accounts or quarterly accounts or other standard disclosures. The sale of a division of PEL is a decision the PEL has to take as per Clause 3.2.3A of the Model Code and the PEL has to decide the trigger point in such matters. Once, the PEL decides the trigger date then the onus can be passed on to the Compliance Officer. Here there is nothing on record to show that the PEL / Board had taken a decision relating to the trigger and informed the Compliance Officer prior to the Board's decision on May 21, 2010. Thus, there was a failure to abide by the Clause 3.2.1 and 3.2.3(f) of the Model Code of Conduct. The AO found that once the violation was established the penalty becomes leviable irrespective of the intention.

The question that needs to be answered is whether the imposition of penalty is the ultimate aim under Section 11 of the SEBI Act. In our view, the object of the SEBI Act is to protect the interest of the investors in the securities market and to promote the development of the securities

market. SEBI has to monitor the activities in the securities market and take appropriate measures if it finds that the provisions of the Act have been violated.

In the instant case, in January 2010, Abbott approached the Chairman of PEL with an offer to acquire the domestic healthcare business of PEL. We find that due diligence was carried out by PEL up to May 2010 in the strictest confidence. Except for certain individuals, who were identified as being privy to the transaction and informed to SEBI in January 2011 itself, no one in PEL was aware of the information to sell the domestic healthcare business at any time prior to the Board meeting and subsequent positive announcement on 21.05.2010. We also find that the Chairman of the PEL informed the members of the Board of PEL on 10.05.2010 of the possibility of the pending deal that may take place, and none of the persons identified as being privy to the deal had sought any pre-clearance for trading in the scrip of PEL.

SEBI had made an investigation and found that only one designated employee had traded in the scrips. The AO found that the said employee was not associated in any manner with the process of domestic healthcare business and was not in possession of the Unpublished Price Sensitive Information (UPSI) relating to the deal. The AO accordingly exonerated him of the charge of insider trading. Apart from the aforesaid instance, the AO has not found any other instance where the UPSI was misused by any employee of PEL, outsider, directors of the PEL, or the individuals who were identified to sell the domestic healthcare business.

The purpose of closing the trading window is for a salutary purpose. It is to ensure that trading is restricted during the period in question and pre-clearance requests can only be sanctioned as per the existing Model Code of PEL. In the given circumstances, even though the trading window was not closed, there was no trading of the scrips by any of the designated employees of the PEL nor any pre-clearance requests were received by PEL. Thus, even though, no announcement was made for closure of the trading window, it was found that PEL ensured compliance with the substance of the Model Code of PEL and the PIT Regulations including the Model Code. We further find that UPSI at all times was preserved and there was no misuse of UPSI.

In the light of the aforesaid, we find that the violation of the Model Code in the given circumstances is technical in nature. We were informed that the PEL is a blue-chip company and has its presence in many countries which has not been denied by the respondent. We were also told that till date there has not been any violation of SEBI Laws. The imposition of penalty, even though meagre would leave an indelible mark and leave a blot on their spotless image. Such blot may not be in the interest of the securities market especially in the international market.

Considering the aforesaid, we are of the opinion that the object of the Act is not only to protect the investors but also the securities market. The appellant is part of the securities market and its existence is required for the healthy growth of the securities market. SEBI is the watchdog and not a bulldog. If there is an infraction of a rule, remedial measures should be taken in the first instance and not punitive measures. In the absence of any direct or clinching evidence of insider

trading or misuse of UPSI, a reasonable benefit of doubt should be extended to the PEL instead of mechanically imposing a penalty. Other factors should be considered including those stated in Section 23J of the Act which apparently was not considered.

When fairness and transparency was shown by PEL in the execution of the deal and there is no evidence of lack of integrity on the part of PEL, it would be harsh to penalize PEL, howsoever small the penal amount it may be.

The AO has imposed a penalty upon PEL for a technical violation of the Model Code. The compliance officer has already settled the matter with SEBI. We feel that in the given situation the imposition of penalty upon PEL and its directors was unwarranted and, in any case, disproportionate. This Tribunal, in appeal, apart from exercising the powers of the Board can also exercise powers to make such orders and give such directions as may be necessary or expedient to secure the ends of justice as specified under Rule 21 of the Securities Appellate Tribunal (Procedure) Rules, 2000. These powers have been conferred upon the Tribunal with a view to do complete justice between the parties which are equitable in nature to be exercised to ensure justice between the parties or to prevent injustice.

Order:

The imposition of penalty is converted into one of warning with a further direction that if any such incident occurs in future, it would be open to SEBI to proceed in accordance with the law.

Review Questions

1. When the trading window is open, trading by designated persons shall be subject to preclearance by the compliance officer, if the value of the proposed trades is above such thresholds as the board of directors may stipulate. State whether True or False.

    a. True

    b. False

2. The objective of the SEBI (Prohibition of Insider Trading) Regulations is to prohibit insiders from _____ on matters relating to insider trading.

    a. Dealing

    b. Communicating

    c. Counselling

    d. All of the above

3. Organisations are required to develop practices based on _____ basis.

    a. Need to know

    b. Ought to know

    c. Need not know

    d. May know

4. _____ means information that is accessible to the public on a non-discriminatory basis.

    a. Generally available information

    b. Price sensitive information

    c. Unpublished price sensitive information

    d. Non-price sensitive information

CHAPTER 8: SEBI (PROHIBITION OF FRAUDULENT AND UNFAIR TRADE PRACTICES RELATING TO SECURITIES MARKET) REGULATIONS, 2003

LEARNING OBJECTIVES:

After studying this chapter, you should know about the:

- Different kind of dealings, prohibited in securities
- Dealings in securities which are considered as fraudulent and unfair trade practices
- Different aspects related to investigation of fraudulent and unfair trade practices

8.1 Introduction

SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003 prohibit fraudulent, unfair and manipulative trade practices in securities. These regulations have been made in exercise of the powers conferred by section 30 of the SEBI Act, 1992.

Regulation 2(1)(c) defines fraud as inclusive of any act, expression, omission or concealment committed whether in a deceitful manner or by a person or by any other person with his connivance or by his agent while dealing in securities in order to induce another person or his agent to deal in securities, whether or not there is any wrongful gain or avoidance of any loss.-- The instances cited are as follows:

a) A knowing misrepresentation of the truth or concealment of material fact in order that another person may act, to his detriment.
b) A suggestion as to a fact which is not true, by one who does not believe it to be true.
c) An active concealment of a fact by a person having knowledge or belief of the fact.
d) A promise made without any intention of performing it.
e) A representation, whether true or false, made in a reckless and careless manner.
f) Any such act or omission as any other law specifically declares to be fraudulent.
g) Deceptive behaviour by a person depriving another of informed consent or full participation.
h) A false statement made without reasonable ground for believing it to be true.
i) The act of an issuer of securities giving out misinformation that affects the market price of the security, resulting in investors being effectively misled even though they did not rely on the statement itself or anything derived from it other than the market price.

8.2 Prohibition of Fraudulent and Unfair Trade Practices

8.2.1 Prohibition of Certain Dealings in Securities

Chapter II of the regulations prohibits certain dealings in securities covering buying, selling or issuance of securities. The regulations prohibit a person to, directly or indirectly:

- buy, sell or deal in securities in a fraudulent manner;
- use or employ in connection with issue, purchase or sale of any security listed or proposed to be listed, any manipulative or deceptive device or contrivance in contravention of the provisions of SEBI Act or rules or regulations made thereunder;
- employ any device, scheme or artifice to defraud in connection with dealing in or issue of any security listed or proposed to be listed;
- engage in any act, practice, course of business which operates or would operate as a fraud or deceit upon any person in connection with any dealing in or issue of securities, which are listed or proposed to be listed.

8.2.2 Prohibition of Manipulative, Fraudulent and Unfair Trade Practices

Dealing in securities shall be deemed to be a manipulative, fraudulent or unfair trade practice if it involves any of the following:

a) knowingly indulging in an act which creates a false or misleading appearance of trading in the securities market;
b) dealing in security not intended to effect transfer of beneficial ownership but intended to operate only as a device to inflate, depress or cause fluctuations in the price of such security for wrongful gain or avoidance of loss;
c) inducing any person to subscribe to an issue of the securities for fraudulently securing the minimum subscription to such issue of securities, by advancing or agreeing to advance any money to any other person or through any other means;
d) inducing any person for dealing in any securities for artificially inflating, depressing, maintaining or causing fluctuation in the price of securities through any means including by paying, offering or agreeing to pay or offer any money or money's worth, directly or indirectly, to any person;
e) any act or omission amounting to manipulation of the price of security including, influencing or manipulating the reference price or benchmark price of any securities;
f) knowingly publishing or causing to publish or reporting or causing to report by a person dealing in securities any information relating to securities, including financial results, financial statements, mergers and acquisitions, regulatory approvals, which is not true or which he does not believe to be true prior to or in the course of dealing in securities;
g) entering into a transaction in securities without the intention of performing it or without the intention of change of ownership of such security;

h) selling, dealing or pledging of stolen, counterfeit or fraudulently issued securities whether in the physical or dematerialized form:

However, if:

(i) the person selling, dealing in or pledging stolen, counterfeit or fraudulently issued securities was a holder in due course; or

(ii) the stolen, counterfeit or fraudulently issued securities were previously traded on the market through a bonafide transaction,

(iii) such selling, dealing or pledging of stolen, counterfeit or fraudulently issued securities shall not be considered as a manipulative, fraudulent, or unfair trade practice;

i) disseminating information or advice through any media, whether physical or digital, which the disseminator knows to be false or misleading in a reckless or careless manner and which is designed to, or likely to influence the decision of investors dealing in securities

j) a market participant entering into transactions on behalf of client without the knowledge of or instructions from client or mis utilizing or diverting the funds or securities of the client held in a fiduciary capacity;

k) circular transactions in respect of security entered into between persons including intermediaries to artificially provide a false appearance of trading in such security or to inflate, depress or cause fluctuations in the price of such security;

l) fraudulent inducement of any person by a market participant to deal in securities with the objective of enhancing his brokerage or commission or income;

m) an intermediary predating or otherwise falsifying records including contract notes, client instructions, the balance of securities statement, client account statements;

n) any order in securities placed by a person, while directly or indirectly in possession of information that is not publicly available, regarding a substantial impending transaction in those securities, its underlying securities or its derivative;

o) knowingly planting false or misleading news which may induce sale or purchase of securities.

p) mis-selling of securities or services relating to the securities market. Mis-selling means sale of securities or services relating to securities market by any person, directly or indirectly, by–

(i) knowingly making a false or misleading statement, or

(ii) knowingly concealing or omitting material facts, or

(iii) knowingly concealing the associated risk, or

(iv) not taking reasonable care to ensure the suitability of the securities or service to the buyer.

p) illegal mobilization of funds by sponsoring or causing to be sponsored or carrying on or causing to be carried on any collective investment scheme by any person.

For the purposes of this sub-regulation, for the removal of doubts, it is clarified that the acts or omissions listed in this sub-regulation are not exhaustive and that any act or omission is prohibited if it falls within the purview of regulation 3, notwithstanding that it is not included in this sub-regulation or is described as being committed only by a certain category of persons in this sub-regulation. Market Participant shall include any person or entity registered under Section 12 of the Act and its employees and agents.

8.3 Investigation

Chapter III of the Regulations relate to the investigation of transactions of the nature described above. In particular, under regulation 8(1), it shall be the duty of every person who is under investigation:

a) To produce books, accounts and other documents that may be required by the Investigating Authority and also to furnish statements and information that is sought.
b) To appear before the Investigating Authority personally when required to do so and to answer questions posed by the authority.

SEBI may without prejudice to the provisions contained in sub-section (1), (2), (2A) and (3) of section 11 and section 11B of the SEBI Act, by an order, for reasons to be recorded in writing, in the interests of the investors and the securities market, issue or take any of the following actions or directions, either pending investigation or enquiry or on completion of the investigation or enquiry namely –

(a) Suspend the trading of the security found to be or prima facie found to be involved in fraudulent and unfair trade practice on recognised stock exchange
(b) Restrain persons from accessing the securities market and prohibit any person associated with securities market to buy, sell or deal in securities,
(c) Suspend any office-bearer of any stock exchange or self-regulatory organisation from holding such position
(d) Impound and retain the proceeds or securities in respect of any transaction which is in violation or *prima facie* in violation of these regulations,
(e) Direct an intermediary or any person associated with the securities market in any manner not to dispose of or alienate an asset forming part of a fraudulent and unfair transaction.
(f) Prohibit the person concerned from disposing of any of the securities acquired in contravention of these regulations

SEBI may even take the following action against an intermediary:

i. Issue a warning or censure;
ii. Suspend the registration of the intermediary;
iii. Cancel the registration of the intermediary.

Case 8.1: SEBI Vs First Financial Services Limited (FFSL)

Facts of the case:

i. The scrip of FFSL was suspended from trading on the Bombay Stock Exchange (BSE) from June, 2000 to July 08, 2011. After the revocation of suspension and before May 15, 2012, the scrip was traded on only two days July 8, 2011 and November 16, 2011 and the closing price of the scrip on these days was Rs.7.12 and Rs.5.10 respectively.

ii. During this period i.e. (July 08, 2011 to May 15, 2012), the company made two preferential allotments of shares - first on December 08, 2011 (for 54,50,000 equity shares) and another on April 28, 2012 (for 22,50,000 equity shares) at a price of Rs. 20 each to 83 persons. These shares were under lock-in for one year from the date of respective allotment and after the expiry of the lock-in most of these shares were sold in the market.

iii. After the preferential allotment and during the lock-in period, the price of the scrip witnessed a steep rise with very low traded volume. The price of the scrip rose by 4824.3% during the period from May 15, 2012 to February 8, 2013. After the price rise period, the scrip was traded in high volume and most of the shares issued to preferential allottees were off-loaded in the market. This period was mainly between February 11, 2013 and December 12, 2013.

iv. On December 13, 2013 the shares of FFSL were sub-divided into ten equity shares of Re.1 each from one equity share of Rs.10 each. Subsequently, the scrip witnessed a fall in price.

v. There was a marginal increase in profit of FFSL during 2012-13. The company had registered a net profit of Rs. 0.32 crore, Rs. 0.48 crore and Rs. 0.07 crore for the financial year ended March 2012, March 2013 and March 2014 respectively.

vi. The company did not utilise the money received by it on allotment of preference shares to the tune of Rs 15 crores for the purposes for which it was raised and most of the money were transferred back to the allottees or were transferred to certain buyers in the post-lock-in period through multiple layers of transactions. The company had funded some allottees to subscribe to its shares in the preferential allotments.

vii. Nirmal Singh Mertia (from July 26, 2011), S Krishna Rao (from June 5, 2010 to August 10, 2013) and Punuswamy Natarajan (September 26, 1991 to April 15, 2013)}, were the directors of FFSL during the relevant time. Out of the allotment proceeds of Rs 15 crores, a sum of Rs.6.57 crore was transferred back to the allottees indirectly through multiple layers of transactions and around Rs. 7.94 crore was transferred to entities connected to FFSL. During the period 15/05/2012-08/02/2013, there was a huge rise in price of the scrip which was enabled by connected persons.

viii. Subsequently, the preferential allottees were provided hugely profitable exit and several entities connected with the company played a key role in routing/re-routing of allotment proceeds through allegedly bogus commercial transactions.

ix. FFSL and its connected entities had violated the provisions of Section 12A(a), (b) and (c) of the SEBI Act, 1992 read with Regulations 3(a), (b), (c), (d) and Regulations 4(1), 4(2), (a) and (e) of SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003.

Issues were raised by SEBI under the following heads:

- Market manipulation – exorbitant price rise (15/5/2012-8/2/2013)
- Routing and re-routing of funds by FFSL
- Transfer of Proceeds by FFSL- 1st Preferential Allotment
- Transfer of Proceeds by FFSL- 2nd Preferential Allotment
- Fund transfers – FFSL

Summary of findings of SEBI:

- FFSL had no intention to utilise the funds raised through the preferential allotments as per the disclosed objectives at the time of allotment and the preferential allotment was used as a device to route a significant portion of allotment money to certain allottees/ entities, connected to the company.
- These observations coupled with the findings regarding price manipulation by certain FFSL connected entities in the initial phases establish that the preferential allotment exercise of FFSL was merely a façade to benefit some of its connected allottees through the sale of their shares post the lock-in period.
- The fund transfers effected by FFSL post the allotment and the onward transfers made by connected entities thereto and the participation of the connected entities on the buy-side during the exit period without any satisfactory explanation or documentation exposes the fraudulent scheme of the company and its connected entities.
- The allotment proceeds were transferred by FFSL, either to the entities under the control of allottees or to certain entities which through multiple layers of transactions, transferred to the same allottees.
- FFSL, its directors along with the Comfort group and certain other entities orchestrated a fraudulent scheme involving preferential allotment route, which ultimately benefitted a few allottees and was never retained for utilization as per the stated objects of the issue.

Conclusion

a) On the basis of preliminary investigation in the trading and dealings in the scrip two interim orders, dated December 19, 2014 and August 11, 2015, were passed by SEBI. These orders restrained 154 entities from accessing the securities market and prevented them from buying, selling or dealing in securities, either directly or indirectly, in any manner, till further direction. Thereafter, four confirmatory orders dated April 20, 2015, June 02, 2016, June 14, 2016 and August 25, 2016 were passed inter-alia confirming the directions against 149 entities and revoking the directions against 5 entities.

b) FFSL filed an appeal against the aforesaid interim directions of SEBI before SAT. SAT vide order dated May 03, 2017 directed SEBI to pass appropriate order in the matter by March 31, 2018.

c) SEBI passed the final order as per the directives of the SAT on April 2, 2018, due to the intervening holidays from 29th of March to 1st of April, 2018.

d) As per the final order, 29 entities (including FFSL) were restrained from accessing the securities market and were prohibited from buying, selling or otherwise dealing in securities, directly or indirectly, or being associated with the securities market in any manner, for a period of three years, from the date of the order. The order also revoked all the earlier interim and confirmatory orders issued between December 2014 and August 2016.

Case 8.2: Supreme Court order in the case of SEBI vs. Shri Kanaiyalal Baldevbhai Patel and other connected matters

Facts of the case:

Civil Appeal No. 2595 and 2596 of 2013: SEBI investigated the activities of Shri Kanaiyalal Baldevbhai Patel [*herein after* '**KB**' *for brevity*] an individual trader. During the investigation, it was found that KB was putting orders ahead of orders placed by Passport India Investment (Mauritius) Ltd. [*herein after* '**PII**' *for brevity*]. One Dipak Patel was the portfolio manager of PII, who also happens to be a cousin of KB and one Shri Anandkumar Baldevbhai Patel [*herein after* '**AB**' *for brevity*]. It was alleged that Dipak Patel provided information to KB and AB regarding the forthcoming trading activity of the PII. It is to be noted that trades were executed using the telephone number registered in the name of AB at the common residential address of KB and AB. Taking advantage of the information received from Dipak Patel, KB had indulged in trading before the PII and consequently squared off the position when the order of PII was placed in the market. It was estimated that the KB earned a total profit of Rs. 1,56,32,364.01 from the alleged trades.

Civil Appeal No. 2666 of 2013: Sujit Karkera and Group were trading through B.P. Equity Pvt. Ltd. SEBI alleges that they were trading ahead of the trades of CITIGROUP Global Markets Mauritius Pvt. Ltd. (CGMMPL) on the basis of information provided by Suresh Menon (trader of CGMMPL)

who was in possession of the orders of CGMMPL for 6 scrip days. SEBI in its investigation had found that there were several calls made between Suresh Menon and his family friend Sujit Karkera during this time period of 6 days. In these telephonic conversations, it was alleged that there was an exchange of information related to scrip name, order quantity, order timing, and order price of the orders placed by Suresh Menon for CGMMPL. Sujit Karkera utilized the information provided by Suresh Menon to trade thereby making huge profits.

Civil Appeal No. 11195-96 of 2014: Jitendra Kumar Sharma was an equity dealer employed by the Central Bank of India. His responsibilities entailed the preparation of charts for the chief equity dealer and placing orders based on the instructions of the chief equity dealer. Vibha Sharma, who is the wife of Jitendra Kumar Sharma, was a regular trader in the stock market and this fact was disclosed to the Central Bank of India as a good practice of making disclosure to the employer. It is the allegation of SEBI that Vibha Sharma engaged herself in front of running Central Bank of India's large-scale orders allegedly with the knowledge obtained from her husband. Further, SEBI had alleged that Vibha Sharma's trades substantially matched with the trades of the bank during the relevant period thereby violating regulations 3(a), (b), (c), (d) and 4(1) of FUTP 2003.

Civil Appeal No. 5829 of 2014: Pooja Menghan (the appellant) used to trade in scrips of four companies namely Amtek Auto Ltd., Amtek India Ltd., Monnet Ispat Ltd. and Ahmednagar Forgings Ltd. through Religare Securities Ltd., ISF Securities Ltd., India Infoline Securities Ltd. and Narayan Securities Private Ltd. It is alleged against the appellant that, she had bought and sold equal quantities of shares in large volume in these four scrips by utilizing the information provided by Deepak Khurana who was privy to certain confidential information of Religare. SEBI conducted an investigation in the trading of appellants from June 1, 2008 to January 12, 2009. During the investigation, SEBI noticed irregularities in her dealings in the scrips of above mentioned four companies. A general trend of trading was noticed, which further revealed that the appellant was indulged in Front Running. It was found that the appellant's sell orders (quantity and price) substantially matched with the buy orders (quantity and price) of other traders and that her sell order limit price was always above the sell LTP but was the same or very close to the buy limit price of other traders. Moreover, the selling price, quoted by her, was close to the highest price reached on market on those days.

The question which has arisen for consideration is whether 'front running by non-intermediary' is a prohibited practice under regulations 3 (a), (b), (c) and (d) and 4(1) of FUTP 2003.

Findings of the case:

Front-running comprises of at least three forms of conduct. They are:

(1) trading by third parties who are tipped on an impending block trade ("tippee" trading);

(2) transactions in which the owner or purchaser of the block trade himself engages in the offsetting futures or options transaction as a means of "hedging" against price fluctuations caused by the block transaction ("self-front-running"); and

(3) transactions where an intermediary with knowledge of an impending customer block order trades ahead of that order for the intermediary's own profit ("trading ahead").

In this batch of appeals, the first and the last types of trade i.e., tippee trading and trading ahead are dealt with. Trading ahead has been explicitly recognized under regulation 4(2)(q) of FUTP 2003.

Non-intermediary front running may be brought under the prohibition prescribed under regulations 3 and 4 (1), for being fraudulent or unfair trade practice, provided that the ingredients under those heads are satisfied as discussed above. It is clear that in order to establish charges against tippee, under regulations 3 (a), (b), (c) and (d) and 4 (1) of FUTP 2003, one needs to prove that a person who had provided the tip was under a duty to keep the non-public information under confidence, further such breach of duty was known to the tippee and he still trades thereby defrauding the person, whose orders were front-runned, by inducing him to deal at the price he did.

Concerned parties to the transaction were involved in an apparent fraudulent practice violating market integrity. The parting of information with regard to an imminent bulk purchase and the subsequent transaction thereto are so intrinsically connected that no other conclusion but one of joint liability of both the initiator of the fraudulent practice and the other party who had knowingly aided in the same is possible.

Order:

Having regard to the facts of the present cases i.e. the volume of shares sold and purchased; the proximity of time between the transactions of sale and purchase and the repeated nature of transactions on different dates, it would irresistibly lead to an inference that the conduct of the respondents in Appeal Nos. 2595 of 2013, 2596 of 2013 and 2666 of 2013 and appellants in Appeal Nos. 5829 of 2014 and 11195-11196 of 2014 were in breach of the code of business integrity in the securities market. The consequences for such breach including penal consequences under the provisions of Section 15HA of the SEBI Act must visit the concerned defaulters for which reason the orders passed by the Appellate Tribunal impugned in Civil Appeal Nos.2595 of 2013, 2596 of 2013 and 2666 of 2013 are set aside and the findings recorded and the penalty imposed by the Adjudicating Officer is restored.

Consequently, Civil Appeal Nos. 2595, 2596 and 2666 of 2013 are allowed. At the same time, for the same reason, Civil Appeal Nos. 5829 of 2014 and 11195-11196 of 2014 are dismissed.

Case 8.3: Ms Sunita Gupta (Trade Name: M/s Sunita Investments) versus SEBI

Facts of the case:

M/s Sunita Gupta aggrieved by the order of SEBI dated March 27, 2018 which imposed a penalty of Rs. 25 lakh upon the appellant for violation of Sections 12(A)(a), 12(A)(b), 12(A)(c) of SEBI Act, 1992 and regulations 3(a), 3(b), 3(c), 3(d), 4(1), 4(2)(a) & 4(2)(e) of SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003 ('PFUTP Regulations' for short), file an appeal in Securities Appellate Tribunal.

The impugned order relates to trading in the scrip of M/s. Gangotri Textiles Ltd. ('Gangotri' for short) during the period April 7, 2005 to May 31, 2006. The appellant traded in the scrip in Bombay Stock Exchange Ltd. ('BSE' for short) through her broker, namely, Parasram Holdings Pvt. Ltd. ('Parasram' for short). On December 12, 2013 SEBI issued a show-cause notice under Rule 4 of SEBI (Procedure for Holding Inquiry and Imposing Penalties by Adjudicating Officer) Rules, 1995. Thereafter, following the normal procedure of providing personal hearing, seeking replies etc. the AO passed an order dated July 22, 2014 whereby a penalty of Rs. 60 lakh was imposed on the appellant.

Aggrieved by that order, an appeal was filed before this Tribunal (Appeal No. 324 of 2014) and vide order dated April 29, 2016 this Tribunal remanded the matter to the AO SEBI with the following direction: "Since the question as to whether the appellant traded on the Stock Exchange at Mumbai as a sub-broker or in individual capacity goes to the root of the matter, we deem it proper to quash and set aside the impugned order and restore the matter for fresh decision on merits and in accordance with law."

Thereafter, SEBI appointed a fresh AO. Further, a notice dated August 24, 2017 was issued to the appellant seeking to specifically clarify whether all the transactions with regard to the appellant's dealings in the scrip of Gangotri during the period of investigation as alleged in the original show cause notice were carried out in the capacity of a sub-broker. The appellant was also advised to submit all documents relating to her registration as sub-broker along with a copy of the KYC documents in support of her submissions. Further, after giving multiple opportunities for personal hearing and replies etc. the order impugned in this appeal has been passed.

In the impugned order it is held that a number of entities collectively called Vishvas group, including the appellant herein, have manipulated trading in the scrip of Gangotri during the investigation period. During the investigation period these entities had executed a large number of synchronized trade, circular trades and reversal trades and traded in significant variation to the Last Traded Price (LTP) in the shares of Gangotri. Similarly, the total buy and sell quantity in BSE by the members of the Vishvas group during the investigation period was 5198404 shares and 4711903 respectively. Similarly, the group bought and sold 3876420 and 3592980 shares respectively at NSE. The appellant had bought and sold 342246 shares of Gangotri in BSE. During

the investigation period the price of the scrip varied from 43 rupees to 71 rupees indicating substantial volatility. Findings relating to the appellant as well as the Vishvas group synchronized trading, circular trading, reversal trading and how the LTP was manipulated by placing orders at far away prices form LTP has been done are all described in detail in the impugned order.

Findings of the case:

The appellant has not given any documents / evidence to demonstrate that she was dealing on behalf of her clients in terms of bank account transactions, demat account transactions, ledgers, contract notes etc. Moreover, the appellant was registered as a client of Parasram, her broker, since June 2002 and executed the impugned trades in BSE as a client of Parasram. All the trades were carried out in the Unique Client Code (UCC) of the appellant and that Unique Client Code is not that of any sub-broker. The broker, Parasram itself confirmed that the impugned trades were carried out by the appellant in her capacity as client. There is no document/ agreement entered into between the stockbroker, the appellant and her so-called client Perfect Car Scanners Pvt. Ltd. The finding in the order of the Delhi High Court in the matter of National Stock Exchange (supra) relates to a broker. Even a broker needs membership with an exchange to trade in it while it needs only one registration with SEBI. In any case, that order is applicable to brokers; not to sub-brokers. Therefore, the AO has not invited any contempt of court. Moreover, the appellant was aware of this legal position and therefore she had made an application for registration before BSE which was subsequently withdrawn. Further, pursuant to an amendment to broker regulations in the year 2003 sub-brokers were prohibited from handling funds and securities of clients and issuing contract notes to clients. Therefore, there is no laxity in the finding of the AO that the appellant was executing her trades in the capacity as a client and not in the capacity of a sub-broker of BSE.

The appellant has violated provisions of the SEBI Act and PFUTP Regulations as held in the impugned order.

It is evident that the appellant, along with other entities in the Vishvas group has indulged in synchronized and circular trading and contributed substantially in raising the LTP. The exact figures relating to each category of trading and LTP contribution is given in the impugned order. What is disputed by the appellant is that she had no connection with the Vishvas group and synchronization / circularity happened just by chance. However, given the proximity of time between trading by these entities and the number of such instances of trades we are unable to appreciate this submission of the appellant. Further, the contention of the appellant is that appellant was trading as a sub-broker and the matter was remanded to SEBI by this Tribunal on April 29, 2016 mainly on this ground. However, it is clearly demonstrated in the impugned order that the appellant could not produce any evidence relating to her contention that she was trading on behalf of a client, namely, Perfect Car Scanners Pvt. Ltd.

The trading details, its nature, time etc. reveal the manipulation in the scrip of Gangotri. Apart from stating that that the appellant has no connection with the Vishvas group the appellant could not explain why and how so many of her trades were in the nature of synchronized and reversed trades and that too most of the time within a few seconds with trades of other entities in the Vishvas group. Such synchronization and reversal of trade are not possible without a prior meeting of minds.

The submission that the penalty imposed is too harsh also does not have any merit. On remand by this Tribunal and reconsideration the AO of SEBI has reduced the amount of penalty from Rs. 60 lakh to Rs. 25 lakh. Further, the penalty imposable under Section 15HA of the SEBI Act is three times the amount of profit or Rs. 25 crore whichever is higher.

Therefore, while imposing an amount of Rs. 25 lakh only as a penalty the AO has factored in all the mitigating circumstances including that the appellant might have made a loss.

Order:

No reason to interfere with the amount of penalty imposed. Appeal is dismissed.

Case 8.4: SEBI v/s Hemant Ghai, Shyam Mohini Ghai, Jaya Hemant Ghai in the matter of CNBC Awaaz "Stock 20-20" show co-hosted by Hemant Ghai

Facts of the case:

a) On analysis of the trading pattern of 2 entities viz., Jaya Hemant Ghai and Ms Shyam M Ghai for the period January 2019 to May 2020, high co-relation of the trades of aforesaid entities was observed with recommendations furnished in the show stock 20-20 aired on channel CNBC - Aawaz.

Findings of the case:

a) Hemant Ghai was hosting/co-hosting various shows; stock 20-20. This show featured recommendations on certain stocks to be brought/sold during the day

b) Jaya Ghai and Shyam Ghai had undertaken a large number of Buy -today-sell-tomorrow (BTST) trades during the relevant period in synchronisation with recommendations made in the show. Shares were brought the previous day before the recommendation and sold immediately on recommendation day.

c) Jaya Ghai was the wife of Hemant Ghai and Shyam Ghai was the mother of Hemant Ghai.

d)Trades were executed in the trading account of Jaya Ghai and Shyam Ghai in violation of provisions of the SEBI Act and SEBI (PFUTP) Regulations and earned proceeds amounting to Rs 2.95 crore through limited trades examined during the period.

e) Hemant Ghai had advance information on the buy recommendation of shares to be made on the next day and the trades in the trading account of Jaya Ghai and Shyam Ghai were designed to take advantage of advance information of buy recommendation given on the show, knowing fully well that buy recommendation would have a positive impact on price and volume of shares.

f) From the KYC details of Jaya Ghai and Shyam Ghai, it was observed that the email id provided therein belonged to Hemant Ghai. Prima facie, observed that Hemant Ghai was controlling and operating these two trading accounts.

Order:

a) Since the conduct of the aforementioned entities appears to be unfair and not in the interest of investors and the securities market, necessary action has to be taken against them immediately. It is a fit case, pending detailed examination, effective and expeditious preventive action is required by way of ad-interim order to preserve the safety and integrity of the market.

b) Aforesaid entities are restrained from buying, selling or dealing in the securities, either directly or indirectly in any manner whatsoever till further directions

c) Any open position in derivatives contract they can close out/square up till 3 months from date of order

d) Hemant Ghai shall cease and desist from undertaking directly or indirectly any activity related to investment advice, sell/buy recommendations, publishing research reports etc related to the securities market till further directions.

e) Bank accounts of entities to the extent of amount in the order to be impounded. The impounded amount is to be moved to escrow account. The monies kept therein shall not be released without permission of SEBI.

f) Bank account of aforesaid entities are frozen for any further debits till further communication.

g) Aforesaid entities to furnish full inventory of assets held by them jointly or severally including bank accounts, Demat accounts mutual fund investment, immovable properties. These entities did not dispose off or create a charge on the assets

h) Depositories and Registrar Transfer agents to ensure no credits in the accounts held by them jointly or severally till further direction

Review Questions

1. Fraud includes a wilful misrepresentation of truth OR concealment of material fact, in order that another person may act, to his detriment. State whether True or False.

   (a) True

   (b) False

2. The SEBI Fraudulent and Unfair Trade Practices Regulations prohibit a person to, directly or indirectly _____ securities in a fraudulent manner.

   (a) Buy

   (b) Sell

   (c) Deal In

   (d) All of the above

3. Fraud includes an intermediary providing his clients with such information relating to security as cannot be verified by the clients before their dealing in such security. State whether True or False.

   (a) True

   (b) False

4. In cases of fraud, SEBI can _____ the registration of an intermediary.

   (a) Cancel

   (b) Suspend

   (c) Both a & b

   (d) None of the above

CHAPTER 9: PREVENTION OF MONEY LAUNDERING ACT, 2002

LEARNING OBJECTIVES:

After studying this chapter, you should know about:

- Some key provisions of the PMLA, 2002
- Policies and procedures to be put in place by intermediaries to prevent money laundering
- Key features of SEBI (Foreign Portfolio Investors) Regulations, 2014

9.1 Introduction

The Prevention of Money Laundering Act, 2002 (PMLA) forms the core of the legal framework put in place by India to combat money laundering. The provisions of PMLA came into force on July 1 2005. The objective of PMLA is, "***to prevent money-laundering and to provide for confiscation of property derived from, or involved in, money-laundering and for matters connected therewith or incidental thereto.***"

(1) Provisions of the PMLA stipulate that every banking company, financial institution and intermediary shall maintain a record

Every reporting entity shall—

(a) maintain a record of all transactions, including information relating to transactions covered under clause (b), in such manner as to enable it to reconstruct individual transactions;

(b) furnish to the Director within such time as may be prescribed, information relating to such transactions, whether attempted or executed, the nature and value of which may be prescribed;

(c) maintain record of documents evidencing identity of its clients and beneficial owners as well as account files and business correspondence relating to its clients.

(2) Every information maintained, furnished or verified, save as otherwise provided under any law for the time being in force, shall be kept confidential.

(3) The records referred to in clause (a) of sub-section (1) shall be maintained for a period of five years from the date of transaction between a client and the reporting entity.

Every reporting entity shall, prior to the commencement of each specified transaction,—

(a) verify the identity of the clients undertaking such specified transaction by authentication under the Aadhaar (Targeted Delivery of Financial and Other Subsidies, Benefits and Services) Act, 2016 (18 of 2016) in such manner and subject to such conditions, as may be prescribed:

Provided that where verification requires authentication of a person who is not entitled to obtain an Aadhaar number under the provisions of the said Act, verification to authenticate the identity of the client undertaking such specified transaction shall be carried out by such other process or mode, as may be prescribed;
(b) take additional steps to examine the ownership and financial position, including sources of funds of the client, in such manner as may be prescribed;
(c) take additional steps as may be prescribed to record the purpose behind conducting the specified transaction and the intended nature of the relationship between the transaction parties.
(*2*) Where the client fails to fulfill the conditions laid down under sub-section (*1*), the reporting entity shall not allow the specified transaction to be carried out.
(*3*) Where any specified transaction or series of specified transactions undertaken by a client is considered suspicious or likely to involve proceeds of crime, the reporting entity shall increase the future monitoring of the business relationship with the client, including greater scrutiny or transactions in such manner as may be prescribed.
(*4*) The information obtained while applying the enhanced due diligence measures under sub-section (*1*) shall be maintained for a period of five years from the date of transaction between a client and the reporting entity.
Explanation.—For the purposes of this section, "specified transaction" means—
(*a*) any withdrawal or deposit in cash, exceeding such amount;
(*b*) any transaction in foreign exchange, exceeding such amount;
(*c*) any transaction in any high value imports or remittances;
(*d*) such other transaction or class of transactions, in the interest of revenue or where there is a high risk or money-laundering or terrorist financing,
as may be prescribed.]

In the following section, we will discuss the highlights of the PMLA, 2002 and thereafter the master circular on Anti-Money Laundering issued by SEBI.

9.2 Highlights of PMLA, 2002

Section 3 of the PMLA 2002, defines the offence of money laundering as:
"Whosoever directly or indirectly attempts to indulge or knowingly assists or knowingly is a party or is actually involved in any process or activity connected with the proceeds of crime including its concealment, possession, acquisition or use and projecting or claiming it as untainted property shall be guilty of the offence of money laundering."

A person shall be guilty of the offence of money-laundering if such person is found to have directly or indirectly attempted to indulge or knowingly assisted or knowingly is a party or is actually involved in one or more of the following processes or activities connected with proceeds of crime, namely: —

(a) concealment; or
(b) possession; or
(c) acquisition; or
(d) use; or
(e) projecting as untainted property; or
(f) claiming as untainted property,
in any manner whatsoever

The process or activity connected with proceeds of crime is a continuing activity and continues till such time a person is directly or indirectly enjoying the proceeds of crime by its concealment or possession or acquisition or use or projecting it as untainted property or claiming it as untainted property in any manner whatsoever

Any person found indulging in any offence of money laundering as defined in section 3 of the PMLA, shall be punished as per provisions mentioned in section 4 of the Act.

"Whoever commits the offence of money-laundering shall be punishable with rigorous imprisonment for a term which shall not be less than 3 years but which may extend to 7 years and shall also be liable to fine. In cases where the proceeds of crime involved in money-laundering relate to any offence as specified in Part A of the Schedule to the PMLA, 2002, the term of imprisonment shall not be less than 3 years but which may extend to 10 years."

Section 5 of the PMLA, 2002 states that in cases where the Director, or any other officer not below the rank of Deputy Director, authorized by the Director, has reason to believe on the basis of the material in his possession that -
(a) any person is in possession of any proceeds of crime; and
(b) such proceeds of crime are likely to be concealed, transferred or dealt with in any manner which may result in frustrating any proceedings relating to the confiscation of such proceeds of crime, then he may order to attach such property for a period not exceeding 180 days from the date of such order.

The Central Government shall appoint an Adjudicating Authority to exercise jurisdiction, powers and authority conferred by or under this Act. On receipt of a complaint, if the Adjudicating Authority has reasons to believe that any person has committed an offence as per section 3 or is in possession of proceeds of crime, it may serve a notice of not less than 30 days on such person calling upon him to indicate the sources of his income, earnings or assets, out of which or by means of which he has acquired the property which has been attached, or, seized or frozen, the evidence on which he relies and other relevant information and particulars , and to show cause why all or any of such properties should not be declared to be the properties involved in money-laundering and confiscated by the Central Government.

The Obligations on banking companies, financial institutions and intermediaries has been specified in Section 12 of the PMLA 2002:

1. Every reporting entity shall –
    a. maintain a record of all transactions, including information relating to transactions covered under clause (b) in such manner as to enable it to reconstruct individual transactions;
    b. furnish to the Director within such time as may be prescribed, information relating to such transactions, whether attempted or executed the nature and value of which may be prescribed;
    c. maintain record of documents evidencing identity of its clients and beneficial owners as well as account files and business correspondence relating to its clients.
2. Every information maintained, furnished or verified, save as otherwise provided under any law for the time being in force, shall be kept confidential.
3. The records referred to in clause (a) of sub-section (1) shall be maintained for a period of five years from the date of transaction between a client and the reporting entity.
4. The records referred to in clause (e) of sub-section (1) shall be maintained for a period of five years after the business relationship between a client and the reporting entity has ended or the account has been closed whichever is later.

Section 12 AA of PMLA stipulates enhanced due diligence by reporting entities. The details are given below:

2. Every reporting entity shall, prior to the commencement of each specified transaction, —

(a) verify the identity of the clients undertaking such specified transaction by authentication under the Aadhaar (Targeted Delivery of Financial and Other Subsidies, Benefits and Services) Act, 2016 (18 of 2016) in such manner and subject to such conditions, as may be prescribed, provided that where verification requires authentication of a person who is not entitled to obtain an Aadhaar number under the provisions of the said Act, verification to authenticate the identity of the client undertaking such specified transaction shall be carried out by such other process or mode, as may be prescribed.

(b) take additional steps to examine the ownership and financial position, including sources of funds of the client, in such manner as may be prescribed.

(c) take additional steps as may be prescribed to record the purpose behind conducting the specified transaction and the intended nature of the relationship between the transaction parties.

3. Where the client fails to fulfil the above conditions, the reporting entity shall not allow the specified transaction to be carried out.

4. Where any specified transaction or series of specified transactions undertaken by a client is considered suspicious or likely to involve proceeds of crime, the reporting entity shall increase the future monitoring of the business relationship with the client, including greater scrutiny or transactions in such manner as may be prescribed.

5. The information obtained while applying the enhanced due diligence measures shall be maintained for a period of five years from the date of transaction between a client and the reporting entity.

Specified transaction means:

- any withdrawal or deposit in cash, exceeding such amount;
- any transaction in foreign exchange, exceeding such amount;
- any transaction in any high-value imports or remittances;
- such other transaction or class of transactions, in the interest of revenue or where there is a high risk of money laundering or terrorist financing, as may be prescribed.

To ensure compliance, the Director has been conferred with the following powers as given in Section 12 A and Section 13 of the PMLA 2002:

Section 12A:

(6) The Director may call for from any reporting entity any of the records referred to in subsection 11A, section (1) of section 12, sub-section (1) of section 12AA and any additional information as he considers necessary for the purposes of this Act;

(7) Every reporting entity shall furnish to the Director such information as may be required by him under sub-section (1) within such time and in such manner as he may specify;

(8) Save as otherwise provided under any law for the time being in force, every information sought by the Director under subsection (1) shall be kept confidential.

Section 13:

1. The Director may, either of his own motion or on an application made by any authority, officer or person, make such inquiry or cause such inquiry to be made, as he thinks fit to be necessary, with regard to the obligations of the reporting entity under this Chapter.

1A. If at any stage of inquiry or any other proceedings before him, the Director having regard to the nature and complexity of the case, is of the opinion that it is necessary to do so, he may direct the concerned reporting entity to get its records, as may be specified, audited by an accountant from amongst a panel of accountants maintained by the Central Government for this purpose.

1B. The expenses of and incidental to any audit under sub-section (1A) shall be borne by the Central Government.

2. If the Director, in the course of any inquiry, finds that a reporting entity or its designated director on the Board or any of its employees has failed to comply with the obligations under this Chapter, then, without prejudice to any other action that may be taken under any other provision of this Act, he may issue a warning in writing or direct such reporting entity or its designated director on the Board or any of its employees to comply with specific instructions or direct such reporting entity or its designated director on the Board or any of its employees to send reports as such interval as may be prescribed or by an order impose a monetary penalty on such reporting entity or its designated director on the Board or any of its employees which shall not be less than ten thousand rupees but may extend to one lakh rupees for each failure.

3. The Director shall forward a copy of the order so passed to every banking company, financial institution or intermediary or person who is a party to the proceeding.

   Explanation- For the purposes of this section, the accountant shall mean a Chartered accountant within the meaning of the Chartered Accountants Act, 1949."

Any person aggrieved by the order passed by the Director or the Adjudicating Officer under the PMLA, 2002 may prefer to appeal to the Appellate Tribunal.

As per the PMLA Act and subsequent PMLA Rules notified under the Act, the intermediaries are required to appoint a Principal Officer as per the above Act. The Principal Officer is responsible to discharge the legal obligations to report suspicious transactions to authorities. The Principal Officer is responsible for reviewing the alerts received from regulators/exchanges. Further Designated Director is defined as a person designated by the reporting entity to ensure overall compliance with the obligations imposed under the Act and Rules. Every reporting entity shall communicate to FIU Delhi/Regulator on name, designation and address of Designated Director and Principal Officer.

9.3 Highlights of SEBI Circular on AML/CFT

As per provisions of PMLA, intermediaries registered under SEBI Act shall have to adhere to the provisions as given in the PMLA. A 'Principal Officer' needs to be designated who shall be responsible for ensuring compliance of the provisions of the PMLA. SEBI has issued necessary directives vide circulars from time to time, covering issues related to Know Your Client (KYC) norms, Anti-Money Laundering (AML), Client Due Diligence (CDD). These directives lay down minimum requirements and it is emphasised that the intermediaries may, according to their requirements specify additional disclosures to be made by the clients to address the concerns of money laundering and suspicious transactions undertaken by the clients.

The essential principles specified in this circular are given below:

These Directives have taken into account the requirements of the PMLA as applicable to the intermediaries registered under Section 12 of the SEBI Act. The detailed Directives in Section II have outlined relevant measures and procedures to guide the registered intermediaries in preventing Money Laundering and Terrorist Financing. Some of these suggested measures and procedures may not be applicable in every circumstance. Each intermediary shall consider carefully the specific nature of its business, organizational structure, type of client and transaction, etc. to satisfy itself that the measures taken by it are adequate and appropriate and follow the spirit of the suggested measures in Section II and the requirements as laid down in the PMLA.

The Government has issued an order dated February 02, 2021 in relation to combating financing of terrorism under the Unlawful Activities (Prevention) Act, 1967 (UAPA), Key areas covered in the said order are as follows:

1. Appointment and communication details of the UAPA Nodal officers
2. Communication of list of designated individuals/entities
3. Regarding funds, financial assets or economic resources or related services held in the form of bank accounts, stocks or insurance policies etc
4. Regarding financial assets or economic resources of the nature of immovable properties
5. Regarding real estate agents, dealers or precious metals /stones and other designated non-financial business and profession
6. Regarding the implementation of requests received from foreign countries under a resolution passed by the UN Security Council
7. Regarding exemption to be granted in accordance with UNSCR

8. Regarding the procedure for unfreezing of funds, financial assets or economic resources or related services of individuals/entities inadvertently affected by the freezing mechanism upon verification that the person or entity is not a designated person
9. Regarding prevention of entry into or transit through India

Procedure for communication of compliance of action taken under Sec 51 A of UAPA

9.3.1 Obligation to establish policies and procedures

To be in compliance with the guidelines of anti-money laundering, senior management of a registered intermediary should be fully committed to establishing appropriate policies and procedures for the prevention of money laundering and terrorist financing and ensuring their effectiveness and compliance with all relevant legal and regulatory requirements. The registered intermediaries should:

a) Issue a statement of policies and procedures on a group basis where applicable for dealing with money laundering reflecting the current statutory and regulatory requirements;
b) Ensure that the content of these directives are understood by all staff members;
c) Regularly review the policies and procedures on the prevention of money laundering and terrorist financing to ensure effectiveness. Further to ensure effectiveness the person who reviews should be different from the person framing the policies and procedures;
d) Adopt client acceptance policies and procedures that are sensitive to the risk of Money Laundering (ML) and Terrorism Financing (TF);
e) Undertake client due diligence (CDD) measures to an extent that is sensitive to the risk of money laundering depending on the type of client, business relationship or transaction;
f) Have a system in place for identifying, monitoring and reporting suspected money laundering to the law enforcement authorities;
g) Develop staff members' awareness and vigilance to guard against ML and TF.

9.3.2 Policies and Procedures

Policies and procedures to combat Money Laundering should cover:

- Communication of group policies relating to the prevention of money laundering and terrorist financing to all management and relevant staff that handle account information, client records etc.
- Client acceptance policy and due diligence measures, including requirements for proper identification;
- Maintenance of records;
- Compliance with relevant statutory and regulatory requirements;
- Cooperation with the relevant law enforcement authorities, including timely disclosure of information; and
- Role of internal audit or compliance function to ensure compliance with the policies, procedures and controls relating to the prevention of money laundering and terrorist

financing, including testing of the system for detecting suspected money laundering transactions evaluating and checking the adequacy of exception reports generated on large and/or irregular transactions, the quality of reporting of suspicious transactions and the level of awareness of front line staff, of their responsibilities in this regard. The internal audit function shall be independent, adequately resourced and commensurate with the size of the business and operations, organization structure, number of clients and other such factors.

9.3.3 Written Anti-Money Laundering Procedures

Each registered intermediary should adopt written procedures to implement the anti-money laundering provisions as envisaged under the PMLA. Such procedures should include the following three specific parameters which are related to the CDD process:

(a) Policy for acceptance of clients
(b) Procedure for identifying the clients
(c) Transaction monitoring and reporting especially Suspicious Transactions Reporting (STR)

9.3.4 Client Due Diligence

The CDD measures comprise the following:

(a) Obtaining sufficient information in order to identify persons who beneficially own or control securities account. Whenever it is apparent that the securities acquired or maintained through an account are beneficially owned by a party other than the client, that party should be identified using client identification and verification procedures. The beneficial owner is the natural person or persons who ultimately own, control or influence a client and/or persons on whose behalf a transaction is being conducted. It also incorporates those persons who exercise ultimate effective control over a legal person or arrangement.

Verify the client's identity using reliable, independent source documents, data or information;

(b) Identify beneficial ownership and control, i.e., determine which individual(s) ultimately own(s) or control(s) the customer and/or the person on whose behalf a transaction is being conducted;

(c) Verify the identity of the beneficial owner of the customer and/or the person on whose behalf a transaction is being conducted, corroborating the information provided in relation to (c);

(d) Conduct ongoing due diligence and scrutiny, i.e., perform ongoing scrutiny of the transactions and account throughout the course of the business relationship to ensure that the transactions being conducted are consistent with the registered intermediary's knowledge of the customer, its business and risk profile, taking into account, where necessary, the customer's source of funds;

(e) Understand the ownership and control structure of the client; and

(f) Registered intermediaries shall periodically update all documents, data or information of all clients and beneficial owners collected under the CDD process.

All registered intermediaries should develop customer acceptance policies and procedures that aim to identify the types of customers that are likely to pose a higher than the average risk of money laundering or terrorist financing. By establishing such policies and procedures, the intermediaries will be in a position to apply CDD on a risk-sensitive basis depending on the type of customer business relationship or transaction. In a nutshell, the following safeguards are to be followed while accepting the clients:

i. No account should be opened in a fictitious / benami name or on an anonymous basis.

ii. Factors of risk perception of the client should be clearly defined having regard to clients' location, nature of the business activity, trading turnover etc. and manner of making payment for transactions undertaken. The parameters should enable the classification of clients into low, medium and high risk. Clients of special category (CSC) (as given below) may, if necessary, be classified even higher. Such clients require a higher degree of due diligence and regular update of Know Your Client (KYC) profile. CSC shall include the following:

   a. Non - resident clients;

   b. High net-worth clients;

   c. Trust, Charities, Non-Governmental Organizations (NGOs) and organizations receiving donations;

   d. Companies having close family shareholdings or beneficial ownership;

   e. Politically Exposed Persons (PEP) are individuals who are or have been entrusted with prominent public functions in a foreign country, e.g., Heads of States or Governments, senior politicians, senior government/ judicial/ military officers, senior executives of state-owned corporations, important political party officials, etc. The additional norms applicable to PEP as contained in the circular shall also be applied to the accounts of the family members or close relatives of PEPs;

   f. Companies offering foreign exchange offerings;

   g. Clients in high-risk countries where existence / effectiveness of money laundering controls is suspect, where there is unusual banking secrecy, countries active in narcotics production, countries where corruption (as per Transparency International Corruption Perception Index) is highly prevalent, countries against which government sanctions are applied, countries reputed to be any of the following – Havens/ sponsors of international terrorism, offshore financial centers, tax havens, countries where fraud is highly prevalent; While dealing with clients in high-risk countries

where the existence/ effectiveness of money laundering control is suspect, intermediaries apart from being guided by the Financial Action Task Force (FATF) statements that identify countries that do not or insufficiently apply the FATF Recommendations, published by the FATF on its website (www.fatf-gafi.org), shall also independently access and consider other publicly available information;

h. Non-face to face clients;

i. Clients with dubious reputation as per public information available etc. The above-mentioned list is only illustrative and the intermediary shall exercise independent judgment to ascertain whether any other set of clients shall be classified as CSC or not;

iii. Documentation requirements and other information to be collected in respect of different classes of clients depending on the perceived risk and having regard to the requirements of Rule 9 of the PML Rules, Directives and Circulars issued by SEBI from time to time.

iv. It should be ensured that an account is not opened where the intermediary is unable to apply appropriate CDD / KYC policies. The market intermediary should not continue to do business with such a person and file a suspicious activity report. It should also evaluate whether there is suspicious trading in determining whether to freeze or close the account. The market intermediary should be cautious to ensure that it does not return securities of money that may be from suspicious trades. However, the market intermediary should consult the relevant authorities in determining what action it should take when it suspects suspicious trading.

v. The circumstances under which the client is permitted to act on behalf of another person / entity should be clearly laid down. It should be specified in what manner the account should be operated, transaction limits for the operation, additional authority required for transactions exceeding a specified quantity / value and other appropriate details. Further the rights and responsibilities of both the persons (i.e., the agent-client registered with the intermediary, as well as the person on whose behalf the agent is acting should be clearly laid down). Adequate verification of a person's authority to act on behalf of the customer should also be carried out.

vi. Necessary checks and balances should be put into place before opening an account so as to ensure that the identity of the client does not match with any person having known criminal background or is not banned in any other manner, whether in terms of criminal or civil proceedings by any enforcement agency worldwide.

vii. The CDD process shall necessarily be revisited when there are suspicions of money laundering or financing of terrorism.

9.3.5 Client Identification Procedure (CIP)

The 'Know your Client' (KYC) policy should clearly spell out the client identification procedure to be carried out at different stages i.e. while establishing the intermediary–client relationship, while carrying out transactions for the client or when the intermediary has doubts regarding the veracity or the adequacy of previously obtained client identification data. Intermediaries should comply with the following requirements while putting in place CIP:

(a) All registered intermediaries shall proactively put in place appropriate risk management systems to determine whether their client or potential client or the beneficial owner of such client is a Politically Exposed Person (PEP).

(b) All registered intermediaries are required to obtain senior management approval for establishing business relationships with Politically Exposed Persons (PEPs).

(c) Registered intermediaries should also take reasonable measures to verify the sources of funds as well as wealth of clients and beneficial owners identified as PEP.

(d) The client should be identified by the intermediary by using reliable sources including documents / information. The intermediary should obtain adequate information to satisfactorily establish the identity of each new client and the purpose of the intended nature of the relationship.

(e) The information should be adequate enough to satisfy competent authorities (regulatory / enforcement authorities) in future that due diligence was observed by the intermediary in compliance with the Guidelines. Each original document should be seen prior to acceptance of a copy.

(f) Failure by prospective clients to provide satisfactory evidence of identity shall be noted and reported to the higher authority within the intermediary.

SEBI has prescribed the minimum requirements relating to KYC for certain classes of the registered intermediaries from time to time. Taking into account the basic principles enshrined in the KYC norms which have already been prescribed or which may be prescribed by SEBI from time to time, all registered intermediaries should frame their own internal guidelines based on their experience in dealing with their clients and legal requirements as per the established practices. Further, the intermediary should also maintain continuous familiarity and follow-up where it notices inconsistencies in the Information provided. The underlying principle should be to follow the principles enshrined in the PML Act, 2002 as well as the SEBI Act, 1992 so that the intermediary is aware of the clients on whose behalf it is dealing.

9.3.6 Record Keeping

Registered intermediaries should ensure compliance with the record keeping requirements contained in the SEBI Act, 1992, Rules and Regulations made there-under, PMLA, 2002 as well as other relevant legislation, Rules, Regulations, Exchange Bye-laws and Circulars. They should also

maintain such records as are sufficient to permit reconstruction of individual transactions (including the amounts and types of currencies involved, if any) so as to provide, if necessary, evidence for prosecution of criminal behaviour.

Registered Intermediaries should ensure that all customer and transaction records and information are available on a timely basis to the competent investigating authorities. Where appropriate, they should consider retaining certain records, e.g., customer identification, account files, and business correspondence, for periods which may exceed that required under the SEBI Act, Rules and Regulations framed there-under, PMLA 2002, other relevant legislation, Rules and Regulations or Exchange bye-laws or circulars.

In cases where there is any suspected drug-related or other laundered money or terrorist property, the competent investigating authorities would need to trace through the audit trail for reconstructing a financial profile of the suspect account. To enable this reconstruction, registered Intermediaries should retain the following information for the accounts of their customers in order to maintain a satisfactory audit trail:

(a) the beneficial owner of the account;
(b) the volume of the funds flowing through the account; and
(c) for selected transactions the origin of the funds; the form in which the funds were offered or withdrawn, e.g., cash, cheques, etc.; the identity of the person undertaking the transaction; the destination of the funds; the form of instruction and authority.

9.3.7 Retention of Records

Intermediaries need to ensure that they take appropriate steps to evolve an internal mechanism for proper maintenance and preservation of such records and information in a manner that allows easy and quick retrieval of data as and when requested by the competent authorities. Further, the records need to be maintained and preserved for a period of five years from the date of transactions between the client and intermediary. The records evidencing the identity of its clients and beneficial owners as well as account files and business correspondence shall be maintained and preserved for a period of five years after the business relationship between a client and intermediary has ended or the account has been closed whichever is later.

- All necessary records on transactions, both domestic and international, shall be maintained at least for the minimum period prescribed under the relevant Act and Rules (PMLA and rules framed thereunder as well SEBI Act) and other legislation, Regulations or exchange Byelaws or circulars.
- Records on client identification, account files and business correspondence shall also be kept for the same period.

In situations where the records relate to ongoing investigations or transactions which have been the subject of a suspicious transaction reporting, they shall be retained until it is confirmed that the case has been closed.

Registered Intermediaries shall maintain and preserve the records of information related to transactions, whether attempted or executed, which are reported to the Director, FIU – IND, as required under Rules 7 and 8 of the PML Rules, for a period of five years from the date of the transaction between the client and the intermediary.

9.3.8 Monitoring of Transactions

Regular monitoring of transactions is vital for ensuring effectiveness of the AML procedures. This is possible only if the intermediary has an understanding of the normal activity of the client so that it can identify deviations in transactions / activities. The intermediary has to pay special attention to all complex, unusually large transactions / patterns which appear to have no economic purpose. The intermediary may specify internal threshold limits for each class of client accounts and pay special attention to transactions that exceed these limits. The background including all documents/office records /memorandums/clarifications sought pertaining to such transactions and purpose thereof should also be examined carefully and findings be recorded in writing. Further such findings, records and related documents shall be made available to auditors and also to SEBI/stock exchanges/FIU-IND/other relevant authorities, during audit, inspection or as and when required.

9.3.9 Suspicious Transaction Monitoring & Reporting

Intermediaries shall ensure that appropriate steps are taken to enable suspicious transactions to be recognized and have appropriate procedures for reporting suspicious transactions. While determining suspicious transactions, intermediaries shall be guided by the definition of a suspicious transaction contained in PML Rules as amended from time to time. SEBI in its master circular has given an illustrative list of circumstances, which may be in the nature of suspicious transactions. The same is reproduced below:

- Clients whose identity verification seems difficult or clients that appear not to cooperate;
- Asset management services for clients where the source of the funds is not clear or not in keeping with the client's apparent standing /business activity;
- Clients based in high-risk jurisdictions;
- Substantial increases in business without apparent cause;
- Clients transferring large sums of money to or from overseas locations with instructions for payment in cash;
- Attempted transfer of investment proceeds to apparently unrelated third parties;

- Unusual transactions by CSCs and businesses undertaken by offshore banks/ financial services, businesses reported to be in the nature of export/ import of small items.

Any suspicious transaction shall be immediately notified to the Money Laundering Control Officer or any other designated officer within the intermediary. The notification may be done in the form of a detailed report with specific reference to the clients, transactions and the nature/ reason of suspicion. However, it shall be ensured that there is continuity in dealing with the client as normal until told otherwise and the client shall not be told of the report/suspicion. In exceptional circumstances, consent may not be given to continue to operate the account, and transactions may be suspended, in one or more jurisdictions concerned in the transaction, or other action taken. The Principal Officer/Money Laundering Control Officer and other appropriate compliance, risk management and related staff members shall have timely access to client identification data and CDD information, transaction records and other relevant information.
It is likely that in some cases transactions are abandoned or aborted by clients on being asked to give some details or to provide documents. It is clarified that the intermediary shall report all such attempted transactions in STRs, even if not completed by clients, irrespective of the amount of the transaction.

The clients of high-risk countries, including countries where the existence and effectiveness of money laundering controls is suspect or which do not or insufficiently apply FATF standards, are categorized as 'CSC'. Intermediaries are directed that such clients shall also be subject to appropriate counter measures. These measures may include further enhanced scrutiny of transactions, enhanced relevant reporting mechanisms or systematic reporting of financial transactions, and applying enhanced due diligence while expanding business relationships with the identified country or persons in that country etc.

9.3.10 Reporting to Financial Intelligence Unit-India
Intermediaries shall adhere to the following:

a) The Cash Transaction Report (CTR) (wherever applicable) for each month shall be submitted to FIU-IND by 15th of the succeeding month.

b) The Suspicious Transaction Report (STR) shall be submitted within 7 days of arriving at a conclusion that any transaction, whether cash or non-cash or a series of transactions integrally connected are of suspicious nature. The Principal Officer shall record his reasons for treating any transaction or a series of transactions as suspicious. It shall be ensured that there is no undue delay in arriving at such a conclusion.

c) The Non-Profit Organization Transaction Reports (NTRs) for each month shall be submitted to FIU-IND by 15th of the succeeding month.

d) The Principal Officer will be responsible for timely submission of CTR, STR and NTR to FIU-IND;

e) Utmost confidentiality shall be maintained in the filing of CTR, STR and NTR to FIU-IND.

f) No nil reporting needs to be made to FIU-IND in case there are no cash/ suspicious/ non –profit organization transactions to be reported.

Intermediaries shall not put any restrictions on operations in the accounts where an STR has been made. Intermediaries and their directors, officers and employees (permanent and temporary) shall be prohibited from disclosing ("tipping off") the fact that an STR or related information is being reported or provided to the FIU-IND. This prohibition on tipping off extends not only to the filing of the STR and/ or related information but even before, during and after the submission of an STR. Thus, it shall be ensured that there is no tipping off to the client at any level. It is clarified that the registered intermediaries, irrespective of the amount of transaction and/or the threshold limit envisaged for predicate offences specified in part B of Schedule of PMLA, 2002, shall file STR if they have reasonable grounds to believe that the transactions involve proceeds of crime.

In terms of the PML Rules, intermediaries are required to report information relating to cash and suspicious transactions to the Director, Financial Intelligence Unit-India, New Delhi. Email id. Website: http://fiuindia.gov.in

Email:

helpdesk@fiuindia.gov.in (For FINnet and general queries)

ctrcell@fiuindia.gov.in (For Reporting Entity / Principal Officer registration related queries)

complaints@fiuindia.gov.in (For any complaints)

Case 9.1: SEBI vs Marfatia Stock Broking Private Limited

SEBI conducted an inspection of books of accounts, documents and other records of Marfatia Stock Broking Private Limited (hereinafter referred to as "**Marfatia**") for the period from April 1, 2012 to March 31, 2013 to ascertain whether the Anti-Money Laundering (AML) Policy was in place within 30 days of the promulgation of SEBI circular ISD/CIR/RR/AML/1/06 dated January 18, 2006 read with SEBI Master Circular No. CIR/ISD/AML/3/2010 dated December 31, 2010 on Anti Money Laundering and whether there is a violation of Clause A(1), A(2) and A(5) of Code of Conduct specified under Schedule II read with Regulation 9 of SEBI (Stock Broker) Regulations, 1992 (hereinafter referred to as Brokers Regulations) and regulation 26(xvi) of Brokers Regulations.

In this regard, a show-cause notice was issued to the Marfatia. In response, Marfatia submitted their reply through letter and was granted an opportunity of personal hearing before the Adjudicating Officer. The following issues were considered:

(a) Whether Marfatia has violated the provisions of Circular No. ISD/CIR/RR/AML/1/06 dated January 18, 2006 read with SEBI Master Circular No. CIR/ISD/AML/3/2010 dated December 31, 2010; Clause A(1), A(2) and A(5) of Code of Conduct specified under Schedule II read with Regulation 9 of Brokers Regulations and regulation 26(xvi) of Brokers Regulations?

(b) Do the violations, if any, on the part of Marfatia attract monetary penalty under section 15HB of SEBI Act?

(c) If so, what would be the quantum of monetary penalty that can be imposed on Marfatia after taking into consideration the factors mentioned in section 15J of the SEBI Act read with the Adjudication Rules?

Findings of the case:

As per the Circular No. ISD/CIR/RR/AML/1/06 dated January 18, 2006, Marfatia was required to have an AML policy in place within 30 days from the date of the said Circular. Marfatia had admitted that it had adopted AML policy on June 30, 2009. However, it had submitted that though a separate AML Policy was not documented, but the requirements of PMLA were duly incorporated in the relevant policies itself like KYC policy and RMS policy. The purpose of having the documented procedure is to ensure compliance with the regulatory requirements and maintain internal controls to put checks and balances to curb money laundering by incorporating various requirements. It is noted that Marfatia had documented processes for activities like the Client Registration process and risk management control although there was no separate documented policy within the prescribed timeline, the various requirements were adopted in other policies. In view of the same, the allegation of not complying with the provisions of the circular does not stand established.

With regard to the appointment of Principal Officer, when the inspection team had sought the comments of Marfatia regarding the appointment of Principal Officer, it had submitted that Mr Vijaykumar Bharatbhai Shah was appointed on March 19, 2008. During the adjudication proceedings, Marfatia submitted a copy of letter dated February 13, 2006 addressed to the FIU mentioning that it had appointed Mr Hiren Bipin Chandra Shah as a Principal Officer on February 2, 2006. The copy of the said letter was never brought to the notice of SEBI before the adjudication proceedings. Also, Marfatia had submitted only the proof of despatch of the said letter in the form of a courier slip of a courier company and there is no proof of delivery. Since there is nothing on record to suggest the contrary, Adjudicating Officer was inclined to accept the submission of Marfatia that it had appointed Mr Hiren Bipin Chandra Shah as the Principal Officer on February 02, 2006 and has duly informed FIU about it. Hence, there is no violation on the part of the Marfatia.

Order:

The observations made during the inspection were procedural in nature and all of these were complied with after being pointed out by the inspection team. No serious observations were made where the investors' interests would have been adversely affected. The Adjudicating Officer did not find the case fit for imposing monetary penalty and disposed of the Marfatia of the Show Cause Notice.

Case 9.2: **SEBI vs. Shreepati Holdings & Finance Pvt. Ltd.**

SEBI carried out an inspection of books of accounts, documents and other records of Shreepati Holdings & Finance Pvt., Ltd., Stock Broker (SHF) on February 13 and 18, 2015, inter alia, to examine the systems put in place by SHF to comply with the Anti-Money Laundering (AML) and Combating the financing of terrorism (CFT) norms. The period of inspection was Financial Year 2013-14 and April 1, 2014 till December 31, 2014 ("inspection period").

Pursuant to the communication of findings of inspection to the SHF and analysing its' reply therein, SEBI initiated Adjudication proceedings against the SHF for the alleged violation of SEBI Circulars ref. no. (a) CIR/ISD/AML/3/2010 dated December 31, 2010, (b) CIR/MIRSD/2/2013 dated January 24, 2013, (c) CIR/MIRSD/11/2014 dated March 12, 2014, Clauses A (2) and A (5) of the Code of Conduct read with Regulation 9 (f), Regulations 26 (xv), (xvi) and (xx) of SEBI (Stock Brokers) Regulations, 1992 *(hereinafter referred to as Stock Brokers Regulations).*

Issues for consideration:

a. Whether SHF has violated the provisions of SEBI Circulars ref. no. (a) CIR/ISD/AML/3/2010 dated December 31, 2010, (b) CIR/MIRSD/2/2013 dated January 24, 2013, (c) CIR/MIRSD/11/2014 dated March 12, 2014, Clauses A (2) and A (5) of the Code of Conduct read with Regulation 9 (f), Regulations 26 (xv), (xvi) and (xx) of SEBI (Stock Brokers) Regulations, 1992 (hereinafter referred to as Stock Brokers Regulations).

b. Does the violation, if any, attract monetary penalty under Section 15HB of SEBI Act.?

c. If so, what would be the monetary penalty that can be imposed taking into consideration the factors mentioned in Section 15J of SEBI Act?

Allegations and findings:

1. SHF had delayed in updating the AML Policy, in terms of SEBI Circular dated March 12, 2014. SHF in its reply to the SCN admitted that it had updated the AML Policy on November 23, 2014, which resulted in a delay of 8 months. SHF also argued that the SEBI Circular dated March 12, 2014 did not prescribe any fixed timeline within which an intermediary was required to update the AML policy. The argument did not find merit, as SHF cannot absolve it from the mandatory obligation of immediate compliance of the provisions of the SEBI

Circular. Therefore, it was found that SHF did not comply with the provisions of the SEBI Circular dated March 12, 2014.

2. During the inspection period, as per the manual transaction reviewing system, SHF had submitted that no suspicious alerts have been generated by it. However, during the said period, SHF had received suspicious transaction alerts from NSE and BSE. As per the Stock Exchange circular requirements, SHF was required to analyse those alerts, update KYC information of the concerned clients, where required, seek an explanation from the clients involved, seek additional documentary evidence, etc., and then record the final observations after the analysis.

3. SHF had received 83 alerts from BSE and 54 alerts from NSE during the period of inspection. It was observed in the inspection that SHF closed all the alerts received from the exchanges without assigning any reason for the same and did not maintain any record, either electronic or written, of the reasons for closing those alerts. There were no records available, either electronic or written, of the data which were examined while closing those alerts. No additional information or documents were sought from the involved clients in order to analyse the alerts.

4. SHF did not have any system/ mechanism to monitor transactions with respect to client transactions vis-à-vis the declared client financials. It was corroborated by the fact that the SHF did not have any written down policy on such alerts and also did not generate any alerts during the period under consideration.

Conclusions:

1. SHF had violated the provisions of SEBI Circulars dated December 31, 2010, January 24, 2013 and March 21, 2014, Clauses A (2) and A (5) of the Code of Conduct read with Regulation 9 (f), Regulations 26 (xv), (xvi) and (xx) of SEBI (*Stock Brokers) Regulations.*

2. SHF had admittedly not rectified the observations made in the inspection. SHF took corrective steps only after issuance of Show Cause Notice (SCN) in the instant proceedings. It was noted that the non-compliance with SEBI's directions issued to give effect to the amendments carried out to PMLA and PML Rules, in order to prevent money laundering and terror financing, was grave in nature.

3. SHF had not taken steps to rectify the deficiencies observed in the inspection immediately after the same were brought to its' notice, but rectified in the month of February 2015 only after issuance of SCN in the instant proceedings in August, 2017 i.e., after a delay of more than two years. Had the inspection been not carried out and the instant proceedings have not been carried out, SHF would have remained non-compliant with respect to AML & CFT.

4. The Directives issued by SEBI from time to time set out the steps that a registered intermediary or its representatives shall implement to discourage and to identify any money laundering or terrorist financing activities. Any lapse in non-compliance of the same by an Intermediary poses a serious threat to the national economy and national interest. Therefore, there is a need to impose a penalty on SHF which will act as a deterrent in future.

Order:

A penalty of Rs. 3,00,000/- (Rupees Three lakhs only) was imposed on, Shreepati Holdings & Finance Pvt., Ltd., under Section 15HB of SEBI Act for violation of the provisions of SEBI Circulars dated December 31, 2010, January 24, 2013 and March 21, 2014, Clauses A (2) and A (5) of the Code of Conduct read with Regulation 9 (f), Regulations 26 (xv), (xvi) and (xx) of SEBI (Stock Brokers) Regulations, which was commensurate with the violations.

Case 9.3: **FIU Delhi v/s Pay Pal**

Facts of the case:

a) American online payment gateway giant PayPal has been imposed Rs 96 lakh penalty by the FIU for alleged contravention of the anti-money laundering law and accused of "concealing" suspect financial transactions and abetting "disintegration" of India's financial system.

b) PayPal, which began India operations in November 2017, said it was fully committed to follow due processes and is "carefully reviewing the matter".
The company has also been charged with "defeating and frustrating" the tenets of public interest and the provisions of the Prevention of Money Laundering Act (PMLA), which aims to keep the country's financial system safe from economic crimes, terrorist financing and black money transactions.

c) Calling the contraventions as "deliberate and willful", the Financial Intelligence Unit (FIU) in a scathing 27-page order issued on December 17 held the company guilty on three broad counts, the fundamental being its failure to register itself as a "reporting entity" with the federal agency as mandated under the PMLA.
"... I, in exercise of powers conferred upon me under section 13(2)(d) of the PMLA, 2002 impose a total fine of Rs 96 lakh only on PayPal Payments Private Limited which will be commensurate with the violations committed by it," the order issued by FIU Director Pankaj Kumar Mishra said. It said that "there is ample evidence of the wilful violation of the law and, therefore, PayPal cannot be let off with a penalty that should normally be imposed for minor violations".

d) The order directs the company to pay the fine within 45 days and also register itself as a reporting entity with the FIU, appoint a principal officer and director for communication within a fortnight of the receipt of the order.

e) As per the order issued under section 13 of the PMLA, PayPal refused the FIU's directive and hence a show-cause notice was issued to it in September last year.

f) PayPal defended its action and cited Reserve Bank of India guidelines to state that it only operates as an Online Payment Gateway Service Provider (OPGSP) or a payment intermediary in India and is "not covered within the definition of a payment system operator or financial institution and in turn, not covered under the definition of a reporting entity under the PMLA".
"Therefore, at this time, payment intermediaries, such as PayPal, are not required to register as such with the FIU-India," it said in its reply to the agency. PayPal also stated that it has "submitted" to the RBI its decision to cease domestic payment aggregator business in India before June next year.

g) The FIU, however, rejected its claims and said PayPal was very much involved in the handling of funds in India, is a "financial institution" and hence qualifies to be a reporting entity under the PMLA.
"The business model offered by PayPal clearly indicated that it not only acts as an intermediary but actively undertakes money transfer operations...

"PayPal undertakes to settle an online transaction by moving money from the customer's account (issuing bank) to the merchant account, which ultimately transmits funds to the merchant's bank account (acquiring bank) when the transaction is finalised," the order said.
It added, "By virtue of enabling payment system for its users by way of credit card, debit card, money transfer operations, PayPal is functioning as a payment system operator and is therefore deemed to be a reporting entity..."

The order said while the company "defies" the process in India, its parent company in the US - PayPal Inc. - reports suspicious transactions to the American FIU and also to similar agencies in Australia and the UK.
Sharing of suspicious transaction reports by PayPal was "crucial" in enabling FIU to share such information with Indian law enforcement agencies and by refusing to register it was "not only concealing suspect financial transactions but is also abetting in the disintegration of India's financial system" and posing "enhanced risk to the financial system of India", the order said.
It noted that if PayPal's contention was accepted, the objective of the anti-money laundering law would be rendered "redundant" and other such entities "will find some reason to technically

escape being categorised as one (reporting entity) and frustrate the very purpose and object of the PMLA

h) PayPal appealed against the FIU's order before the Delhi High Court. In January 2021, the Court directed the Finance Ministry to constitute a committee comprising its own and Reserve Bank of India's nominee to decide the following question: should providers of payment gateway services be classified as payment system operators? Further, it stayed the December 17, 2020 order of the Financial Intelligence Unit (FIU) India imposing the penalty on PayPal, subject to the payment gateway maintaining records of all its transactions in a secure server and depositing within two weeks in the high court a bank guarantee of Rs 96 lakh. PayPal deposited the bank guarantee in the high court

i) In February 2021, The Centre told the Delhi High Court on Friday that it has set up a committee, as directed by it, on whether a company like PayPal can be considered a payment system operator as well as a reporting entity under the Prevention of Money Laundering Act (PMLA).

Review Questions

1. Record of transactions to be maintained under the Prevention of Money Laundering Act includes Cash transactions of the value of more than _____.

   (a) Rs.10 lakh

   (b) Rs. 20 lakh

   (c) Rs. 25 lakh

   (d) Rs. 1 crore

2. Cash Transactions Reports (CTR) for each month should be submitted to FIU-IND by:

   (a) 10th of the succeeding month

   (b) 15th of the succeeding month.

   (c) 20th of the succeeding month

   (d) 30th of the succeeding month

3. The Suspicious Transaction Report (STR) shall be submitted within _____days of arriving at a conclusion that any transaction, is of suspicious nature.

   (a) 14

   (b) 5

   (c) 7

   (d) 2

4. Written Anti-Money Laundering procedures need not include:

   (a) Policy for acceptance of clients

   (b) Procedure for identifying the clients

   (c) Transaction monitoring and reporting especially Suspicious Transactions Reporting (STR

   (d) None of the above

CHAPTER 10: SEBI (KYC REGISTRATION AGENCY) REGULATIONS, 2011

LEARNING OBJECTIVES:

After studying this chapter, you should know about:

- Registration of a KYC Registration Agency (KRA)
- Functions and obligations of KRA and intermediaries
- Code of conduct of KRA
- Guidelines for intermediaries, KRA's and in-person verification

10.1 Introduction

The provisions of The Prevention of Money Laundering Act, 2002 (PMLA), has made it mandatory for all Intermediaries to comply with the 'Know Your Client' (KYC) norms of the applicants desirous of trading / investing / dealing in the securities market. KYC means the procedure prescribed by SEBI for identifying and verifying the proof of address and identity and compliance with rules, regulations, guidelines and circulars issued by SEBI or any other authority for Prevention of Money Laundering from time to time.

SEBI on December 1, 2011 has notified the SEBI (KYC Registration Agency) Regulations, 2011. SEBI further issued the guidelines on December 23, 2011[12] to effectively implement the Regulations.

The SEBI (KYC Registration Agency) Regulations, 2011, hereinafter referred to as SEBI KRA Regulations provides that the KRA agency be registered with SEBI. The KRA is a centralized agency that will maintain and make available the information provided by a client to an intermediary to comply with the KYC norms

10.2 Registration as a KRA

SEBI shall consider the application for grant of certificate of registration as a KRA from an applicant who is a fit and proper person[13] and who belongs to one of the following categories as given below provided that any conflict of interest does not exist between the role of the applicant as KRA and other commercial activities of the applicant, its associates and group companies, namely:

(a) A wholly owned subsidiary of a recognized stock exchange, having a nation-wide network of trading terminals, or;

(b) A wholly owned subsidiary of a depository or any other intermediary registered with the Board or;

[12]SEBI Circular Ref. No. MIRSD/Cir- 26 /2011 December 23, 2011.

[13]As per the SEBI Intermediaries Regulations

(c) A wholly owned subsidiary of a Self-Regulatory Organization (SRO) registered under SEBI (Self-Regulatory Organization) Regulations, 2004.

The applicant also has to assure SEBI about the organizational capabilities, technology and systems and safeguards for maintaining data privacy and also measures undertaken for preventing unauthorized data sharing. Further, the applicant should also have a networth of at least Rs. 25 crore on a continuous basis.

Grant of Certificate of Registration

- The certificate of registration shall be valid unless it is suspended or cancelled by SEBI.
- The grant of certificate of registration shall be subject to the payment of such fees and in such manner as specified in Schedule II of these regulations.
- The KRA shall immediately intimate the Board, details of changes that have taken place in the information that was submitted while seeking registration.
- Where the KRA proposes change in control, it shall obtain prior approval of the Board for continuing to act as such after the change.

The KRA applicant shall pay the following fees:

i. Application Fee (non-refundable) – Rs. 50,000
ii. Registration Fees – Rs. 1,00,000
iii. Annual Fees – Rs. 1,00,000

10.3 Obligations on Surrendering Certificate of Registration

A KRA who wishes to surrender the certificate of registration must satisfy SEBI about the factors, as it may deem fit, including but not limited to the following:

- Arrangements made by KRA for maintenance and preservation of records and other documents required to be maintained under these regulations;
- Redressal of investor grievances;
- Transfer of records of its clients;
- Arrangements made by it for ensuring continuity of service to the clients;
- Defaults or pending action, if any.

On and from the date of the surrender or cancellation of the certificate, the KRA shall-

- return the certificate of registration which has been cancelled, to SEBI and shall not represent itself to be a holder of the certificate for carrying out the activity for which such certificate had been granted;
- cease to carry on any activity in respect of which the certificate had been granted;

- transfer its activities to another entity holding a valid certificate of registration to carry on such activity and allow its clients to withdraw any assignment given to it, without any additional cost to such client;
- make provisions as regards liability incurred or assumed by it;
- take such other action including the action relating to any records or documents that may be in custody or control of such person, within the time period and in the manner, as may be required under these regulations, or as may be directed by SEBI.

10.4 Functions and Obligations of KRA and Intermediary

The KRA shall obtain the KYC documents of the client from the intermediary. The documents shall be as prescribed by SEBI and in terms of the rules, regulations, guidelines and circulars issued by SEBI or any other authority for Prevention of Money Laundering, from time to time.

10.4.1 Functions and Obligations of KRA

KRA shall:

a) Prepare the Operating Instructions in co-ordination with other KRA(s) and issue the same to implement the requirements of these regulations.

b) Have electronic connectivity with other KRAs in order to establish interoperability[14] among KRAs.

c) Have a secure data transmission link with other KRA(s) and with each intermediary that uploads the KYC documents on its system and relies upon its data.

d) Be responsible for storing, safeguarding and retrieving the KYC documents and submit to SEBI or any other statutory authority as and when required.

e) KRA shall carry out an independent validation of the KYC records uploaded onto its system by the intermediary in such a manner as specified by the Board from time to time.

f) Retain the KYC documents of the client, in electronic form for the period specified by rules made under the Prevention of Money Laundering Act, 2002 (15 of 2003), as well as ensuring that retrieval of KYC information is facilitated within the stipulated time period.

g) Any information updated about a client shall be disseminated by KRA to all intermediaries that avail of the services of the KRA in respect of that client.

h) Ensure that the integrity of the automatic data processing systems for electronic records is maintained at all times.

[14]Inter-operability means the ability of the KRA to determine whether the KYC documents of the client are in the custody of another KRA.

i) Take all precautions necessary to ensure that the KYC documents/records are not lost, destroyed or tampered with and that sufficient backup of electronic records is available at all times at a different place.

j) Have adequate mechanisms for the purposes of reviewing, monitoring and evaluating its controls, systems, procedures and safeguards.

k) Cause an audit of its controls, systems, procedures and safeguards to be carried out periodically and take corrective actions for deficiencies, if any and report to SEBI.

l) Take all reasonable measures to prevent unauthorized access to its database and have audit of its systems and procedures at regular intervals as specified by the SEBI from time to time.

m) Have checks built in its system so that an intermediary can access the information only for the clients who approach him.

n) Appoint a compliance officer who shall be responsible for monitoring the compliance of the Act, rules and regulations, notifications, guidelines, instructions, etc., issued by SEBI or the Central Government and for redressal of client's grievances. The compliance officer shall immediately and independently report to SEBI any non-compliance observed by him.

o) Send a letter to each client after receipt of the KYC documents from the intermediary, confirming the client's details thereof.

p) Take adequate steps for the redressal of the grievances of the clients within one month of the date of receipt of the complaint and keep the client and SEBI informed about the number, nature and other particulars of the complaints from such investors. KRAs are also required to develop the monitoring mechanism through internal audits and inspections and encourage investors to use SCORES for lodging their grievances.

q) KRA shall maintain an audit trail of any upload/ modification /download regarding the KYC records of each client.

10.4.2 Functions and Obligations of the Intermediary

The Intermediary has the following functions and obligations –

a) The intermediary shall perform the initial KYC/due diligence of the client, upload the KYC information with proper authentication on the system of the KRA, furnish the scanned images of the KYC documents to the KRA, and retain the physical KYC documents:

   Provided that in the case of clients of a mutual fund, the Registrar to an Issue and Share Transfer Agent appointed by the mutual fund may perform the initial KYC/due diligence of the client, upload the KYC information with proper authentication on the system of the KRA, and furnish the scanned images of KYC documents to the KRA.

b) The intermediary or the mutual fund, as the case may be, shall furnish the physical KYC documents or authenticated copies thereof to the KRA, whenever so desired by the KRA.

c) When the client approaches another intermediary subsequently, the intermediary shall verify and download the client's details from the system of KRA:

Provided that upon receipt of the information on the change in KYC details and status of the clients by the intermediary or when it comes to the knowledge of the intermediary, at any stage, the intermediary shall be responsible for uploading the updated information on the system of KRA and retaining the physical documents.

d) An intermediary shall not use the KYC data of a client obtained from the KRA for purposes other than it is meant for; nor shall it make any commercial gain by sharing the same with any third party including its affiliates or associates.

e) The intermediary shall have the ultimate responsibility for the KYC of its clients, by undertaking enhanced KYC measures commensurate with the risk profile of its clients.

f) The intermediary shall integrate its systems with the KRA to facilitate seamless movement of KYC documents to and from the intermediary to the KRA.

10.5 Code of Conduct for KRA

1. A KRA shall make all efforts to protect the interest of its clients.
2. It should maintain high standards of integrity, dignity and fairness in the conduct of its business and fulfil its obligations in a prompt, ethical and professional manner.
3. A KRA shall at all times exercise due diligence, ensure proper care and exercise independent professional judgment. It should ensure that any change in registration status/any penal action taken by SEBI or any material change in a financial position that may adversely affect the interests of clients is promptly displayed on its website.
4. A KRA shall not divulge to anybody either orally or in writing, directly or indirectly, any confidential information about the clients which has come to its knowledge, without taking prior permission of its clients, except where such disclosures are required to be made in compliance with any law for the time being in force.
5. A KRA shall not indulge in any unfair competition. It shall display on its website adequate and appropriate information about its business, including contact details of persons and services available to clients.
6. All investor grievances should be redressed in a timely and appropriate manner. A KRA shall make reasonable efforts to avoid misrepresentation and ensure that the information provided to the clients and intermediaries is not misleading.
7. A KRA shall abide by the provisions of the Act and the rules, regulations issued by the Government and SEBI, from time to time, as may be applicable. It shall not make an untrue statement or suppress any material fact in any documents, reports, papers or information furnished to SEBI.

8. A KRA shall ensure that SEBI is promptly informed about any action, legal proceeding, etc., initiated against it in respect of any material breach or non-compliance by it, of any law, rules, regulations and directions of SEBI or any other regulatory body.
9. (a) A KRA or any of his employees shall not render, directly or indirectly, any investment advice about any security in the publicly accessible media; (b) A KRA shall not make a recommendation to any client who might be expected to rely thereon to acquire, dispose of or retain any securities.
10. A KRA shall ensure that any person it employs or appoints to conduct business is fit and proper and otherwise qualified to act, in the capacity so employed or appointed including having relevant professional training or experience.
11. A KRA shall have internal control procedures and financial and operational capabilities which can be reasonably expected to protect its operations, its clients from financial loss arising from theft, fraud, and other dishonest acts, professional misconduct or omissions. The KRA shall be responsible for the acts or omissions of its employees with respect to the conduct of its business.
12. A KRA shall provide adequate freedom and powers to its compliance officer for the effective discharge of its duties.
13. A KRA shall ensure that the senior management, particularly decision-makers have access to all relevant information about the business on a timely basis.
14. A KRA shall ensure that good corporate policies and corporate governance are in place.
15. A KRA should have adequately trained staff and arrangements to render fair, prompt and competent services to its clients.
16. A KRA shall develop its own internal code of conduct for governing its internal operations and laying down its standards of appropriate conduct for its employees and officers in the carrying out of their duties. Such a code may extend to the maintenance of professional excellence and standards, integrity, confidentiality, objectivity, avoidance of conflict of interests, disclosure of shareholdings and interests, etc.
17. KRA shall not be a party to (a) creation of false market; (b) price rigging or manipulation; (c) passing of unpublished price sensitive information in respect of securities which are listed and proposed to be listed in any stock exchange to any person or intermediary.
18. A KRA shall maintain a proper inward and outward system for all types of mail received and dispatched in all forms.
19. A KRA shall follow the maker-checker concept in its activities to ensure the accuracy of data.

20. A KRA shall not indulge in manipulative, fraudulent practices in the process of identification, verification and updation of a Client's KYC information with a view to distorting market equilibrium or making personal gains.

10.6 Guidelines for Intermediaries, KRAs and In-person Verification

For Intermediaries:

i. Once the initial KYC of the new clients are done, the intermediary shall immediately upload the KYC information on the system of the KRA and send the KYC documents (KYC application form and supporting documents of the clients) to the KRA within 10 working days from the date of execution of documents by the client and maintain the proof of dispatch.

ii. In case a client's KYC documents which have been sent to KRA is incomplete, the same shall be communicated to the intermediary who shall forward the required information / documents promptly to KRA.

iii. While uploading the clients' data the intermediary shall ensure that there is no duplication of data in the KRA system.

iv. The intermediary shall carry out KYC when the client chooses to trade/ invest / deal through it.

v. The intermediary is also required to follow the risk-based due diligence approach. Also, they are required to conduct ongoing client due diligence based on the risk profile and financial position of the clients as prescribed by SEBI.

vi. The intermediaries shall also maintain electronic records of KYCs of clients and keeping physical records would not be necessary. It shall promptly provide KYC related information to KRA, as and when required.

vii. The intermediary shall have adequate internal controls to ensure the security /authenticity of data uploaded by it.

For KRAs:

i. KRA system shall provide KYC information in data and image form to the intermediary.

ii. KRA shall send a letter to the client within 10 working days of the receipt of the initial/updated KYC documents from intermediary, confirming the details thereof and maintain the proof of dispatch.

iii. KRA(s) shall develop systems, in coordination with each other, to prevent duplication of entry of KYC details of a client and to ensure uniformity in formats of uploading / modification / downloading of KYC data by the intermediary.

iv. KRA shall maintain an audit trail of the upload / modifications / downloads made in the KYC data, by the intermediary in its system.

v. KRA shall ensure that a comprehensive audit of its systems, controls, procedures, safeguards and security of information and documents is carried out annually by an independent auditor. The Audit Report along with the steps taken to rectify the deficiencies, if any, shall be placed before its Board of Directors. Thereafter, the KRA shall send the Action Taken Report to SEBI within 3 months.

vi. KRA systems shall clearly indicate the status of clients falling under PAN exempt categories.

vii. A client can start trading/investing/dealing with the intermediary and its group/subsidiary/ holding company as soon as the initial KYC is done and other necessary information is obtained. The remaining process of KRA can still be in progress at that time.

viii. KRA is also required to follow the risk-based due diligence approach. Also, they are required to conduct ongoing client due diligence based on the risk profile and financial position of the clients as prescribed by SEBI.

SEBI KRA Regulations, 2011, has been amended on January 28, 2022 vide a Gazette Notification No. SEBI/LAD-NRO/GN/2022/72. With a view to implement the regulations effectively, the additional guidelines have been issued by SEBI, such as;

- KRAs shall continue to act as repository of KYC data in the securities market andshall be responsible for storing, safeguarding and retrieving the KYC documents and submit to the Board or any other statutory authority as and when required.
- KRAs shall independently validate records of those clients (existing as well as new) whose KYC has been completed using Aadhaar as an OVD. The records of those clients whohave completed KYC using non-Aadhaar OVD shall be validated only upon receiving the Aadhaar Number.
- During the process of validation, KRAs shall validate the following details:
  a. Aadhaar through Unique Identification Authority of India (UIDAI) authentication/verification mechanism.
  b. Mobile number and e-mail ID using OTP validation (only in cases where mobile number and e-mail ID provided by client are not seeded with Aadhaar)
  c. PAN using the Income Tax Database.[15]

[15] https://www.sebi.gov.in/legal/circulars/apr-2022/guidelines-in-pursuance-of-amendment-to-sebi-kyc-registration-agency-kra-regulations-2011_57676.html
https://www.sebi.gov.in/legal/circulars/jul-2022/implementation-of-circular-on-guidelines-in-pursuance-of-amendment-to-sebi-kyc-know-your-client-registration-agency-kra-regulations-2011-_61220.html

In-Person Verification (IPV):

To bring uniformity in the KYC procedure across intermediaries, the IPV requirements for all the intermediaries have been streamlined by SEBI. Intermediaries registered with SEBI as Stock Brokers, KRAs, Depository Participants, Mutual Funds, Portfolio Managers, Venture Capital Funds and Collective Investment Schemes need to mandatorily carry out IPV for all their clients. The intermediary has to ensure that the details of the person carrying out the IPV are recorded on the KYC form at the time of IPV. The IPV carried out by one SEBI registered intermediary shall be relied upon by another intermediary. For Stock Brokers, their Authorised persons may perform the IPV.

Case 10.1: **SEBI order in the case of M/s Tradebulls Securities Private Limited**

SEBI conducted an inspection to look into the Know Your Client (KYC) procedures followed by M/s. Tradebulls Securities (P) Ltd.(TSL) . The inspection was conducted on May 28-29, 2013. During such inspection, from the sample check of 17 KYCs carried out at the TSL's Registered Office in Ahmedabad.

Facts of the case:

a) There was substantial delay by the TSL in implementing the SEBI Circular No. CIR/MIRSD/16/2011 dated August 22, 2011 on KYC. The Inspection has alleged that the TSL continued with old KYC forms till March 01, 2012, which were supposed to be discontinued with effect from September 22, 2011;

b) There was a substantial delay in uploading KYC documents with KYC Registration Agency (KRA), though circular No. MIRSD/Cir-26/2011 dated December 23, 2011 inter alia stipulated that after doing the initial KYC of the new clients, the intermediary shall forthwith upload the KYC information on the system of the KRA and send the KYC documents i.e. KYC application form and supporting documents of the clients to the KRA within 10 working days from the date of execution of documents by the client and maintain the proof of dispatch. On perusal of the back-office data for the period from March 2013 to May 2013, it was observed that the delay in uploading KYC forms in 172 cases was in the range of 14 to 253 days;

c) In respect of uploading of the details of 'existing clients' as required by SEBI Circular dated April 13, 2012, the Inspection team noted that the TSL had delayed implementation of the said SEBI Circular dated April 13, 2012, and till the date of inspection had not uploaded KYC documents as required;

d) Clause-C of the Annexure-3 to SEBI Circular dated August 22, 2011 specifies the format wherein the client has to sign against each market segment in which he/she wishes to trade-in. However, from the new KYC form adopted by the TSL , it was observed that another column of check box had been added along with the signature of the client. It was also observed that in certain cases,

the clients had signed against all market segments. A copy of the same was provided to the TSL as Annexure-II in the Show Cause Notice (SCN). This practice followed by the broker was not found by the Inspection to be in line with the intent of the said SEBI Circular;

e) In certain cases, the client had signed at all places (individual/ non-individual/ declaration by HUF/ sole proprietorship, company etc) in KYC form, even which may not be applicable to him. It was also observed that in a majority of cases among sample size, there was a tick in the box that client had opted for not nominating anyone. It was observed that it was difficult to understand the reason why the majority of clients had opted not to nominate anyone and that it may apparently have happened as a client would have signed the nomination form, whereas the box for not nominating anyone would have been ticked later;

f) Clause 3(ii) of SEBI Circular dated December 23, 2011 required the intermediaries to ensure that the details of name of the person doing in-person verification (IPV), his/ her designation, organization with signature and date be recorded on the KYC format at the time of In-Person Verification. Inspection observed that though the official conducting IPV had signed the document, however, the name, designation and other details of the official carrying out IPV were not recorded by the TSL as required.

Issues for consideration:

- Whether TSL has violated the provisions of SEBI Circulars No. CIR/MIRSD/16/2011 dated August 22, 2011, No. MIRSD/Cir-2/2011 dated December 23, 2011 and No. MIRSD/Cir-5/2012 dated April 13, 2012?
- Whether further, TSL has violated the provisions of Clause A(1), A(2) and A(5) of the Code of Conduct specified under Schedule II read with Regulation 7 of the Brokers Regulations?
- Does the violation, if any, attract monetary penalty under Section 15 HB of SEBI Act?
- If so, what would be the monetary penalty that can be imposed taking into consideration the factors mentioned in Section 15J of SEBI Act?

Conclusion:

TSL has violated/ not complied with the provisions of SEBI Circular Nos. MIRSD/16/2011 dated August 22, 2011, MIRSD/Cir- 26/2011 dated December 23, 2011 and MIRSD/Cir-5/2012 dated April 13, 2012. Further, in view of such non-compliance, TSL has failed to adhere to the prescribed code of conduct in respect of the high standard of integrity, promptitude, fairness, due skill, care and diligence, and thereby did not abide by the Act, rules and regulations in term of Regulation 7 read with clauses A(1), A(2) and A(5) of code of conduct for stockbrokers, specified under Schedule II of Brokers Regulations.

In regard to the above violation/ non-compliance by TSL, the Adjudicating Officer has imposed monetary penalty under Section 15HB of the SEBI Act, which reads as under:

15HB. Penalty for contravention where no separate penalty has been provided-

Whoever fails to comply with any provision of this Act, the rules or the regulations made or directions issued by the Board thereunder for which no separate penalty has been provided, shall be liable to a penalty which may extend to one crore rupees."

Order:

After taking into consideration all the facts and circumstances of the case, the Adjudicating Officer imposed a penalty of Rs. 10,00,000/- (Rupees Ten Lakh only) against M/s. Tradebulls Securities Private Limited under Section 15HB of the SEBI Act, 1992 which will be commensurate with the violations.

Case 10.2: **SEBI v/s Aadinath Securities**

Facts of the case:

a) During the inspection of Aadinath Securities along with other observations it was noted that notice has not uploaded details of its client KYC as stipulated by SEBI in the KRA circular

b) Aadinath Securities claimed it has subsequently complied with the requirements and subsequent inspections conducted (Post Jan 2016) had no adverse findings pertaining to KYC and KRA indicating implementation of corrective action

Findings of the case:

a) In this case admittedly, notice has complied the compliance of the requirements of circulars dated December 23, 2011 and April 13, 2012 in this regard belatedly in December 2015 i.e., much beyond the permissible time.

The reason shown by Aadinath Securities is not plausible and Aadinath Securities cannot be exonerated for such inordinate delay in compliance of requirements for the reason forwarded by its reply.

b) Uniform KYC and uploading of information on the KRA portal are meant to protect the integrity of the securities market and to implement anti money laundering measures. The timelines stipulated therein are of the essence and cannot be ignored for such a long period as found in this case. The lapse of Aadinath Securities being a registered stockbroker clearly shows a lack of due diligence and care on its part. Lapse in this case with regard to non-compliance with these circulars are not venial and would attract penalty action in accordance with law

Order:

Monetary penalty of Rs 1 lakh on Aadinath Securities under section 15HB of SEBI Act, 1992 for defaults and failure as found herein.

Review Questions

1. To effectively implement the KYC guidelines, SEBI notified the _____.

   (a) SEBI (Self-Regulatory Organization) Regulations, 2004

   (b) PMLA, 2002

   (c) SEBI (KYC Registration Agency) Regulations, 2011

   (d) None of the above

2. KRA shall have secure data transmission links with _____ that uploads the KYC documents on its system.

   (a) Other KRAs

   (b) Intermediaries

   (c) Exchanges

   (d) Both (a) and (b)

3. Once the initial KYC of the new clients are done, the intermediary shall immediately upload the KYC information within _____ on the system of the KRA and send the KYC.

   (a) 5 working days

   (b) 7 working days

   (c) 10 working days

   (d) 15 working days

4. KRA systems shall clearly indicate the status of clients falling under PAN exempt categories. State whether TRUE or FALSE.

   (a) True

   (b) False

PART B – UNDERSTANDING INTERMEDIARY SPECIFIC REGULATIONS

CHAPTER 11: SEBI (FOREIGN PORTFOLIO INVESTORS) REGULATIONS, 2019

LEARNING OBJECTIVES:

After studying this chapter, you should know about:

- Eligibility Criteria of Foreign Portfolio Investors
- Approval to act as designated depository participant Investment Conditions and Restrictions

SEBI (Foreign Portfolio Investors) Regulations were formed to provide the framework for registration and procedures with regard to foreign investors who propose to make portfolio investment in India. As per the SEBI (Foreign Portfolio Investors) Regulations, 2019, the Foreign Portfolio Investor means a person who satisfies the eligibility criteria as provided under Regulation 4 of the said SEBI regulations and shall be deemed to be an intermediary in terms of provision of Act.

11.1 Eligibility Criteria of Foreign Portfolio Investors

As per the SEBI (Foreign Portfolio Investors) Regulations, the designated depository participant shall not consider an application for grant of certificate of registration as a foreign portfolio investor unless the applicant satisfies the following conditions, namely-

a) the applicant is not a resident Indian;

b) the applicant is not a non-resident Indian or an overseas citizen of India;

c) non-resident Indians or overseas citizens of India or resident Indian individuals may be constituents of the applicant provided they meet conditions specified by the Board from time to time

However, resident Indian other than individuals, may also be constituents of the applicant, subject to the following conditions, namely –

(i) such resident Indian, other than individuals, is an eligible fund manager of the applicant, as provided under sub-section (4) of section 9A of the Income Tax Act, 1961 (43 of 1961); and

(ii) the applicant is an eligible investment fund as provided under sub-section (3) of section 9A of the Income Tax Act, 1961 (43 of 1961) which has been granted approval under the Income Tax Rules, 1962

It is further provided that resident Indian, other than individuals, may also be constituents of the applicant, subject to the following conditions, namely –

(i) the applicant is an Alternative Investment Fund setup in the International Financial Services Centres and regulated by the International Financial Services Centres Authority;

(ii) such resident Indian, other than individuals, is a Sponsor or Manager of the applicant; and

(iii) the contribution of such resident Indian, other than individuals, shall be up to-

(a) 2.5% of the corpus of the applicant or US $ 7,50,000 (whichever is lower), in case the applicant is a Category I or Category II Alternative Investment Fund; or

(b) 5% of the corpus of the applicant or US $ 1.5 million (whichever is lower), in case the applicant is a Category III Alternative Investment Fund

d) The applicant is a resident of a country whose securities market regulator is a signatory to the International Organisation of Securities Commissions Multilateral Memorandum of Understanding or a signatory to bilateral MoU with SEBI. Provided that an applicant being Government or Government related investor shall be considered as eligible for registration if such applicant is a resident in the country as may be approved by the Government of India

e) The applicant being a bank is a resident of a country whose central bank is a member of the Bank for International Settlements. Provided that a central bank applicant need not be a member of Bank for International Settlements;

f) The applicant or its underlying investors contributing twenty-five per cent or more in the corpus of the applicant or identified on the basis of control, shall not be the person(s) mentioned in the Sanctions List notified from time to time by the United Nations Security Council and is not a resident in the country identified in the public statement of Financial Action Task Force as:

    a. A jurisdiction having a strategic Anti-Money Laundering or Combating the Financing of Terrorism deficiencies to which counter measures apply; or

b. A jurisdiction that has not made sufficient progress in addressing the deficiencies or has not committed to an action plan developed with the Financial Action Task Force (FATF) to address the deficiencies;

g) The applicant is a fit and proper person based on the criteria specified in Schedule II of the SEBI (Intermediaries) Regulations, 2008, and

h) Any other criteria specified by SEBI from time to time.

i) However, clause (a), (d) and (e) shall not apply to an applicant incorporated or established in an International Financial Services Centre.

11.2 Categories of Foreign Portfolio Investor

An applicant shall seek registration as a foreign portfolio investor in one of the categories mentioned below or any other category as may be specified by SEBI from time to time:

FPI Category	Type of entity
Category-I	(i) Government and Government related investors such as central banks, sovereign wealth funds, international or multilateral organizations or agencies including entities controlled or at least 75% directly or indirectly owned by Government and Government related investor (ii) Pension funds and university funds; (iii) Regulated entities such as insurance or reinsurance entities, banks, asset management companies, investment managers, investment advisors, portfolio managers, broker-dealers and swap dealers; (iv) Entities from the FATF member countries or from any country specified by the Central Government by an order or by way of an agreement or treaty with other sovereign Governments (v) An entity (A) whose investment manager is from the Financial Action Task Force member country and such an investment manager is registered as a Category I foreign portfolio investor; or (B) which is at least seventy-five per cent owned, directly or indirectly by another entity, eligible under sub-clause (ii), (iii) and (iv) of clause (a) of this regulation and such an eligible entity is from a Financial Action Task Force member country: Provided that such an investment manager or eligible entity undertakes the responsibility of all the acts of commission or omission of the applicants seeking registration under this sub-clause.
Category-II	i) Regulated funds not eligible as Category-I foreign portfolio investor;

	ii) Endowments and foundations; iii) Charitable organisations; iv) Corporate bodies; v) Family offices; vi) Individuals; vii) Regulated entities investing on behalf of their client, as per conditions specified by SEBI from time to time viii) Unregulated funds in the form of limited partnership and trusts

An applicant incorporated or established in an International Financial Services Centre shall be deemed to be appropriately regulated.

11.3 Approval to act as a designated depository participant

1. No person shall act as a designated depository participant (DDP) unless it has obtained the approval of the SEBI
2. An application for approval to act as designated DP shall be made to SEBI through the depository in which the applicant has an agreement to act as a participant and shall be accompanied by the application fee.
3. The depository shall forward the application to SEBI, as early as possible, but no later than 30 days from the date of receipt by the depository, along with its recommendations and after certifying that the participant complies with the eligibility criteria as provided for in these regulations.

11.3.1 Eligibility Criteria of designated Depository Participant

SEBI shall not consider an application for the grant of approval as a designated depository participant unless the applicant satisfies the following conditions:

(a) the applicant is a registered depository participant under the SEBI (Depositories and Participants) Regulations, 1996;
(b) the applicant is a registered Custodian under the SEBI (Custodian) Regulations, 1996;
(c) the applicant is an Authorised Dealer Category-1 bank authorised by the Reserve Bank of India under the Foreign Exchange Management Act, 1999;
(d) the applicant has a multinational presence, either through its branches or through agency relationships with overseas intermediaries regulated in their respective home jurisdictions;
(e) the applicant has systems and procedures to comply with the requirements of the Financial Action Task Force Standards, PMLA, 2002, Rules prescribed thereunder and the circulars issued from time to time by the Board;
(f) the applicant is a fit and proper person based on the criteria specified in Schedule II of the SEBI (Intermediaries) Regulations, 2008; and

(g) any other criteria as may be specified by the SEBI from time to time. Notwithstanding anything as mentioned above, SEBI may consider an application from an entity, regulated in India or in its home jurisdiction, for grant of approval to act as designated depository participant, upon being satisfied that the applicant has sufficient experience in providing custodial services and that the grant of such approval is in the interest of the development of the securities market:

Such entity shall be registered with the SEBI as a participant and custodian and shall have a tie-up with Authorised Dealer Category-1 bank.

11.4 Investment Conditions and Restrictions

Regulation 20 of the SEBI (Foreign Portfolio Investors) Regulations, 2019 specifies the investment restrictions.

1. A foreign portfolio investor shall invest only in the following securities, namely-

(a) shares, debentures and warrants issued by a body corporate; listed or to be listed on a recognized stock exchange in India;

(b) units of schemes launched by mutual funds under Chapter V, VI-A and VI-B of the Securities and Exchange Board of India (Mutual Fund) Regulations, 1996;

(c) units of schemes floated by a Collective Investment Scheme in accordance with the Securities and Exchange Board of India (Collective Investment Schemes) Regulations, 1999;

(d) derivatives traded on a recognized stock exchange;

(e) units of Real Estate Investment Trusts, Infrastructure Investment Trusts and units of Category III Alternative Investment Funds registered with the Board;

(f) Indian Depository Receipts;

(g) any debt securities or other instruments as permitted by the Reserve Bank of India for foreign portfolio investors to invest in from time to time; and

(h) such other instruments as specified by the Board from time to time. (2) Where a foreign portfolio investor, prior to commencement of these regulations, holds equity shares in a company whose shares are not listed on any recognised stock exchange and continues to hold such shares after the initial public offering and listing thereof, such shares shall be subject to lock-in for the same period, if any, as is applicable to shares held by a foreign direct investor placed in similar position, under the policy of the Government of India relating to foreign direct investment for the time being in force.

(2) In respect of investments in the secondary market, the following additional conditions shall apply:

(a) A foreign portfolio investor shall transact in the securities in India only on the basis of taking and giving delivery of securities purchased or sold;

(b) Nothing contained in clause (a) shall apply to –

(i) any transactions in derivatives on a recognized stock exchange;

(ii) short-selling transactions in accordance with the framework specified by the Board;

(iii) any transaction in securities pursuant to an agreement entered into with the merchant banker in the process of market making or subscribing to an unsubscribed portion of the issue as per the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018;

(iv) any other transaction specified by the Board;

(c) The transaction involving dealing in securities by a foreign portfolio investor shall be only through stockbrokers registered with the Board;

(d) Nothing contained in clause (c) of this sub-regulation shall apply to –

(i) transactions in Government securities and such other securities falling under the purview of the Reserve Bank of India carried out in the manner as specified by the Reserve Bank of India;

(ii) sale of securities in response to a letter of offer sent by an acquirer in accordance with the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011;

(iii) sale of securities in response to an offer made by any promoter or acquirer in accordance with the SEBI (Delisting of Equity Shares) Regulations, 2009;

(iv) sale of securities in accordance with the SEBI (Buy-back of Securities) Regulations, 2018;

(v) divestment of securities in response to an offer by Indian companies in accordance with Operative Guidelines for Disinvestment of Shares by Indian Companies in the overseas market through the issue of American Depository Receipts or Global Depository Receipts as notified by the Government of India from time to time;

(vi) any bid for, or acquisition of, securities in response to an offer for disinvestment of shares made by the Central Government or any State Government;

(vii) any transaction in securities pursuant to an agreement entered into with merchant banker in the process of market making or subscribing to an unsubscribed portion of the issue as per the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018;

(viii) transactions in corporate bonds by foreign portfolio investors;

(ix) transactions on the electronic book provider platform of recognised stock exchanges;

(x) transactions to receive, hold and sell unlisted securities as referred at regulation 20(2) and transactions in unlisted securities received through involuntary corporate actions including a scheme of a merger or demerger approved in accordance with the provisions of the Companies Act, 2013 as well as the applicable guidelines issued by the Board or pursuant to implementation of any resolution plan approved under the Insolvency and

Bankruptcy Code, 2016 or in accordance with the guidelines issued by the Government of India or the Reserve Bank of India or any other regulator for a scheme of debt resolution: Such unlisted holdings of the foreign portfolio investor shall be treated as Foreign Direct Investment;

(xi) transactions for the transfer of right entitlements;

(xii) purchase or sale transactions of illiquid or suspended or delisted securities by a foreign portfolio investor;

Illiquid securities shall mean those securities that are not frequently traded in terms of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018;

(xiii) transactions between registered foreign portfolio investors, who are multi-investment manager structure of the same beneficial owner and have common Permanent Account Number; and

(xiv) any other transaction as may be specified by the SEBI;

(e) A foreign portfolio investor shall hold, deliver or cause to be delivered securities only in the dematerialized form:

However, any shares held in the physical form, before the commencement of these regulations, may continue to be held in the physical form, if such shares cannot be dematerialised. It is further stated that all the Rights Entitlements may be held or transferred in non-dematerialized form.

(4) In respect of investments in the debt securities, the foreign portfolio investors shall also comply with terms, conditions or directions, specified or issued by SEBI or Reserve Bank of India, from time to time, in addition to other conditions specified in these regulations.

(5) Unless otherwise approved by SEBI, securities shall be registered in the name of the foreign portfolio investor as a beneficial owner as defined under the Depositories Act, 1996.

(6) The purchase of equity shares of each company by a single foreign portfolio investor including its investor group shall be below ten per cent of the total paid-up equity capital on a fully diluted basis of the company:

Where the total investment under these regulations by a foreign portfolio investor including its investor group exceeds the threshold of below ten per cent of the total paid-up equity capital in a listed or to be listed company on a fully diluted basis, the foreign portfolio investor shall divest the excess holding within five trading days from the date of settlement of the trades resulting in the breach: Provided further that in case the foreign portfolio investor fails to divest the excess holding, the entire investment in the company by such foreign portfolio investor including its investor group shall be considered as an investment under the Foreign Direct Investment, as per the procedure specified by the Board and the foreign portfolio investor and its investor group shall not make further portfolio investment in that company under these regulations,

(7) An entity, registered as a foreign portfolio investor shall be permitted to invest in Indian securities as a person resident outside India in accordance with provisions of the Foreign Exchange Management Act, 1999, rules and regulations made thereunder].

(8) A foreign portfolio investor may lend or borrow securities in accordance with the framework specified by the SEBI in this regard.
(9) The investment by the foreign portfolio investor shall also be subject to such other conditions and restrictions as may be specified by the Government of India from time to time.

11.5 Suspension, cancellation or surrender of certificate

1) Registration granted by the designated depository participant on behalf of SEBI under these regulations shall be permanent unless suspended or cancelled by SEBI or surrendered by the foreign portfolio investor.

2) Suspension and Cancellation of certificate of registration granted by SEBI under these regulations shall be dealt with in the manner as provided in chapter V of SEBI Intermediaries Regulation, 2008.

3) Any foreign portfolio investor desirous of surrendering the certificate of registration may request for such surrender to the designated depository participant who shall accept the surrender of the certificate of registration after obtaining approval from SEBI. While accepting surrender applications, depository participants may impose such conditions as may be specified by SEBI.

SEBI vide its circular SEBI/HO/IMD/FPI&C/CIR/P/2021/045 dated March 30, 2021 advised designated depository participants to adhere to the following guidelines:
a) While making an application to SEBI for seeking a No objection certificate (NOC) for surrender, the DDP shall confirm the following with respect to the FPI.
i) Accounts held by the applicant in the capacity of FPI have nil balance and are blocked for further transactions. Further, the CP code of the FPI is also blocked.
ii) There are no dues /fees pending towards SEBI
iii) There are no actions /proceedings pending against the said applicant.

b) DDP shall ensure to execute the following within 10 days from the date of receipt of NOC from SEBI
i) all the accounts (including bank account and securities account) held by the applicant in the capacity of FPI are closed and
ii) the Custodial Participant (CP) code is deactivated.

11.6 Conditions for Issuance of Offshore Derivative Instruments

(1) No foreign portfolio investor may issue, subscribe to or otherwise deal in offshore derivative instruments, directly or indirectly, unless the following conditions are satisfied:

(a) such offshore derivative instruments are issued only by persons registered as Category I foreign portfolio investor;

(b) such offshore derivative instruments are issued only to persons eligible for registration as Category I foreign portfolio investors;

For the purpose of this sub-regulation, where an entity has an investment manager SEBI who is from the Financial Action Task Force member country, the investment manager shall not be required to be registered as a Category I foreign portfolio investor;

(c) such offshore derivative instruments are issued after compliance with the 'know your client' norms as specified by the Board; and

(d) such other conditions as may be specified by the Board from time to time.

(2) A foreign portfolio investor shall ensure that any transfer of offshore derivative instruments issued by or on behalf of it, is made subject to the following conditions:

(a) such offshore derivative instruments are transferred to persons subject to fulfilment of sub-regulation (1); and

(b) prior consent of the foreign portfolio investor is obtained for such transfer, except when the persons to whom the offshore derivative instruments are to be transferred are pre-approved by the foreign portfolio investor.

(3) A foreign portfolio investor shall fully disclose to the SEBI any information concerning the terms of and parties to off-shore derivative instruments, by whatever names they are called, entered into by it relating to any securities listed or proposed to be listed in any stock exchange in India, as and when and in such form as the Board may specify.

(4) A foreign portfolio investor shall collect the regulatory fee, from every subscriber of the offshore derivative instrument issued by it and deposit the same with the SEBI.

11.7 Code of Conduct for foreign portfolio investor

1) A foreign portfolio investor and its key personnel shall observe high standards of integrity, fairness and professionalism in all dealings in the Indian securities market with intermediaries, regulatory and other government authorities.

2) A foreign portfolio investor shall, at all times, render high standards of service, exercise due diligence and independent professional judgment.

3) A foreign portfolio investor shall ensure and maintain confidentiality in respect of trades done on its own behalf or on behalf of its clients.

4) A foreign portfolio investor shall ensure the following

(a) Clear segregation of its own money and securities and that of its client's money and securities.

(b) Arm's length relationship between its business of fund management/investment and its other business.

5) A foreign portfolio investor shall maintain an appropriate level of knowledge and competency and abide by the provisions of the Act, regulations made thereunder and the circulars and guidelines, which may be applicable and relevant to the activities carried on by it. Every foreign portfolio investor shall also comply with the award of the Ombudsman and the decision of the Board under Securities and Exchange Board of India (Ombudsman) Regulations, 2003.

6) A foreign portfolio investor shall not make any untrue statement or suppress any material fact in any documents, reports or information to be furnished to the designated depository participant and/or Board

7) A foreign portfolio investor shall ensure that good corporate policies and corporate governance policies are observed by it.

8) A foreign portfolio investor shall ensure that it does not engage in fraudulent and manipulative transactions in the securities listed in any stock exchange in India.

9) A foreign portfolio investor or any of its directors or managers shall not, either through its/his own account or through an associate or family members, relatives or friends indulge in any insider trading.

10) A foreign portfolio investor shall not be a party to or instrumental for –
a) creation of a false market in securities listed or proposed to be listed in any stock exchange in India;
b) price rigging or manipulation of prices of securities listed or proposed to be listed in any stock exchange in India;
c) passing of price-sensitive information to any person or intermediary in the securities market

SEBI vide its circular no. IMD/FPI&C/CIR/P/2019/124 dated November 5, 2019 has issued operational guidelines (OG) for FPI's, Designated Depository Participants and eligible foreign investors. The OG are issued to facilitate the implementation of the 2109 Regulations. The 2019 Regulations made several transformational changes which included a reduction in the number of FPI categories from three to two, removal of broad-based criteria, granting category 1 status to certain entities based on FATF member countries, permitting off-market of certain securities, enabling set up of IFSC etc. The OG provides further clarity on the aforementioned amendments primarily relating to the re-categorisation of FPI, permitting appropriately regulated entities such as private banks to invest on behalf of their clients without the need to have a common portfolio, streamlining KYC requirements, removing opaque structures etc.[16]

[16]SEBI has issued a master circular superseding the OG: https://www.sebi.gov.in/legal/master-circulars/dec-2022/master-circular-for-foreign-portfolio-investors-designated-depository-participants-and-eligible-foreign-investors_66356.html

The OG are divided into the following sections
1) FPI registration-related activities
2) KYC requirements for FPIs
3) Investment conditions/restriction on FPI
4) Issuance of Offshore derivative instruments (ODI) by FPI
5) Participation /functioning of eligible foreign portfolio investors (EFIs) in IFSC

Some Key features mentioned in OG are as follows:
1) FPI Registration related activities
a) Re-categorisation of registration shall be carried out depositories in consultation with DDP's
b) Appropriately regulated entities such as banks, AMC, IAs, portfolio managers, insurance/reinsurance entities are permitted to invest on behalf of their clients after obtaining Category II registration subject to fulfilment of conditions prescribed therein.
c) FPIs to provide beneficial owner (BO) declaration for each fund/sub-fund/share class/equivalent structure having segregated portfolio before investing in India
d) FPI's to ensure that sub-fund/share class/equivalent structures who do not adhere to requirement shall not invest in India
e) Resident India's/NRIs/OCIs are permitted to be constituent of FPI provided prescribed conditions are met.
f) Where there is a change in status of contracting jurisdiction i.e., FPI was in compliant jurisdiction at the time of registration certificate and thereafter it turns into non-compliant jurisdiction or jurisdiction of high risk as per FATF statement, such FPI shall not be allowed to make fresh purchases till the jurisdiction/FPI becomes compliant. FPI will be allowed to sell already purchased securities.

2) KYC requirements
a) Category I FPIs from high-risk jurisdiction other than government entities to comply with KYC requirements for category II FPIs
b) For non-pan KYC document, reliance to be placed on same group regulated entity of custodian provided the entity is from FATF member country
c) Category I FPIs being government entities are exempted from providing details of BO.
d) PAN is not mandatory for BO/senior management/authorized signatories of FPIs and UN entities/multilateral agencies which are exempt from payment of taxes/filing returns in India.

3) Investment conditions/restriction on FPI
a) FPIs are permitted to sell off-market unlisted, illiquid, suspended and delisted shares in accordance with pricing guidelines for such sale as per FEMA
b) FPIs are eligible to invest in corporate debt issues which are to be listed without any end-use restriction as applicable to unlisted debt securities. However, if listing does not happen within 30

days or the issue is not meeting end-use restriction, FPI shall immediately dispose of such investment to domestic investor or issuer.

c) Where the total investment by FPI/and or its investor group in a company is 10% or more of its equity capital on a fully diluted basis, and the same is treated as FDI

i) FPI/investor group to inform custodian of its choice

ii) no further portfolio investment shall be permitted by such FPI/investor group in such company

iii) sale of such investment shall be made under the same route as acquired

4) Issuance of Offshore Derivative Instruments (ODI) by FPI,

a) Separate FPI registration are required for ODI and proprietary derivative instruments

b) ODI issuing FPI is not permitted to co-mingle its non-derivative proprietary investments and ODI hedge investment with its proprietary derivative investment or vice versa under the same FPI registration

c) Clubbing provisions as provided in 2019 regulations also apply to ODI

d) ODI issuing FPIs are required to identify and verify the BOs in the ODI subscriber entities in the same manner as applicable to FPIs

e) KYC review of high-risk ODI subscribers should be done annually whereas low-risk ODI subscribers should be done once in three years

5) Participation /functioning of eligible foreign portfolio investors (EFIs) in IFSC

a) EFIs operating in IFSC shall not be treated as entities regulated by SEBI

b) In case of EFI not registered with SEBI as FPI and also not having a bank account in IFSC, KYC of category II FPIs shall apply. PAN shall not be applicable to KYC purpose to EFIs in IFSC

Case 11.1: **SEBI v/s HSBC (DDP and Custodian) in the matter of Pathway Finance Societe a Responsibility Limtee**

Facts of the case:

a) HSBC is designated depository participant (DDP) and Custodian of FPI – Pathway Finance Societe

b) Violation observed of Regulation 32(1)(e) and 32(2)(f) of SEBI (Foreign Portfolio Investors) Regulations, 2014, Clauses 5.1.3, 5.1.4 and 5.6.2 of Operational guidelines of DDP's issued vide SEBI Circular No. CIR/IMD/FIIC/02/2014 dated January 08, 2014 and against HSBC Custodian for violation of Regulation 26(2)(b) of FPI Regulations and Clause 3 of the Code of Conduct for Custodian of Securities as stipulated in Schedule III read with Regulation 12 of SEBI (Custodian of Securities) Regulations, 1996

c) Based on the submissions made by the FPI regarding the change in name of the FPI, change in ownership and change in jurisdiction, it was alleged that the entity to which FPI registration was granted, no longer exists. Therefore, any investment activity undertaken by the FPI in India post

undergoing the said changes (in January 2017), was allegedly ultra vires despite knowing that the current FPI registration was no longer valid, the said FPI was able to make an investment in corporate debt and sent the instructions for funding to the custodian on December 19, 2017 and custodian released the payment on December 20, 2017. Thus, the changed entity was able to transact as an FPI without holding a valid registration in contravention of Section 12(1A) of SEBI Act & Regulation 3(1) of FPI Regulations.

Findings of the case:

a) DDP failed to ensure that only registered FPI invests in the securities market and also failed to inform SEBI immediately when there was a more than six months delay in intimation of change of address by the FPI, in alleged violation Regulation 32(1)(e) and 32(2)(f) of FPI Regulations, and Clauses 5.1.3, 5.1.4 and 5.6.2 of Operational guidelines of DDP's issued vide SEBI Circular No. CIR/IMD/FIIC/02/2014 dated January 08, 2014 is not established

b) Custodian failed to restrict the FPI from participating in the debt limits auction on December 14, 2017 and failed to block the accounts of the said FPI even after knowing about the FPI's change in address on December 11, 2017 in alleged violation of Regulation 26(2)(b) of FPI Regulations and Clause 3 of the Code of Conduct for Custodian of Securities as stipulated in Schedule III read with Regulation 12 of Custodian Regulations is not established

c) It is established that DDP failed to intimate SEBI immediately, when there was a more than six-month delay in intimation by Pathway of a material change i.e., Change of domicile, thus violating clause 5.1.4 of Operational guidelines of DDP's issued vide SEBI Circular No. CIR/IMD/FIIC/02/2014

d) Function of a DDP in granting registration to FPI is carried out on behalf of SEBI and casts an obligation on the DDP to be prompt in reporting to SEBI where such reporting is called for. The DDP was lax in reporting change of address and domicile of the FPI

Order:

Penalty of 5 lakhs upon HSBC – DDP under Section 15A(b) of the SEBI Act for violation of clause 5.1.4 of Operational guidelines of DDP's issued vide SEBI Circular No. CIR/IMD/FIIC/02/2014 dated January 08, 2014.

Review Questions:

1. A foreign portfolio investor shall invest only in which of the following securities?

   (a) Domestic Mutual Fund Schemes

   (b) Derivatives traded on a recognised stock exchange

   (c) Units of Real Estate Investment Trusts

   (d) All of the above

2. In respect of investments in the debt securities, the foreign portfolio investors need not comply with any conditions or directions given by Reserve Bank of India, as long as it is meeting the restrictions and conditions as specified by SEBI in its SEBI (FPI) Regulations. State whether True or False.

   (a) True

   (b) False

3. The purchase of equity shares of each company by a single foreign portfolio investor including its investor group shall be below _____ per cent of the total paid-up equity capital on a fully diluted basis of the company.

   (a) 10

   (b) 15

   (c) 20

   (d) 30

4. A Designated Depository Participant (DDP) may consider an FPI application, which has been previously rejected by another DDP. State True or False.

   (g) True

   (h) False

CHAPTER 12: SEBI (STOCK BROKERS) REGULATIONS, 1992

LEARNING OBJECTIVES:

After studying this chapter, you should know about some salient features of the:

- SEBI (Stock brokers) Regulations, 1992
- SEBI (Alternative Investment Funds) Regulations, 2012
- SEBI (Portfolio Management Services) Regulations, 2020

12.1 Introduction to SEBI (Stock Brokers) Regulations, 1992

The SEBI (Stock Brokers) Regulations, 1992 is required to be followed by persons who wish to register as a stockbroker for doing any transaction or business in the securities market. Stockbrokers shall ensure that they comply at all times with the various sections as given under this regulation.

12.1.1 Registration of Stock Brokers

The stockbrokers shall ensure that they comply at all times with the conditions of registration under ***regulation 9*** as follows:

- the stockbroker holds the membership of any stock exchange;
- the stockbroker shall abide by the rules, regulations and bye-laws of the stock exchange which are applicable to him;
- where the stockbroker proposes a change in control, he shall obtain prior approval of SEBI for continuing to act as such after the change;
- the stockbroker shall pay fees charged by the SEBI;
- the stockbroker shall take adequate steps to redress investors' grievances within 1 month of the date of receipt of the complaint and keep SEBI informed about such complaints as and when required by SEBI;
- the stockbroker shall at all times abide by the Code of Conduct as specified in the Regulations; and
- the stockbroker shall at all times maintain the minimum net worth as specified in the Regulations.
- the stockbroker who acts as an underwriter shall enter into a valid agreement with the body corporate on whose behalf it is acting as underwriter.
- Every stockbroker shall be entitled to act as underwriter only out of its own networth/funds.

No separate registration shall be required for a stockbroker registered with the SEBI to act as a clearing member in a clearing corporation of which he is admitted as a member, subject to a grant of approval by the concerned clearing corporation.

A stockbroker may appoint one or more Authorised Person(s)[17] after obtaining specific prior approval from the stock exchange concerned for each such person. The approval, as well as the appointment, shall be for a specific segment of the exchange.

It is mandatory for member-brokers to enter into an agreement with the Authorised person. The agreement lays down the rights and responsibilities of member-brokers as well as an Authorised person.

12.1.2 General Obligations and Responsibilities

The stockbroker's general obligations and responsibilities are elaborated under regulation 17 to 18B which are given below:

Under ***regulation 17(1),*** every stock-broker shall keep and maintain the following books of accounts, records and documents:

a) Register of transactions (Sauda Book);
b) Clients' ledger;
c) General ledger;
d) Journals;
e) Cash Book;
f) Bank passbook;
g) Documents register containing, inter-alia, particulars of securities received and delivered in physical form and the statement of accounts and other records relating to receipt and delivery of securities provided by the Depository Participants in respect of dematerialized securities.
h) Members' contract books showing details of all contracts entered into by him with other members of the same exchange or counterfoils or duplicates of memos of confirmation issued to such other member;
i) Counterfoils or duplicates of contract notes issued to clients;
j) Written consent of clients in respect of contracts entered into as principals;
k) Margin deposit book;
l) Client account opening form in the format as may be specified by SEBI.
m) A stock broker in the Execution Only Platforms segment, shall keep and maintain the books of account, records and documents as may be specified by the Board from time to time.

There are further requirements specified for a stock broker who acts as an underwriter which is required to be followed.

[17] "Authorised Person" (AP) means any person – Individual, partnership firm, LLP or body corporate – who is appointed as such by a stock broker (including trading member) and who provides access to trading platform of a stock exchange as an agent of the stock broker.

Regulation 17(1A) states that a stock broker in the Execution Only Platforms segment, shall keep and maintain the books of account, records and documents as may be specified by the Board from time to time. ***Regulation 17(2)*** states that every stock broker shall intimate to SEBI the place where the books of accounts, records and documents are maintained. Additionally, ***regulation 18***, also states that every stock broker shall preserve the books of account and other records maintained under regulation 17 for a minimum period of 5 years. Under the stockbroker regulation, the requirement of a compliance officer is also mandated under the ***regulation 18A*** which states that every stock broker shall appoint a compliance officer who shall be responsible for monitoring the compliance of the Act, rules and regulations, notifications, guidelines instructions, etc. and for a redress of investors' grievances. The compliance officer shall immediately and independently report to SEBI any non-compliance observed by him. Further, ***regulation 18D*** describes about the enhanced obligations and responsibilities for Qualified Stock Brokers.

SEBI has been issuing circulars and master circulars for registered trading members with respect to these regulations. These circulars include, inter alia, the requirement of base minimum capital.

12.1.3 Procedure for Inspection by SEBI

Regulation 19 of the SEBI (Stock Brokers) Regulations gives SEBI the right to inspect. SEBI may appoint inspecting authority to undertake inspection of the books of account, other records and documents of the stockbrokers. The purpose of the inspection under regulation 19(1) would be to;

- Ensure that the books of account and other books are being maintained in the manner required;
- Ensure that the provisions of the Act, rules, regulations and the provisions of the SCRA and the rules made thereunder are being complied with;

Whenever any such inspection (as per Regulation 19) is initiated, the stock-broker has the following obligations under ***regulation 21***:

- It shall be the duty of every director, proprietor, partner, officer and employee of the stock-broker, to produce to the inspecting authority such books, accounts and other documents in his custody or control and furnish him with the statements and information relating to the transactions in the securities market within such time as the inspecting authority may require.
- The stock-broker shall allow the inspecting authority to have reasonable access to the premises occupied by the stockbroker or by any other person on his behalf and also extend reasonable facility for examining any books, records, documents and computer data in the possession of the stock-broker or any other person and also provide copies of documents or other materials which, in the opinion of the inspecting authority are relevant.
- The inspecting authority, in the course of the inspection, shall be entitled to examine or record statements of any member, director, and employee of the stockbroker.

- It shall be the duty of every director, proprietor, partner, officer and employee of the stockbroker to give to the inspecting authority all assistance in connection with the inspection, which the stockbroker may be reasonably expected to give.

The inspecting authority shall submit the inspection report to SEBI.Based on the same, SEBI may take such action as it may deem fit and appropriate. SEBI may also appoint a qualified auditor under ***regulation 24***, to investigate the books of account or affairs of any stockbroker. The auditor so appointed shall have the same powers of the inspecting authority and the stockbroker shall have the same obligations as mentioned in the point above.

12.1.4 Action in case of Default

A stockbroker who contravenes any of the provisions of the Act, rules or regulations framed thereunder is liable for any one or more of the following actions –

(a) Monetary penalty
(b) Penalties as specified under the SEBI (Intermediaries) Regulations, 2008[18] including suspension or cancellation of certificate of registration as a stockbroker
(c) Prosecution under regulation 24 of the SEBI Act.

Monetary Penalty

Under regulation 26, a stockbroker shall be liable to adjudication proceedings for imposing monetary penalty in respect of the following violations:

a. Failure to file any return or report with SEBI.
b. Failure to furnish any information, books or other documents within 15 days of issue of notice by SEBI.
c. Failure to maintain books of accounts or records as per the Act, rules or regulations framed thereunder.
d. Failure to redress the grievances of investors within 30 days of receipt of notice from SEBI.
e. Failure to issue contract notes in the form and manner specified by the stock exchange of which such broker is a member.
f. Failure to deliver any security or make payment of the amount due to the investor within 48 hours of the settlement of trade unless the client has agreed in writing otherwise.
g. Charging of brokerage which is in excess of brokerage specified in the regulations or the bye-laws of the stock exchange.
h. Dealing in securities of a body corporate listed on any stock exchange on his own behalf or behalf of any other person on the basis of any unpublished price sensitive information.
i. Procuring or communicating any unpublished price sensitive information except as required in the ordinary course of business or under any law.
j. Counselling any person to deal in securities of anybody corporate on the basis of unpublished price sensitive information.

[18]Chapter V of the SEBI (Intermediaries) Regulations, 2008 which would be discussed in the later section of this workbook.

k. Indulging in fraudulent and unfair trade practices relating to securities.
l. Failure to maintain client account opening form.
m. Failure to segregate his own funds or securities from the client's funds or securities or using the securities or funds of the client for his own purpose or purpose of any other client.
n. Failure to comply with directions issued by SEBI under the Act or the regulations framed thereunder.
o. Failure to exercise due skill, care and diligence.
p. Failure to obtain prior approval of SEBI in case of change in control of the stockbroker.
q. Failure to satisfy the net worth or capital adequacy norms, if any, specified by SEBI.
r. Extending the use of trading terminals to any unauthorized person or place.
s. Violations for which no separate penalty has been provided under these regulations.

SEBI has issued a circular no. SEBI/HO/MIRSD/DOP/CIR/P/2018/153 dated December 17, 2018 relating to early warning mechanisms to prevent diversion of client securities. The threshold for such early warning signals shall be decided by the Stock Exchanges, Depositories and Clearing Corporations with mutual consultation.

Early warning signals, for prevention of diversion of clients' securities, may include the following

1. Deterioration in the financial health of the stock broker/ depository participant based on any of the following parameters:
   a) Significant reduction in net worth over previous half-year / year.
   b) Significant losses in the previous half years/years.
   c) Delay in reporting of Annual Report, Balance Sheet, Internal Audit Reports, Risk-Based Supervision (RBS) data and any other data related to its financial health to the Stock Exchanges / Depositories.
   d) Failure to submit information sought by the Stock Exchange/Depositories on its dealing with related parties/promoters.
   e) Significant mark-to-market loss on proprietary account/related party accounts
   f) Repeated instances of pay-in shortages.
   g) Significant trading exposure or amount of loans or advances given to and investments made in related parties/groups.
   h) Sudden activation of a significant number of dormant client's accounts and/or significant activity in the dormant account/s.
   i) Significant number of UCC modifications.

j) Resignation of Statutory Auditors or Directors.

2. Early warning signals in relation to securities pledge transactions by the stockbroker to be identified by the Depositories and shall be shared with Stock Exchanges which may include:
   a) Alerts for stockbrokers maintaining multiple proprietary Demat accounts and opening any new Demat account in the name of stockbroker for client purpose.
   b) Movement of shares to / from a large number of clients' Demat accounts or large value shares to stockbroker proprietary accounts and vice versa.
   c) Transfer of large value of shares through off-market transfers other than for settlement purposes.
   d) Invocation of the pledge of securities by lenders against a stockbroker or his clients.
   e) Significant depletion of client's shares in the stockbroker client account maintained by the stockbroker.
3. Increase in number of investor complaints against the stock broker / depository participant alleging un-authorized trading / unauthorized delivery instructions being processed and non-receipt of funds and securities and non-resolution of the same.
4. Alerts generated from the monthly / weekly submissions made by stockbroker under Risk-Based Supervision (RBS) or Enhanced Supervision to the Stock Exchanges.

a) Non-recovery of significant dues from debit balance clients over a period of time.

b) Significant dues to credit balance clients over a period of time.

c) Failure by a stock broker to upload weekly data regarding monitoring of clients' funds as specified in SEBI's circular on Enhanced Supervision, for 3 consecutive weeks.

d) Pledging securities in case of clients having credit balance and using the funds so raised against them for own purposes or for funding debit balance of clients.

e) Mis-reporting / wrong reporting about the client funds / securities.

f) Significant increase in Risk-Based Supervision (RBS) score.

5. Stock broker's terminal disabled for a certain number of days in any segment / Stock Exchange in the previous quarter.

   Based on the analysis of the early warning data, if it is established that the stock broker's financial health has deteriorated and/ or he has made an unauthorized transfer of funds/securities of the client, in such cases, Stock Exchanges / Depositories shall jointly take preventive actions on the stockbroker which may include one or more of, but not limited, to the following:

Actions to be initiated by the Stock Exchanges include:

a) Blocking off a certain percentage of available collaterals towards margin.

b) Check securities register in respect of securities received and transferred against pay-in / pay-out against settlement and client's securities received as collateral.

c) Check details of funds and securities available with the clearing member, Clearing Corporation and the Depository of that stockbroker.

d) Impose limits on proprietary trading by the stockbroker.

e) Prescribe and monitor shorter time duration for settlement of Running Account of clients.

f) Conduct a meeting with the designated directors of the stockbroker to seek an appropriate explanation.

g) Uniform action of deactivation of trading terminals by all Stock Exchanges based on the communication received from other Stock Exchange.

h) Initiate inspection of the stock broker / depository participant.

i) Cross-check information submitted by the stock broker with other independent sources like collateral details with the Clearing Corporation, transactions in Bank and Depositories, with statement collected directly etc.

j) Where client money and securities diversion are suspected, appoint a forensic auditor to trace trails of entire funds and securities of clients.

Actions to be taken by the Depositories include:

a) Restriction on a further pledge of client securities from the client's account by freezing the stockbroker client account for debit.

b) Imposition of 100% concurrent audit on the depository participant.

c) Cessation / restriction on uses of Power of Attorney (POA) given to stockbroker by clients mapped to such brokers only to meet settlement obligation of that client. Clients to issue instructions electronically or through Delivery Instruction Slip (DIS) for delivery of shares for off-market transfers.

The Stock Exchanges / Clearing Corporations / Depositories may take any other measure as they deem fit.

Towards this, in November 2019, SEBI directed Stock exchanges and depositories to map the existing Unique Client Code (UCC) UCCs with the Demat account of the clients. SEBI also advised Stock Exchanges and Depositories to ensure that inactive, non-operational UCCs are not misused

and put in place a mechanism to ensure that inactive, non-operational UCCs are weeded out in the process of mapping clients' UCC with their Demat account.[19]

12.1.5 Action under SEBI (Intermediaries) Regulations including suspension or cancellation of certificate of registration

Under regulation 27, a stockbroker is liable to enquiry proceedings under SEBI (Intermediaries) Regulations, including suspension or cancellation of his certificate of registration as a stockbroker if he –

i. ceases to be a member of a stock exchange; or
ii. has been declared defaulter by a stock exchange and has not been re-admitted as a member within a period of six months; or
iii. surrenders his certificate of registration to SEBI; or
iv. has been found to be not a fit and proper person by SEBI; or
v. has been declared insolvent or order for winding up has been passed in the case of a broker being a company registered under the Companies Act; or
vi. any of the partners or whole-time director in case a broker is a company registered under the Companies Act, 2013 has been convicted by a court for an offence involving moral turpitude; or
vii. fails to pay the fee as prescribed in the regulations; or
viii. fails to comply with the rules, regulations and bye-laws of the stock exchange of which it is a member; or
ix. fails to co-operate with the inspecting or investigating authority; or
x. fails to abide by any award of the Ombudsman or decision of SEBI under the SEBI (Ombudsman) Regulations, 2003; or
xi. fails to pay the penalty imposed by the Adjudicating Officer; or
xii. indulges in market manipulation of securities or index; or
xiii. indulges in insider trading in violation of SEBI (Prohibition of Insider Trading) Regulations, 1992; or
xiv. violates SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003; or
xv. commits a violation of any of the provisions for which monetary penalty or other penalties could be imposed; or
xvi. fails to comply with the circulars issued by SEBI; or
xvii. commits violations specified in regulation 26 which in the opinion of SEBI are of a grievous nature.

<u>Prosecution</u>

[19] https://www.sebi.gov.in/legal/circulars/nov-2019/mapping-of-unique-client-code-ucc-with-demat-account-of-the-clients_44983.html

Under regulation 28, a stockbroker shall be liable for prosecution as per regulation 24 of the SEBI Act for any of the following violations –

a. Dealing in securities without obtaining a certificate of registration from SEBI as a stockbroker.
b. Dealing in securities or providing trading floor or assisting in trading outside the recognized stock exchange in violation of provisions of the SCRA or rules made or notifications issued thereunder.
c. Market manipulation of securities or index.
d. Indulging in insider trading in violation of SEBI (Prohibition of Insider Trading) Regulations, 1992.
e. Violating the SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003.
f. Failure without reasonable cause –
    - to produce to the investigating authority or any person authorized by him in this behalf, any books registers,
    - to appear before the investigating authority personally or to answer any question which is put to him by the investigating authority; or
    - to sign the notes of any examination taken down by the investigating authority.
g. Failure to pay penalty imposed by the adjudicating officer or failure to comply with any of his directions or orders.

12.1.6 Code of Conduct for Brokers

A stockbroker needs to adhere to a particular code of conduct as prescribed in the schedule II of the regulations, which has been discussed herein.

A. <u>General</u>

1) Integrity: A stock-broker, must maintain high standards of integrity, promptitude and fairness in the conduct of all his business.
2) Exercise of Due Skill and Care: A stock-broker, must act with due skill, care and diligence in the conduct of all its business.
3) Manipulation: A stockbroker should not indulge in manipulative, fraudulent or deceptive transactions or schemes or spread rumours with a view to distorting market equilibrium or making personal gains.
4) Malpractices: A stockbroker should not create a false market either singly or in concert with others or indulge in any act detrimental to the investors' interest or which leads to interference with the fair and smooth functioning of the market. A stockbroker should not involve himself in excessive speculative business in the market beyond reasonable levels not commensurate with its financial soundness.

5) Compliance with Statutory Requirements: A stockbroker should abide by all the provisions of the Act and the rules, regulations issued by the Government, the SEBI and the stock exchange from time to time as may be applicable to him.

B. Duty to the Investor

1) Execution of Orders: A stock-broker, in its dealings with the clients and the general investing public, should faithfully execute the orders for buying and selling of securities at the best available market price and not refuse to deal with a small investor merely on the ground of the volume of business involved. A stockbroker also should promptly inform its client about the execution or non-execution of an order, and make prompt payment in respect of securities sold and arrange for the prompt delivery of securities purchased by clients.
2) Issue of Contract Note: A stockbroker should issue without delay to its client or client of the sub-broker, as the case may be a contract note for all transactions in the form as specified by the stock exchange.
3) Breach of Trust: A stockbroker should not disclose or discuss with any other person or make improper use of the details of personal investments and other information of a confidential nature of the client which he comes to know in its business relationship.
4) Business and Commission:
   a) A stockbroker should not encourage sales or purchases of securities with the sole object of generating brokerage or commission.
   b) A stockbroker should not furnish false or misleading quotations or give any other false or misleading advice or information to the clients with a view of inducing him to do business in particular securities and enabling himself to earn brokerage or commission thereby.
5) Business of Defaulting Clients: A stock-broker should not deal or transact business knowingly, directly or indirectly or execute an order for a client who has failed to carry out his commitments in relation to securities with another stock-broker.
6) Fairness to Clients: A stockbroker, when dealing with a client, must disclose whether he is acting as a principal or as an agent and should ensure at the same time that no conflict of interest arises between him and the client. In the event of a conflict of interest, he should inform the client accordingly and should not seek to gain a direct or indirect personal advantage from the situation and also not consider the clients' interest inferior to his own.
7) Investment Advice: A stock-broker should not make a recommendation to any client who might be expected to rely thereon to acquire, dispose of, retain any securities unless he has reasonable grounds for believing that the recommendation is suitable for such a client upon the basis of the facts, if disclosed by such a client as to his own security holdings, financial situation and objectives of such investment. The stockbroker should seek such information from clients, wherever it feels it is appropriate to do so.

7A) Investment Advice in publicly accessible media –

(a) A stockbroker or any of its employees shall not render, directly or indirectly, any investment advice about any security in the publicly accessible media, whether real-time or non-real-time, unless disclosure of his interest including the interest of his dependent family members and the employer including their long or short position in the said security has been made, while rendering such advice.

(b) In case, an employee of the stockbroker is rendering such advice, he shall also disclose the interest of his dependent family members and the employer including their long or short position in the said security while rendering such advice.

8) Competence of Stock Broker: A stockbroker should have adequately trained staff and arrangements to render fair, prompt and competent services to its clients.

C. Dealing with other Stock Brokers

1) Conduct of Dealings: A stockbroker shall co-operate with the other contracting party in comparing unmatched transactions. A stockbroker should not knowingly and wilfully deliver documents that constitute bad delivery and shall cooperate with other contracting party for prompt replacement of documents that are declared as bad delivery.
2) Protection of Clients Interests: A stock-broker shall extend the fullest cooperation to other stock-brokers in protecting the interests of its clients regarding their rights to dividends, bonus shares, right shares and any other right related to such securities.
3) Transactions with Stock-Brokers: A stock-broker should carry out his transactions with other stock-brokers and shall comply with his obligations in completing the settlement of transactions with them.
4) Advertisement and Publicity: A stockbroker should not advertise his business publicly unless permitted by the stock exchange.
5) Inducement of Clients: A stockbroker should not resort to unfair means of inducing clients from other stock- brokers.
6) False or Misleading Returns: A stockbroker shall not neglect or fail or refuse to submit the required returns and not make any false or misleading statement on any returns required to be submitted to SEBI and the stock exchange.

In order to enable the users to have access to the applicable circulars in one place, SEBI issued master circular reference no. SEBI/HO/MIRSD/DOP1/CIR/P/2018/87 dated June 1, 2018.[20] It covers in detail the following aspects

1) Registration of stockbroker
2) Trading account opening, unique client code, know your client, KYC registration agency, central KYC registry

[20] https://www.sebi.gov.in/legal/master-circulars/jun-2018/master-circular-for-stock-brokers_39166.html

3) Supervision and Oversight
4) Dealings with clients
5) Technology related
6) Change in status, constitution, control and affiliation
7) Subsidiary
8) Foreign account tax compliance act
9) Score Investor grievance
10) General

Duties of a stock broker as an underwriter is also specified in detail. You are requested to refer to an updated circular issued by SEBI and Stock Exchanges from time to time for detailed understanding.

12.1.7 Regulation of Transactions between Clients and Brokers

SEBI vide its notification (No. SO 855 (E), dated 29-11-1994) have prescribed regulations for transactions between clients and brokers. It shall be compulsory for all member brokers to keep the money of the clients in a separate account and their own money in a separate account. No payment of transactions in which the member broker takes a position as a principal will be allowed to be made from the clients' accounts. However, there are circumstances under which transfer from clients account to member brokers account may be allowed, the same are enumerated below:

(1)	(2)	(3)
A.	Member Broker to Keep Accounts	Every member broker shall keep such books of account, as will be necessary, to show and distinguish in connection with his business as a member – i. Moneys received from or on account of and money, paid to or on account of each of his clients, and ii. The moneys received and the moneys paid on the member's own account.
B.	Obligation to pay money into clients' accounts	Every member broker who holds or receives money on account of a client shall forthwith pay such money to current or deposit account at the bank to be kept in the name of the member in the title of which the word "clients" shall appear. Member broker may keep one consolidated clients account for all the clients or accounts in the name of each client *Provided* when a member receives a cheque or draft belonging to the client and part to the member, he shall pay the whole of such cheque or draft into the clients

		account and effect subsequent transfer as per prescribed guidelines.
C.	What moneys to be paid into "clients account"	No money shall be paid into clients account other than – i. Money held or received on account of clients; ii. Such money belonging to the member as may be necessary for the purpose of opening or maintaining the account; iii. Money for replacement of any sum which may by mistake or accident have been drawn from the account in contravention of point D (to be discussed below) iv. A cheque or draft received by the member representing in part money belonging to the client and in part money due to the member.
D.	What moneys to be withdrawn from "clients account"	No money shall be drawn from clients account other than- i. Money properly required for payment to or on behalf of clients or for or towards payment of a debt due to the member from clients or money drawn on client's authority, or money in respect of which there is a liability of clients to the members, provided that money so drawn shall not, in any case, exceed the total of the money held for the time being for such each client. ii. Such money belonging to the member as may have been paid into the client account as discussed under points C (ii) and C (iv). iii. Money which may by mistake or accident has been paid into such account in contravention of point C.

It shall also be compulsory for all member brokers to keep separate accounts for client's securities and to keep such books of account, as may be necessary, to distinguish such securities from his / their own securities. Such accounts for clients' securities shall *inter alia* provide for the following:

a. Securities received for sale or kept pending delivery in the market;
b. Securities fully paid for, pending delivery to clients;
c. Securities received for transfer or sent for transfer by the member, in the name of the client or his nominee(s);
d. Securities that are fully paid for and are held in custody by the Member as security/ margin etc. Proper authorisation from the client for the same shall be obtained by the member;
e. Fully paid for client's securities registered in the name of the member, if any, towards margin requirement, etc.;

The member brokers need to make the payment to their clients or deliver the securities purchased within two working days of payout unless the client has requested otherwise. It is also compulsory for the member broker to issue the contract note to the client for its purchase or sale within 24 hours of the execution of the contract. We will here further discuss the other things which fall under the ambit of the client-broker relationship.

12.1.8 Client Agreement

Client registration documents are segregated into mandatory and non-mandatory parts. Client agreement, Know Your Client (KYC) and the Risk Disclosure Document (RDD) constitute the mandatory part. For registration of a client, along with the client application form, the client agreement also needs to be filled. The agreement should cover details of all issues that clearly define the relationship and the extent of liabilities between the client and the trading/clearing member. The following areas are necessarily needed to be included in the agreement, however additional clauses may also be inserted by the Exchange or the Broker.

- In case there is any change in the information provided by the client to the member at the time of opening the account, the client shall immediately notify the member of such change in writing.
- The agreement shall clearly specify the client's responsibility for all investment decisions and his complete understanding of the risks involved in trading of various derivatives contracts. The member shall ensure that the client has read and signed the Risk Disclosure Document.
- The agreement shall specify the nature of services provided by the broker e.g., trading facilities, clearing facilities, advisory services, portfolio management services etc.
- The agreement shall indicate the rate of brokerage/commission/fee charged by the broker in respect of various services provided by the member. The broker shall not charge brokerage more than the maximum brokerage permitted as per the rules, regulations and bye-laws of the Exchange /SEBI.
- The client's liability to pay margins as required by the trading/ clearing member or exchange or clearing corporation within the stipulated time should be clearly specified. It should also be indicated that if the broker finds it necessary, he should be authorised to levy and collect the additional margins over and above those imposed by the Exchange /Clearing Corporation and the client shall be liable to pay the margins within the stipulated time.
- The broker shall have the authority to liquidate /close positions of the client for non-payment of margins, outstanding debts etc. Any amount of loss would be charged to the client in such an event.
- The money deposited by the client shall be kept in a separate account by the member, distinct from his own account and cannot be used by the broker for himself or for any purpose other than the purpose mentioned by the client.
- The agreement may contain any other additional provisions as considered necessary by the broker/exchanges.

12.1.8.1 Know Your Client (KYC) Form[21]

The broker is required to ensure that the client fills up the KYC, along with the 'Client Agreement and the Risk Disclosure Document'. In the KYC, the broker should ensure complete details of client information, bank and depository account details, financial details of the constituent, investment / trading experience, references, financial documents and signature of the client are provided. The photograph, proof of address and identity and the Board resolution for corporate clients permitting trading in derivative products are also required as a part of the KYC. Clients should also indicate the segments in which they would like to transact.

SEBI has issued guidelines in pursuance of the SEBI KYC Registration Agency (KRA) Regulations, 2011 and In-Person verification which have been discussed in chapter 10. The KRA system shall be applicable for all new client accounts opened from January 1, 2012.

12.1.8.2 Risk Disclosure Document (RDD)[22]

In order to familiarize the investors or the clients, the broker members are required to sign a risk disclosure document (RDD) with their clients, informing them of the various risks associated with dealing in the securities market. The text of the RDD is provided in the regulations however, the exchanges may also prescribe any additional disclosure requirements which are considered necessary by them. RDD is mandatory for every client as per SEBI regulations.

12.1.8.3 Uniform Documentary Requirements for Trading

SEBI has prescribed the uniform formats of the client registration form and broker-client agreement vide its circular no. SMD/Policy/Cir/5-97 dated April 11, 1997. In order to bring about uniformity in documentary requirements across different segments and exchanges and also to avoid duplication and multiplicity of documents, SEBI in consultation with the exchanges has formulated a uniform set of documents which are as listed below:

Client Registration Form: Uniform across all the segments and exchanges where the broker is trading on different segments and exchanges.

Member Clients Agreement: Uniform across all exchanges. However, a separate agreement in the same format would be required for each of the exchanges where the broker is trading on different exchanges.

Though the aforementioned are the model formats, the stock exchange or the stockbroker may incorporate any additional clauses in the documents provided they are not in conflict with any of the clauses in the model document, as also the Rules, Regulations, Articles, Bye-laws, Circulars, Directives and Guidelines.

[21] SEBI circular reference no. MIRSD/SE/Cir-19/2009 dated December 3,2009

[22] The Risk Disclosure Document (RDD) should be read by each and every client into equities/derivatives trading and a signed copy of the same should be obtained by the broker from all its clients.

The requirement of obtaining the client registration form may be waived for SEBI registered Foreign Portfolio Investors (FPIs), Mutual Funds (MFs), Venture Capital Funds (VCFs) and Foreign Venture Capital Investors (FVCIs), Scheduled Commercial Banks (SCBs) etc.

12.1.8.4 Unique Client Code (UCC)

It is mandatory for the broker to allot and use the unique client code (UCC) for all its clients. For this purpose, the broker shall collect and maintain in their back-office the Permanent Account Number (PAN) allotted by the Income Tax Department for all their clients. In the case of other entities –

- Brokers shall verify the documents with respect to the unique code retain a copy of the document.
- The brokers shall also be required to furnish the above particulars of their clients to the stock exchanges /clearing corporations and the same would be updated on a monthly basis. Such information for a particular month should reach the exchange within 7 working days of the following month.
- The Stock Exchanges shall be required to maintain a database of client details submitted by brokers. Historical records of all quarterly submissions shall be maintained for a period of 7 years by the exchanges.

12.1.8.5 Contract Note

As already mentioned above, the trading member / broker have to ensure that the contract notes are issued in the prescribed format within 24 hours of execution of the trades on the exchanges. Copies of the contract and the proof of delivery/despatch are also to be maintained by the broker. The contract notes should contain the signature of the authorised person, the UCC and PAN details of the client along with the trade price at which the trade was executed and the brokerage charged. The contract number should also have a running serial number. The details of the dealing office through which the deal was transacted and the PAN number of the trading member / broker should also be mentioned on the contract note.

12.1.8.6 Electronic Contract Note

The contract notes can be issued by the brokers in electronic form authenticated by means of digital signatures. All the members of the stock exchanges who are desirous of issuing Electronic Contract Notes (ECNs) to their clients shall comply with the following conditions:

i. *Issuing ECNs when specifically consented*: The digitally signed ECNs may be sent only to those clients who have opted to receive the contract notes in an electronic form, either in the member-client agreement /tripartite agreement or by a separate letter.
ii. *Where to send ECNs*: The usual mode of delivery of ECNs to the clients shall be through email. For this purpose, the client shall provide an appropriate email account to the member which shall be made available at all times for such receipts of ECNs.

iii. *Requirement of digital signature*: All ECNs sent through the email shall be digitally signed, encrypted, non-tamperable and shall comply with the provisions of the IT Act, 2000.

iv. *Format:* The format of the issuance of the ECN is prescribed by the stock exchange and the brokers need to conform to it.

12.1.8.7 Statement of Accounts

To avoid disputes arising between clients and brokers pertaining to payments due to / from the clients, the trading members SEBI vide circular no. SEBI/HO/MIRSD/DOP/P/CIR/2022/101 dated July 27, 2022 directed that the settlement of running account of funds of the client shall be done by the Trading member (TM) after considering the End of the day (EOD) obligation of funds as on the date of settlement across all the Exchanges, on first Friday of the Quarter (i.e., Apr-Jun, Jul-Sep, Oct-Dec, Jan–Mar) for all the clients i.e., the running account of funds shall be settled on first Friday of October 2022, January 2023, April 2023, July 2023 and so on for all the clients. If first Friday is a trading holiday, then such settlement shall happen on the previous trading day. For clients, who have opted for Monthly settlement, running account shall be settled on first Friday of every month. If first Friday is a trading holiday, then such settlement shall happen on the previous trading day. [23]

SEBI circular no. CIR/HO/MIRSD/DOP/CIR/P/2019/75 dated June 20, 2019, settlement of running account for securities has been discontinued and therefore, SEBI circulars dated December 03, 2009 and September 26, 2016, are now applicable for settlement of running account of client's "funds" only.

SEBI, vide circular no. SEBI/HO/MIRSD/DOP/CIR/P/2020/28 dated February 25, 2020, discontinued title transfer of securities to the demat account of Trading Member for margin purposes and Trading Member shall accept collateral from the clients in the form of securities only by way of 'margin pledge' created in the Depository system.

In case of a client having any outstanding trade position on the day on which settlement of running account of funds is scheduled, a Trading Member may retain funds calculated in the manner specified below:

a) Entire pay-in obligation of funds outstanding at the end of the day on settlement of running account, of T Day & T-1 day.

b) Margin liability as on the date of settlement of running account, in all segments and additional margins (maximum up to 125% of total margin liability on the day of settlement). The margin liability shall include the end of the day margin requirement excluding the MTM and pay-in

[23] https://www.sebi.gov.in/legal/circulars/jul-2022/settlement-of-running-account-of-client-s-funds-lying-with-trading-member-tm-_61222.html
https://www.sebi.gov.in/legal/circulars/jun-2021/settlement-of-running-account-of-client-s-funds-lying-with-trading-member-tm-_50570.html

obligation, therefore, Trading Member may retain 225% of the total margin liability in all the segments across the exchange.

Client's running account shall be considered settled only by making actual payment into client's bank account and not by making any journal entries. Journal entries in the client account shall be permitted only for levy/reversal of charges in the client's account.

Once the Trading Member settles the running account of funds of a client, an intimation shall be sent to the client by SMS on the mobile number and also by email. The intimation should also include details about the transfer of funds (in case of electronic transfer – transaction number and date; in case of physical payment instruments – instrument number and date). Trading Member shall send the retention statement along with the statement of running accounts to the clients as per the existing provisions within 5 working days

Client shall bring any dispute on the statement of running account, to the notice of Trading Member within 30 working days from the date of the statement.

12.2 Direct Market Access

Direct Market Access (DMA) is a facility that permits the brokers to offer clients direct access to the exchange trading system through the broker's infrastructure without manual intervention by the broker. This was brought into effect vide the SEBI circular (MRD/DoP/SE/Cir-7/2008 dated April 3, 2008). Some of the advantages offered by DMA are direct control of clients over orders, faster execution of client orders, reduced risk of errors associated with manual order entry, greater transparency, increased liquidity, lower impact costs for large orders, better audit trails and better use of hedging and arbitrage opportunities through the use of decision support tools / algorithms for trading. As per the SEBI Circular, the DMA facility initially is being restricted to institutional clients only. Further, SEBI vide circular no. MRD/DoP/SE/Cir-03/2009 dated February 20, 2009 permits that the facility of DMA provided by the stockbroker shall be used by the client or an investment manager of the client. A SEBI registered entity shall be permitted to act as investment manager on behalf of institutional clients. In case the facility of DMA is used by the client through an investment manager, the investment manager may execute necessary documents on behalf of the client. The Exchange/Broker are required to ensure proper audit trails are available to establish identity of the ultimate client.[24]

12.2.1 Operational Specifications

The broker should ensure sound audit trail for all the DMA orders and trades and be able to provide identification of actual user-id for all such orders and trades. The audit trail data should

[24] https://www.sebi.gov.in/legal/circulars/aug-2012/direct-market-access-clarification_23183.html

also be available for at least 5 years. The DMA system shall have sufficient security features including password protection for the user ID, automatic expiry of passwords at the end of a reasonable duration and re-initialisation of access on entering fresh passwords. A systems audit of the DMA systems and software shall be periodically carried out by the broker as may be specified by the exchange and a certificate in this regard shall be submitted to the exchange.

12.2.2 Client Authorization

Brokers shall specifically authorise clients or investment managers acting on behalf of clients for providing DMA facility after fulfilling Know Your Client (KYC) requirements and carrying out due diligence. Brokers shall maintain proper records of such due diligence.

12.2.3 Cross Trades

It is also to be noted that the brokers using the DMA facility for routing client orders shall not be allowed to cross trades of their clients with each other. All orders must be offered to the market for matching.

12.2.4 Broker's liability

The broker shall be fully responsible and liable for all orders emanating through their DMA systems. It shall be the responsibility of the broker to ensure that only clients who fulfil the eligibility criteria are permitted to use the DMA facility.

12.3 Algorithmic Trading

Algorithmic trading includes any type of automated route-based trading where decision making is delegated to a computer model. High-Frequency Trading is a type of algorithmic trading that is latency-sensitive and is characterised by a high daily portfolio turnover and high order to trade ratio (OTR). SEBI Circular No. CIR/MRD/DP/ 09 /2012 dated March 30, 2012 had specified the broad guidelines on algorithmic trading. Any order that is generated using automated execution logic shall be known as algorithmic trading. The guidelines for stockbrokers are given below:

Stock exchange shall ensure that the stock broker shall provide the facility of algorithmic trading only upon the prior permission of the stock exchange. Stock exchange shall subject the systems of the stockbroker to initial conformance tests to ensure that the checks mentioned below are in place and that the stock broker's system facilitates orderly trading and integrity of the securities market. Further, the stock exchange shall suitably schedule such conformance tests and thereafter, convey the outcome of the test to the stockbroker. For stockbrokers already providing Algo trading, the stock exchange shall ensure that the risk controls specified in this circular are implemented by the stockbroker.

Additionally, the annual system audit report for a stockbroker, as submitted to the stock exchange, shall include a specific report ensuring that the checks are in place. Such system audit shall be conducted by Certified Information System Auditors (CISA) empanelled by stock exchanges. Further, the stock exchange shall subject the stockbroker systems to more frequent system audits, if required.

The stockbroker, desirous of placing orders generated using algos, shall satisfy the stock exchange with regard to the implementation of the following minimum levels of risk controls at its end –

(i) Price check – Algo orders shall not be released in breach of the price bands defined by the exchange for security.

(ii) Quantity check – Algo orders shall not be released in breach of the quantity limit as defined by the exchange for the security.

(iii) Order Value check – Algo orders shall not be released in breach of the 'value per order' as defined by the stock exchanges.

(iv) Cumulative Open Order Value check – The individual client level cumulative open order value check, may be prescribed by the broker for the clients. Cumulative Open Order Value for a client is the total value of its unexecuted orders released from the stock broker system.

(v) Automated Execution check – An Algo shall account for all executed, un-executed and unconfirmed orders, placed by it before releasing further order(s). Further, the Algo system shall have pre-defined parameters for an automatic stoppage in the event of algo execution leading to a loop or a runaway situation.

(vi) All algorithmic orders are tagged with a unique identifier provided by the stock exchange in order to establish audit trail.

The other risk management checks already put in place by the exchange shall continue and the exchange may re-evaluate such checks if deemed necessary in view of Algo trading. The stockbroker, desirous of placing orders generated using algos, shall submit to the respective stock exchange an undertaking that –

(i) The stock broker has proper procedures, systems and technical capability to carry out trading through the use of algorithms.

(ii) The stockbroker has procedures and arrangements to safeguard algorithms from misuse or unauthorized access.

(iii) The stockbroker has real-time monitoring systems to identify algorithms that may not behave as expected. Stockbrokers shall keep the stock exchange informed of such incidents immediately.

(iv) The stockbroker shall maintain logs of all trading activities to facilitate the audit trail. The stock broker shall maintain a record of control parameters, orders, trades and data points emanating from trades executed through algorithm trading.

(v) The stockbroker shall inform the stock exchange of any modification or change to the approved algos or systems used for algos.

The stock exchange, if required, shall seek conformance of such modified algo or systems to the requirements specified in the circular.

The stockbrokers that provide the facility of algorithmic trading shall subject their algorithmic trading system to a system audit every six months in order to ensure that the requirements prescribed by SEBI / stock exchanges with regard to algorithmic trading are effectively implemented. Such system audit of the algorithmic trading system shall be undertaken by a system auditor who possesses any of the following certifications:
i. CISA (Certified Information System Auditors) from ISACA;
ii. DISA (Post Qualification Certification in Information Systems Audit) from Institute of Chartered Accountants of India (ICAI);
iii. CISM (Certified Information Securities Manager) from ISACA;
iv. CISSP (Certified Information Systems Security Professional) from International Information Systems Security Certification Consortium, commonly known as (ISC)2

Deficiencies or issues identified during the process of system audit of trading algorithm / software shall be reported by the stockbroker to the stock exchange immediately on completion of the system audit. Further, the stock broker shall take immediate corrective actions to rectify such deficiencies / issues.

In case of serious deficiencies / issues or failure of the stock broker to take satisfactory corrective action, the stock exchange shall not allow the stockbroker to use the trading software till deficiencies / issues with the trading software are rectified and a satisfactory system audit report is submitted to the stock exchange. Stock exchanges may also consider imposing suitable penalties in case of failure of the stockbroker to take satisfactory corrective action to its system within the time period specified by the stock exchanges.

The stockbroker, desirous of placing orders generated using algos, shall submit to the respective stock exchange an undertaking that -

i. The stockbroker has proper procedures, systems and technical capability to carry out trading through the use of algorithms.

ii. The stockbroker has procedures and arrangements to safeguard algorithms from misuse or unauthorized access.

iii. The stockbroker has real-time monitoring systems to identify algorithms that may not behave as expected. Stockbroker shall keep the stock exchange informed of such incidents immediately.

iv. The stockbroker shall maintain logs of all trading activities to facilitate audit trail. The stockbroker shall maintain a record of control parameters, orders, trades and data points emanating from trades executed through algorithm trading.

v. The stockbroker shall inform the stock exchange of any modification or change to the approved algos or systems used for algos.

In order to address the concerns relating to algorithmic trading and co-location / proximity hosting facility offered by stock exchanges and to provide a level playing field between Algorithmic/ Co-located trading and manual trading, SEBI vide its circular no. SEBI/HO/MRD/DP/CIR/P/2018/62 dated April 9, 2018 introduced various measures, some of which are listed below:

1) Under Managed Co-location service, space/rack in co-location facility shall be allotted to eligible vendors by the stock exchange along with provision for receiving market data for further dissemination of the same to their client members and the facility to place orders (algorithmic / non-algorithmic) by the client members from such facility.

2) The vendors shall provide the technical know-how, hardware, software and other associated expertise as services to trading members and shall be responsible for the upkeep and maintenance of all infrastructure in the racks provided to them.

3) Stock exchanges shall supervise and monitor such facilities on a continuous basis remaining responsible and accountable for actions of vendors providing managed co-location services and ensuring integrity, security and privacy of data being handled at the facility.

4) Exchanges shall also publish reference latency, which is the time taken for an order message to travel between a reference rack in the Colocation facility and the Core Router.

5) Tick-by-Tick (TBT) data feed offered by stock exchanges provides a detailed view of the entire order book, which includes details relating to addition, modification and cancellation of orders and trades on a real-time basis. In order to create a more level playing field among the different

types of market participants, Stock Exchanges shall provide TBT Feeds to all the trading members, free of cost, subject to trading members creating the necessary infrastructure for receiving and processing it.

6) Stock exchanges were advised to put in place a penalty structure that acts as an effective economic disincentive for high daily order-to-trade ratio (OTR) of algo orders placed by trading members.

7) In order to ensure enhanced surveillance, a unique algo id shall be assigned to each algorithm approval taken from the Exchange.

8) Stimulated environment to be provided by stock exchanges for testing of software. Such facility is over and above the mock framework prescribed by SEBI.

12.4 Margin Trading

Margin Trading facility is offered to an investor in buying of shares and securities from the available resources by allowing him to pay a fraction of the total transaction value called a margin. The margin can be given in the form of cash or shares as collateral depending upon the availability with the respective investor. In short, it can be termed as leveraging a position in the market with cash or collateral by the investor. In this transaction, the broker funds the balance amount

“Initial margin” means the minimum amount, calculated as a percentage of the transaction value, to be placed by the client, with the broker, before the actual purchase. The broker will advance the balance amount to meet full settlement obligations.

“Maintenance margin” means the minimum amount, calculated as a percentage of the market value of the securities, calculated with respect to the last trading day’s closing price, to be maintained by the client with the broker.

“Margin Trading Facility” or MTF means and refers to the facility pursuant to which part of the transaction value due to the Stock Exchange, at the time of purchase of Shares, shall be paid by the broker on behalf of the Client on Client’s request, on such terms and conditions as contained in the Agreement.

SEBI has issued a Comprehensive Review of Margin Trading Facility vide Circular No. CIR/MRD/DP/54/2017 dated June 13, 2017 which stands modified as per Circular No.

SEBI/HO/MRD/MRD-PoD-3/P/CIR/2022/166 dated Nov 30, 2022[25]. Equity shares and units of Equity ETFs that are classified as 'Group I security' as per SEBI circular MRD/DoP/SE/Cir-07/2005 dated February 23, 2005 shall be eligible for MTF..

The Stockbrokers shall be required to comply with the following conditions:

i. The stocks or units of Equity ETFsdeposited as collateral with the stock broker for availing MTF('Collaterals') and the stocks or units of Equity ETFspurchased under the MTF ('Funded stocks') shall be identifiable separately and no comingling shall be permitted for the purpose of computation of funding amount.;

ii. Collateral and Funded stocks shall be marked to market on a daily basis;

iii. In case of an increase in the value of Collaterals, stockbrokers may have the option of granting further exposure to their clients subject to applicable haircuts;

iv. However, no such exposure shall be permitted on the increased value of Funded stocks.

Stockbrokers shall ensure maintenance of the aforesaid margin at all times during the period that the margin trading facility is being availed by the client. In case of a shortfall, the stockbroker shall make necessary margin calls.
The exchange/stockbroker, based on the risk assessment, shall have the discretion to impose/collect a higher margin than the margin specified (above).

Liquidation of Securities by the Stockbroker in Case of Default by the Client

The stockbroker shall list out situations/conditions in which the securities may be liquidated and such situations/conditions shall be included in the "Rights and Obligations Document". The broker shall liquidate the securities if the client fails to meet the margin call to comply with the conditions as mentioned in this circular or specified in the "Rights and Obligations Document" specified by the exchange.

However, the broker shall not liquidate or use in any manner the securities of the client in any situation other than the conditions as stipulated by SEBI.

[25] https://www.sebi.gov.in/legal/circulars/nov-2022/inclusion-of-equity-exchange-traded-funds-as-list-of-eligible-securities-under-margin-trading-facility_65683.html

Eligibility Requirements for Stockbrokers to Provide Margin Trading Facility to Clients

- Only corporate stockbrokers with a net worth of at least Rs.3.00 crore shall be eligible to offer margin trading facilities to their clients.
- The "net worth" for the purpose of margin trading facility shall be as specified in SEBI (Stockbrokers) Regulations, 1992.
- The stockbrokers shall submit to the stock exchange a half-yearly certificate, as on 31st March and 30th September of each year, from an auditor confirming the net worth. Such a certificate shall be submitted not later than 30th April and 31st October of every year.

Source of Funds

- For the purpose of providing the margin trading facility, a stockbroker may use their own funds or borrow funds from scheduled commercial banks and/or NBFCs regulated by RBI, borrow funds by way of issuance of CP and by way of unsecured long term loans from their promoters and directors. The borrowing by way of issuance of CPs shall be subject to compliance with appropriate RBI Guidelines. The borrowing by way of unsecured long term loans from the promoters and directors shall be subject to the compliance with appropriate provisions of Companies Act, 2013.
- A stockbroker shall not be permitted to borrow funds from any other source, other than the sources stated above.
- The stockbroker shall not use the funds of any client for providing the margin trading facility to another client, even if the same is authorized by the first client.

Leverage and Exposure Limits

- At any point in time, the total indebtedness of a stockbroker for the purpose of margin trading shall not exceed 5 times its net worth, calculated as per para 12 above.
- The maximum allowable exposure of the broker towards the margin trading facility shall be within the self-imposed prudential limits and shall not, in any case, exceed the borrowed funds and 50% of his "net worth".

While providing the margin trading facility, the broker shall ensure that:

c) exposure to any single client at any point of time shall not exceed 10% of the broker's maximum allowable exposure.

d) exposure towards stocks and/or units of Equity ETFs purchased under MTF and collateral keptin the form of stocksand/or units of Equity ETFs are well diversified. Stock brokers shall have appropriate Board approved policy in this regard..

Disclosure Requirement

The stockbroker shall disclose to the stock exchanges details on gross exposure towards margin trading facility including name of the client, Category of holding (Promoter/promoter group or non-promoter), clients' Permanent Account Number ("PAN"), name of the scrips (Collateral stocks and Funded stocks) and if the stockbroker has borrowed funds for the purpose of providing margin trading facility, name of the lender and amount borrowed, on or before noon on the following trading day.

The stock exchanges shall disclose on their websites the scrip wise gross outstanding in margin accounts with all brokers to the market. Such disclosure regarding margin trading done on any day shall be made available after the trading hours, on the following day, through its website.

The stock exchanges shall put in place a suitable mechanism to capture and maintain all relevant details including member-wise, client-wise, scrip-wise information regarding outstanding positions in margin trading facility and also source of funds of the stockbrokers, on the exchange both on daily as well as on cumulative basis.

Rights and Obligations for Margin Trading

The stock exchanges shall frame a Rights and Obligations document laying down the rights and obligations of stockbrokers and clients for the purpose of a margin trading facility. The Rights and Obligations document shall be mandatory and binding on the Broker/Trading Member and the clients for executing trade in the Margin Trading framework.

The broker/exchange may modify the Rights and Obligations document only for stipulating any additional or more stringent conditions, provided that no such modification shall have the effect of diluting any of the conditions laid down in the circular or the Rights and Obligations document.

Maintenance of Records

The stockbroker shall maintain separate client-wise ledgers for funds and securities of clients availing margin trading facility.

The stockbroker shall maintain a separate record of details of the funds used and sources of funds for the purpose of margin trading.

The books of accounts, maintained by the broker, with respect to the margin trading facility offered by it, shall be audited on a half-yearly basis. The stockbroker shall submit an auditor's certificate to the exchange within one month from the date of the half-year ending 31st March and 30th September of a year certifying, inter alia, the extent of compliance with the conditions of the margin trading facility.

Other Conditions

- A broker shall take adequate care and exercise due diligence before providing a margin trading facility to any client.

- Any disputes arising between the client and the stockbroker in connection with the margin trading facility shall have the same treatment as normal trades and should be covered under the investor grievance redressal mechanism, arbitration mechanism of the stock exchange.

- SGF and IPF shall be available for transactions done on the exchange, whether through a normal or margin trading facility. However, any losses suffered in connection with the margin trading facility availed by the client from the stockbroker shall not be covered under IPF.

- The stockbrokers wishing to extend margin trading facility to their clients shall be required to obtain prior permission from the exchange where the margin trading facility is proposed to be offered. The exchange shall have the right to withdraw this permission at a later date, after giving reasons for the same.

12.5 Authorised Persons

An Authorised Person is 'Any person, individual, partnership firm, LLP or body corporate, who is appointed as such by a stock broker (including Trading Member) and who provides access to the trading platform of a Stock Exchange as an agent of the Stock broker'[26]

Individual, Partnership Firm, LLP or Body Corporate are eligible to be appointed as authorised subject to fulfilment of eligibility criteria specifically provided for each category

[26] NSE Ref no. NSE/MEMB/13429 dated November 9, 2009.

Conditions of Appointment

- The Trading Member and Authorised Person shall enter into a written agreement(s) in the form(s) prescribed by the Exchange. The agreement shall inter-alia cover the scope of the activities, responsibilities, confidentiality of information, commission sharing, termination clause etc.
- The Trading Member shall be responsible for all acts of omission and commission of the Authorised Person.
- All acts of omissions and commission of the Authorised Person shall be deemed to be that of the Trading Member.
- The Authorised Person shall not receive or pay any money or securities in its own name or account. All receipts and payments of securities and funds shall be made in the name of or account of a Trading Member.
- The Authorised Person shall receive his remuneration- fees, charges, commission, salary etc. for his services only from the Trading Member and he shall not charge any amount from the clients.
- A person shall not be appointed as an Authorised Person by more than one Trading Member.
- A partner or director of an Authorised Person shall not be appointed as an Authorised Person with the Exchange.
- The Authorized person is not permitted to accept the client's funds and securities. The Trading Member should keep a proper check. Proprietary trading by an Authorized person should be permitted only on his own funds and securities and not using any of the client's fund

12.6 Permitting Underwriting activities by Stockbrokers

In order to permit stockbrokers to carry out underwriting activities, SEBI has amended SEBI (Stockbroker) Regulations 1992, to incorporate provisions related to net-worth, maintenance of records and other compliances for underwriting activities. Key highlights are discussed below:

1) Definitions are inserted in **regulation 2 of SEBI (Stockbrokers) Regulations.** These include the following:

Underwriter– is a person who engages in the business of underwriting of the issue of securities of a body corporate.

Underwriting– This means an agreement to subscribe to or to procure subscription for securities which is issued or offered for sale remaining unsubscribed.

Issue– Issue means an offer of sale or purchase of securities by body corporate or by any other person or a group of persons on its or his or their behalf, as per the case, to or from the public or the holders of securities of such body corporate or person or a group of persons via merchant banker.

2) As per regulation 3, it has been provided that every stockbroker having a valid certificate of registration would be entitled to act as an underwriter.

3) Every stockbroker acting as an underwriter shall enter into an agreement that is valid with the body corporate on whose behalf it acts as an underwriter.

4) Every stockbroker acting as an underwriter should maintain the following books of account and documents, which includes-

- In relation to the underwriter being a body corporate- the copy of balance sheet and profit and loss account at the end of each accounting period and the copy of the auditor's report on the accounts for that period.
- In relation to the underwriter not being body corporate- records in respect of sums of money obtained and expended by them and the matters in respect of which the receipt and expenditure take place and their assets as well as liabilities.

5)Every stockbroker, acts as an underwriter, should enter into an agreement with each body corporate on whose behalf it acts as an underwriter, and the said agreement would, amongst other things, provide for-

- The period for which the agreement would be in force;
- The allocation of duties as well as responsibilities between the underwriter and client;
- The number of underwriting obligations;
- The period within which the underwriter must subscribe to the issue after its intimated by or on behalf of such body corporate;
- The commission amount or brokerage payable to the underwriter;
- If any, details of arrangements made by the underwriter for fulfilling underwriter obligations.

Responsibilities of a stockbroker as an underwriter

1) Every stockbroker acting as an underwriter should not derive any sort of direct or indirect benefit from underwriting the issue apart from the commission or brokerage payable under the agreement for underwriting.
2) The total underwriting obligations under all agreements should not exceed 20 times the net worth.

3) Every stockbroker acting as underwriter, in the event of being called upon to subscribe for the securities of a body corporate pursuant to an agreement, should subscribe to such securities in 45 days of the receipt of such intimation from such body corporate.

Duty as an underwriter

1) The stockbroker shall make all efforts to protect its client's interest;
2) He shall make sure that it and its personnel shall act in an unethical manner in all its dealings with body corporate making an issue of securities;
3) He shall not make any statement, oral or written, which can misrepresent-
   - Services that the underwriter is able to perform for its client or has rendered to any other issuer company;
   - His underwriting commitment.
4) A stockbroker should avoid conflict of interest and should make adequate disclosure of its interest;
5) He should put in place a mechanism to resolve conflicts of interest situation that can arise in the conduct of its business or, if it arises, must take reasonable steps to resolve them in an equitable manner;
6) He should make appropriate disclosures to the client about its possible source or potential areas of conflict of duties and interest when acting as an underwriter which can impair its ability to provide fair, objective, and unbiased services;
7) He should not divulge to other issuer, press, or any other party any confidential information regarding its issuer company that has come to its knowledge and deal in securities of an issuer company without making disclosure to the board and the board of directors of the issuer company;
8) The stockbroker should ensure that any change in registration status/any penal action by the board or any material change in the financials which can adversely affect the interests of clients/investors is informed promptly to the clients, and any business remaining outstanding is transferred to the other registered person as per any instruction of the affected clients/investors;
9) A stockbroker or any of the employees must not render, directly or indirectly any investment advice about any security in the publicly accessible media, real-time or non-real-time, unless a disclosure of its interest including its long/short position in the said security has been made while rendering such advice.

If an employee of the stockbroker renders such advice, the stockbroker should ensure that he shall disclose its interest, the interest of dependent family members and that of the employer including their long or short position in the said security, while rendering such advice.

- A stockbroker or any of its directors, partners, manager having the management of whole or substantially whole of business affairs, shall not either via account or their respective accounts or through their associates or family members, relatives or friends indulge in insider trading;
- Further, he shall not indulge in any unfair competition, which is likely to be harmful to the interest of other entities acting as underwriters carrying on the underwriting business or likely to place such other underwriters in a disadvantageous position pertaining to the underwriter while competing for, or carrying out an assignment;
- The underwriter should not be a party to or instrumental for-
    - Creation of false market;
    - Rigging of price or manipulation;
    - Passing of unpublished price-sensitive information in respect of securities that are listed or proposed to be listed in any stock exchange to any person or intermediary.

Case 12.1: Karvy Stock Broking Limited (KSBL) versus SEBI (SAT Appeal)

Facts of the case:

Based on a preliminary report dated November 22, 2019 given by NSE, the WTM SEBI issued an ex-parte ad interim order dated November 22, 2019 restraining the appellant from taking new clients in respect of its stock broking activities and also prevented the appellant from using the "power of attorney" given by its clients. The WTM also issued other directions the details of all the directions are extracted hereunder:

i. "KSBL is prohibited from taking new clients in respect of its stockbroking activities;

ii. The Depositories i.e., NSDL and CDSL, in order to prevent further misuse of clients' securities by KSBL, are hereby directed not to act upon any instruction given by KSBL in pursuance of power of attorney given to KSBL by its clients, with immediate effect;

iii. The Depositories shall monitor the movement of securities into and from the DP account of clients of KSBL as DP to ensure that clients' operations are not affected;

iv. The Depositories shall not allow transfer of securities from DP account no. 11458979, named KARVY STOCK BROKING LTD (BSE) with immediate effect. The transfer of securities from DP account no. 11458979, named KARVY STOCK BROKING LTD (BSE) shall be permitted only to the respective beneficial owner who has paid in full against these securities, under supervision of NSE; and

v. The Depositories and Stock Exchanges shall initiate appropriate disciplinary regulatory proceedings against the KSBL for misuse of clients' funds and securities as per their respective bye-laws, rules and regulations".

The appellant being aggrieved by the ex-parte ad-interim order has filed the present appeal. The learned senior counsel has confined his submission to only one aspect at this stage namely, the direction number (i) which restrains the appellant from using the power of attorney given by its clients. The learned senior counsel submitted that in due course they would be filing the application for revocation of order before the WTM but in the meantime since direction no. (ii) as stated aforesaid was creating a problem in the settling of the trades of their clients with the clearinghouse it became necessary to seek certain clarifications from the WTM and, in this regard, the appellant issued letters dated November 24, 2019, November 25 and November 26, 2019 seeking certain clarifications. Since no response came forward from the respondent the appeal was filed for this limited purpose.

Findings of the case:

It was contended that direction number no. (ii) restrains the appellant from not acting upon the instructions given to it by its clients pursuant to the power of attorney. Direction number no. (ii) has resulted in the appellants' inability to execute the instructions given by its clients on the basis of the power of attorney. Since the client of the appellant are trading online, they are also unable to transfer the securities from the client Demat account to the pool account for the purpose of clearing the trades with the clearinghouse. Considering the aforesaid, the necessary clarifications were sought from the respondent. On the other hand, the learned senior counsel for the respondent contended that they have serious apprehension in allowing the prayer of the appellant as it might lead to further misuse of the power of attorney given to them by their clients.

Order:

Appeal disposed of with a direction to the WTM to consider the request of the appellant and pass appropriate order after giving an opportunity of hearing to the appellant.

Subsequent developments

1) on December 02, 2019, NSDL issued a press release stating that the securities held in the DP Account had been transferred to the Demat accounts of around 82,559 beneficial owners.

2) on December 13, 2019, SEBI passed an **order** rejecting the plea of the Lenders stating that in the absence of any authorisation from Karvy's clients, the transfer of clients' securities by Karvy to its own DP account amounted to misappropriation and hence, the pledge created in favour of Lenders was invalid. According to the said order, though a Power of Attorney (**PoA**) was executed in favour of Karvy by its clients, the said PoA could have been acted upon only after an order or

instruction was received from such clients for trading on the stock exchanges. In the absence of such authorization, the transfer of securities amounted to misuse of the PoA by Karvy. SEBI held that since the securities in the DP Account belonged to Karvy's clients, the said pledges were unauthorised and invalid, and therefore no rights were created in favour of the Lenders in respect of such securities

3) Further, it was held that in view of the SEBI circular dated June 20, 2019, which prohibited stockbrokers from pledging clients' securities except for meeting clients' pay-in obligations, the pledges continued post the said date were invalid. SEBI further observed that the Lenders had failed to verify Karvy's title over such pledged securities

Final Order:

On November 24, 2020 SEBI passed a confirmatory order. The said order stated the following:
a) NSE vide its email dated November 17, 2020 has informed SEBI that it has issued a press statement informing those funds and securities worth Rs 2,300 crore belonging to about 2.35 lakh investors of KSBL have been settled so far
b) On November 23, 2020, NSE has expelled KSBL and also declared KSBL as a defaulter
c) appropriate actions against KSBL and its directors, are to be initiated by SEBI for violation of the securities laws, as have been found in the forensic audit report and order dated November 23, 2020 of NSE
c)confirmation of the directions issued vide ex-parte ad interim order dated November 22, 2019.
d)KSBL not to alienate any of its assets except with the prior permission of NSE till the settlement of claims of the investors or under direction or order by any Court or Tribunal.

Case 12.2: Reflection Investments versus National Stock Exchange of India Limited (NSE)

Facts of the case:

1. This appeal to SAT has been filed by Reflection Investment (Trading member of NSE) aggrieved by the Order of the NSE dated January 14, 2020 whereby, inter alia, the appellants' (Reflection Investments) membership has been suspended and subsequently effected from January 15, 2020.

2. The appellant is a registered partnership firm and is a SEBI registered trading member of NSE since 1995. The appellant was served with a show-cause notice dated July 30, 2019 by NSE alleging various violations and directing it to show cause as to why action, including suspension and/or monetary penalty, should not be taken against the appellant for the stated alleged violations. The appellant in its reply dated August 19, 2019 assured full compliance with the NSE Rules and Regulations and requested to take a lenient view on some of the violations which inadvertently happened. Thereafter, the Member and Core Settlement Guarantee Fund Committee ("MCSGFC" for convenience) in its meeting held on December 20, 2019 passed an

interim direction prohibiting the appellant from doing any new client registration which was communicated to the appellant vide NSE letter dated December 23, 2019. Thereafter vide impugned order dated January 14, 2020 a penalty of Rs. 5,47,900/- has been levied on the appellant and ordered suspension of the appellant from the membership of the NSE in all segments from the date of this order till the appellant infuses fresh funds/ capital to recoup the shortfall of client funds reported in weekly enhanced supervision submissions and thereafter submits suitable evidence to the satisfaction of the Exchange at the earliest and not later than 45 days from the date of the order. Thereafter, on January 15, 2020 the suspension was effected.

Contentions of the parties:

It is the submission of Shri Vijay Sambrani, Managing Partner of the appellant, appearing on behalf of the appellant that the order suspending the operation of the appellant without any notice has come as a shock since the appellant was making all-out efforts in enhancing its compliance systems and for infusing more funds. Since the suspension was affected from the very next day itself no option was available to the appellant in saving its business. Without going into the details regarding the merits of the case it is the submission of the authorised representative of the appellant that as an immediate relief the appellant may be allowed to operate his broking business to a limited extent which would make it feasible for bringing in more funds. He submitted that already some funds have been infused and by January 31, 2020 he would infuse Rs. 1 crore more so as to reduce the outstanding shortfall to Rs. 5.75 crores by that date and thereafter by the end of each month he would infuse Rs. 1 crore each. Therefore, in effect by the end of six months the entire outstanding shortfall would be wiped out. He also submitted that the appellant may be allowed to operate subject to limits of trading in the cash segment of the Exchange alone till the shortfall is completely removed and if there is any interim increase in the shortfall suspension may be re-implemented. In short, the authorised representative seeks to keep the business alive though in a truncated way and subject to enhanced supervision of NSE and with a time-bound plan of bringing down the shortfall in funds.

We have also heard Shri Boatwalla, learned counsel appearing for respondent NSE as well as perused the records produced before us. We note that there have been a number of charges against the appellant in the show cause notice many of which are sustained in the impugned order as well.

We also note that as an interim direction the appellant was prohibited from registering any new clients. We are also told that the appellant is immediately willing to pay a penalty amount of Rs. 5,47,900/-.

Moreover, the MCSGFC has given a window of up to 45-day time to implement necessary steps to the appellant to infuse funds to recoup the shortfall of client funds. However, from the very next day of the impugned order suspension has been effected.

Conclusion:

Given the above facts and circumstances and the assurance given by the Managing Partner of the appellant, we are of the considered view that some limited relief to the appellant is in the interest of justice. After all, suspending or closing down the business of a broker is in nobody's interest unless it is conclusively proved that the broker is working against the interest of the investors or that of the securities market. The main finding in this matter is relating to some shortfall of client funds reported in the weekly enhanced supervision. Though, this is a serious offence it may not require an immediate cessation of all activities of the appellant. At the same time, we are not inclined to give the relief in terms of the time lines as prayed by the appellant.

Order:

- Appellant shall pay the monetary penalty of Rs. 5,47,900/- within one week.
- If the appellant infuses Rs. 1 crore funds and thereby reduce the shortfall from the current level of Rs. 6.75 crores to Rs. 5.75 crores by January 31, 2020 NSE shall allow the appellant to operate in the cash segment of the Exchange using one Terminal i.e., Terminal No. 5621.
- Permission for the limited trading as at (b) above shall be subject to enhanced supervision of NSE and on the condition that it shall not result in any additional shortfall of client funds.
- Appellant shall recoup the remaining shortfall of Rs. 5.75 crores in two instalments of Rs. 3 crores by February 29, 2020 and Rs. 2.75 crores by March 31, 2020.

NSE shall be at liberty to re-impose the suspension or to take any other appropriate measures in case of failure of the appellant in complying with any of the aforesaid directions

NSE expelled and also declared Reflection Investment as a defaulter on 12th March 2021.

12.7 SEBI (Alternative Investment Funds) Regulations, 2012

12.7.1 Registration as Alternative Investment Funds (AIF)

Alternative Investment Fund means any fund established or incorporated in India in the form of a trust or a company or a limited liability partnership or a body corporate which-

(i) is a privately pooled investment vehicle that collects funds from investors, whether Indian or foreign, for investing it in accordance with a defined investment policy for the benefit of its investors; and

(ii) is not covered under the SEBI (Mutual Funds) Regulations, 1996, SEBI (Collective Investment Schemes) Regulations, 1999 or any other regulations of SEBI to regulate fund management activities:
Provided that the following shall not be considered as Alternative Investment Fund for the purpose of these regulations-
(i) family trusts set up for the benefit of relatives 'as defined under Companies Act, 2013;
(ii) ESOP Trusts set up under the SEBI (Share Based Employee Benefits) Regulations, 2014 or as permitted under Companies Act, 2013;
(iii) employee welfare trusts or gratuity trusts set up for the benefit of employees;
(iv) holding companies as defined under sub-section 46 of section 2 of the Companies Act, 2013;
(v) other special-purpose vehicles not established by fund managers, including securitization trusts, regulated under a specific regulatory framework;
(vi) funds managed by a securitisation company or reconstruction company which is registered with the Reserve Bank of India under Section 3 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002; and
(vii)any such pool of funds which is directly regulated by any other regulator in India;

Hedge Fund means AIF which employs diverse or complex trading strategies and invests and trades in securities having diverse risks or complex products including listed and unlisted derivatives.

Infrastructure fund means AIF which invests primarily in unlisted securities or partnership interest or listed debt or securitised debt instruments of investee companies or special purpose vehicles engaged in or formed for the purpose of operating, developing or holding infrastructure projects

Any person or entity wanting to commence business as an AIF should make an application to SEBI for a grant of certificate of registration in the format as prescribed by SEBI.

Alternative Investment Funds shall seek registration in one of the categories mentioned in the SEBI (Alternative Investment Funds) Regulations and in the case of Category I Alternative Investment Fund, in one of the sub-categories thereof.

a. "Category I Alternative Investment Fund" which invests in start-up or early-stage ventures or social ventures or SMEs or infrastructure or other sectors or areas which the government or regulators consider as socially or economically desirable and shall include venture capital funds, SME Funds, social impact funds, infrastructure funds, special situation funds and such other Alternative Investment Funds as may be specified.

For the purpose of this clause, Alternative Investment Funds which are generally perceived to have positive spillover effects on the economy and for which the Board or Government of India or other regulators in India might consider providing incentives or concessions shall be included and such funds which are formed as trusts or companies shall be construed as "venture capital company" or "venture capital fund" as specified under sub-section (23FB) of Section 10 of the Income Tax Act, 1961.

b. "Category II Alternative Investment Fund" does not fall in Category I and III and does not undertake leverage or borrowing other than to meet day-to-day operational requirements and as permitted in these regulations.

   For the purpose of this clause, Alternative Investment Funds such as private equity funds or debt funds for which no specific incentives or concessions are given by the government or any other Regulator shall be included.

c. "Category III Alternative Investment Fund" employs diverse or complex trading strategies and may employ leverage including through investment in listed or unlisted derivatives.

   For the purpose of this clause, Alternative Investment Funds such as hedge funds or funds that trade with a view to make short term returns or such other funds that are open-ended and for which no specific incentives or concessions are given by the government or any other Regulator shall be included.

12.7.2 Eligibility Criteria

The applicant shall satisfy the following conditions, for SEBI to consider the application for grant of certificate:

a. the memorandum of association in case of a company; or the Trust Deed in case of a Trust; or the Partnership deed in case of a limited liability partnership permits it to carry on the activity of an Alternative Investment Fund;

b. the applicant is prohibited by its memorandum and articles of association or trust deed or partnership deed from making an invitation to the public to subscribe to its securities;

c. in case the applicant is a Trust, the instrument of trust is in the form of a deed and has been duly registered under the provisions of the Registration Act, 1908;

d. in case the applicant is a limited liability partnership, the partnership is duly incorporated and the partnership deed has been duly filed with the Registrar under the provisions of the Limited Liability Partnership Act, 2008;

e. in case the applicant is a body corporate, it is set up or established under the laws of the Central or State Legislature and is permitted to carry on the activities of an Alternative Investment Fund;

f. the applicant, Sponsor and Manager are fit and proper persons based on the criteria specified in Schedule II of the SEBI (Intermediaries) Regulations, 2008;

g. The key investment team of the Manager of Alternative Investment Fund has -

(i) adequate experience, with at least one key personnel having not less than five years of experience in advising or managing pools of capital or in fund or asset or wealth or portfolio management or in the business of buying, selling and dealing of securities or other financial assets; and

(ii) at least one key personnel with professional qualification in finance, accountancy, business management, commerce, economics, capital market or banking from a university or an institution recognized by the Central Government or any State Government or a foreign university, or a CFA charter from the CFA institute or any other qualification as may be specified by the Board:
Provided that the requirements of experience and professional qualification as specified in regulation 4(g)(i) and 4(g)(ii) may also be fulfilled by the same key personnel.]

h. the Manager or Sponsor has the necessary infrastructure and manpower to effectively discharge its activities;

i. the applicant has clearly described at the time of registration the investment objective, the targeted investors, proposed corpus, investment style or strategy and proposed tenure of the fund or scheme;

j. whether the applicant or any entity established by the Sponsor or Manager has earlier been refused registration by SEBI.

12.7.3 Conditions of certificate

(1) The certificate granted under regulation 6 shall, inter-alia, be subject to the following conditions:

a. The Alternative Investment Fund shall abide by the provisions of the Act and these regulations;

b. The Alternative Investment Fund shall not carry on any other activity other than permitted activities;

c. The Alternative Investment Fund shall forthwith inform SEBI in writing, if any information or particulars previously submitted to SEBI are found to be false or misleading in any material particular or if there is any material change in the information already submitted.

(2) An Alternative Investment Fund that has been granted registration under a particular category cannot change its category subsequent to registration, except with the approval of SEBI.

12.7.4 Investment conditions and Restrictions

Investment Strategy

(1) All Alternative Investment Funds shall state investment strategy, investment purpose and its investment methodology in its placement memorandum to the investors.

(2) Any material alteration to the fund strategy shall be made with the consent of at least two-thirds of unit holders by value of their investment in the Alternative Investment Fund.

Investment in Alternative Investment Fund

Investment in all categories of Alternative Investment Funds shall be subject to the following conditions:

a. The Alternative Investment Fund may raise funds from any investor whether Indian, foreign or non-resident Indians by way of issue of units. However, a social impact fund or schemes of a social impact fund may also issue social units.

b. Each scheme of the Alternative Investment Fund shall have a corpus of at least twenty crore rupees. It is further stated that each scheme of the social impact fund shall have a corpus of at least five crore rupees.

c. The Alternative Investment Fund shall not accept from an investor, an investment of value less than one crore rupees. *Provided that in the case of investors who are employees or directors of the Alternative Investment Fund or employees or directors of the Manager, the minimum value of investment shall be twenty-five lakh rupees.* This clause shall not apply to an accredited investor. Further it is stated that in case of a social impact fund which invests only in securities of not for profit organizations registered or listed on a social stock exchange, the minimum value of investment by an individual investor shall be two lakh rupees.

d. The Manager or Sponsor shall have a continuing interest in the Alternative Investment Fund of not less than two and a half per cent of the corpus or five crore rupees, whichever is lower, in the form of investment in the Alternative Investment Fund and such interest shall not be through the waiver of management fees. *Provided that for Category III Alternative Investment Fund, the continuing interest shall be not less than five per cent of the corpus or ten crore rupees, whichever is lower.*

e. The Manager or Sponsor shall disclose their investment in the Alternative Investment Fund to the investors of the Alternative Investment Fund;

f. No scheme of the Alternative Investment Fund shall have more than 1000 investors; *Provided* that the provisions of the Companies Act, 2013 shall apply to the Alternative Investment Fund, if it is formed as a company.

g. The fund shall not solicit or collect funds except by way of a private placement.

Placement Memorandum

1. Alternative Investment Fund shall raise funds through private placement by issue of information memorandum or placement memorandum, by whatever name called.
2. Such information or placement memorandum as specified in point no. 1 shall contain all material information about the Alternative Investment Fund and the Manager, background of the key investment team of the Manager, targeted investors, fees and all other expenses proposed to be charged, tenure of the Alternative Investment Fund or scheme, conditions or limits on redemption, investment strategy, risk management tools and parameters employed, key service providers, terms of reference of the committee constituted for approving the decisions of the Alternative Investment Fund, conflict of interest and procedures to identify and address them, disciplinary history, the terms and conditions on which the Manager offers investment services, its affiliations with other intermediaries, manner of winding up of the Alternative Investment Fund or the scheme and such other information as may be necessary for the investor to take an informed decision on whether to invest in the Alternative Investment Fund.

Schemes

1. The Alternative Investment Fund may launch schemes subject to the filing of placement memorandum with SEBI.
2. Such placement memorandum shall be filed with the SEBI through a merchant banker at least 30 days prior to the launch of the scheme along with the fees as specified in the regulations, provided that payment of scheme fees shall not apply in case of the launch of the first scheme by the Alternative Investment Fund.
3. The Board may communicate its comments, if any, to the merchant banker prior to launch of the scheme and the merchant banker shall ensure that the comments are incorporated in the placement memorandum prior to launch of the scheme

   Provided that the requirements under sub-regulation (2) and (3) shall not apply to large value fund for accredited investors.

Tenure

1. Category I Alternative Investment Fund and Category II Alternative Investment Fund shall be close-ended and the tenure of fund or scheme shall be determined at the time of application subject to sub-regulation (2) of this regulation.
2. Category I and II Alternative Investment Fund or schemes launched by such funds shall have a minimum tenure of three years.
3. Schemes of Category III Alternative Investment Fund may be open-ended or close-ended.

4. The manner of calculating the tenure of a close ended scheme of an Alternative Investment Fund, including the manner of modification of the tenure, may be specified by the Board from time to time.]

5. Extension of the tenure of the close-ended Alternative Investment Fund may be permitted up to two years subject to the approval of two-thirds of the unitholders by value of their investment in the Alternative Investment Fund. Provided that large value funds for accredited investors may be permitted to extend its tenure beyond two years, subject to terms of the contribution agreement, other fund documents and such conditions as may be specified by the Board from time to time.

6. In the absence of consent of unitholders, the Alternative Investment Fund shall fully liquidate within one year following the expiration of the fund tenure or extended tenure.

Listing

1. Units of close-ended Alternative Investment Fund may be listed on stock exchange subject to a minimum tradable lot of one crore rupees.

2. Listing of Alternative Investment Fund units shall be permitted only after the final close of the fund or scheme.

General Investment Conditions.

Investments by all categories of Alternative Investment Funds shall be subject to the following conditions:

(a) Alternative Investment Fund may invest in securities of companies incorporated outside India subject to such conditions or guidelines that may be stipulated or issued by the Reserve Bank of India and SEBI from time to time;

(b) The terms of Co-investment in an investee company by a Manager or Sponsor or co-investor, shall not be more favourable than the terms of investment of the Alternative Investment Fund. However, the terms of exit from the Co-investment in an investee company including the timing of exit shall be identical to the terms applicable to that of exit of the Alternative Investment Fund. It is further stated that the above proviso shall be applicable only for co-investment made from the date of coming into force of this regulation;]

(c) Category I and II of Alternative Investment Funds shall invest not more than twenty five per cent of the investable funds in an Investee Company directly or through investment in the units of other Alternative Investment Funds. However, large value funds for accredited investors of Category I and II may invest up to fifty percent of the investable funds in an investee company directly or through investment in the units of other Alternative Investment Funds;

(d) Category III Alternative Investment Funds shall invest not more than ten per cent of the investable funds in an Investee Company, directly or through investment in units of other Alternative Investment Funds and the large value funds for accredited investors of Category

III Alternative Investment Funds may invest up to twenty per cent of the investable funds in an Investee Company, directly or through investment in units of other Alternative Investment Funds:

Provided that for investment in listed equity of an Investee Company, Category III Alternative Investment Funds may calculate the investment limit of ten per cent of either the investable funds or the net asset value of the scheme and large value funds for accredited investors of Category III Alternative Investment Funds may calculate the investment limit of twenty per cent of either the investable funds or the net asset value of the scheme, subject to the conditions specified by the Board from time to time;]

(e) Alternative Investment Funds which are authorised under the fund documents to invest in units of Alternative Investment Funds shall not offer their units for subscription to other Alternative Investment Funds

(f) Alternative Investment Fund shall not invest except with the approval of seventy five percent of investors by value of their investment in the Alternative Investment Fund in -

(a) associates; or

(b) units of Alternative Investment Funds managed or sponsored by its Manager, Sponsor or associates of its Manager or Sponsor;];

(g) Un-invested portion of the investable funds and divestment proceeds pending distribution to investors may be invested in liquid mutual funds or bank deposits or other liquid assets of higher quality such as Treasury bills, Triparty Repo Dealing and Settlement, Commercial Papers, Certificates of Deposits, etc. till the deployment of funds as per the investment objective or the distribution of the funds to investors as per the terms of the fund documents, as applicable.ive;

(h) Alternative Investment Fund may act as Nominated Investor as specified in clause (b) of sub-regulation (1) of regulation 106N of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009.

(i) Investment by Category I and Category II Alternative Investment Funds in the shares of entities listed on institutional trading platform after the commencement of Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) (Fourth Amendment) Regulations, 2015 shall be deemed to be an investment in 'unlisted securities' for the purpose of these regulations.

Notwithstanding the conditions as specified above, SEBI may specify additional requirements or criteria for Alternative Investment Funds or a specific category thereof.

Conditions for Category I Alternative Investment Funds

1. The following investment conditions shall apply to all Category I Alternative Investment Funds:

   (a) Category I Alternative Investment Fund shall invest in investee companies, venture capital undertaking, special purpose vehicles, limited liability partnerships, in units of other Category I Alternative Investment Funds of the same sub category, or in units of Category II Alternative Investment Funds as specified in this regulation;

   (b) Category I Alternative Investment Funds may engage in hedging, including credit default swaps in terms of the conditions as may be specified by the Board from time to time.

   (c) Category I Alternative Investment Funds shall not borrow funds directly or indirectly or engage in any leverage except for meeting temporary funding requirements for not more than thirty days, on not more than four occasions in a year and not more than ten per cent of the investable funds.

2. The following investment conditions shall apply to venture capital funds in addition to conditions laid down in sub-regulation (1):

   (a) at least seventy-five percent of the investable funds shall be invested in unlisted equity shares or equity linked instruments of a venture capital undertaking or in companies listed or proposed to be listed on a SME exchange or SME segment of an exchange:

   However, the investment conditions specified in clause (a) shall be achieved by the fund by the end of its life cycle.;

   (b) such funds may enter into an agreement with merchant banker to subscribe to the unsubscribed portion of the issue or to receive or deliver securities in the process of market making under Chapter IX of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018 and the provisions of clause (a) and clause (b) of sub-regulation (2) shall not apply in case of acquisition or sale of securities pursuant to such subscription or market-making.

   (c) such funds shall be exempt from sub-regulations (1) and (2) of regulation 3 and sub-regulation (1) of regulation 4 of the Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015 in respect of investment in companies listed on the SME exchange or SME segment of an exchange pursuant to due diligence of such companies subject to the following conditions:

   (i) the fund shall disclose any trading in securities pursuant to such due-diligence, within two trading days of such trading, to the stock exchanges where the investee company is listed;

   (ii) such investment shall be locked in for a period of one year from the date of investment.

3. The following conditions shall apply to SME Funds in addition to conditions laid down in sub-regulation (1):

(a) at least 75 per cent of the investable funds shall be invested in unlisted securities or partnership interest of venture capital undertakings or investee companies which are SMEs or in companies listed or proposed to be listed on SME exchange or SME segment of an exchange or in units of Category II Alternative Investment Funds which invest primarily in such venture capital undertakings or investee companies ;

(b) such funds may enter into an agreement with merchant banker to subscribe to the unsubscribed portion of the issue or to receive or deliver securities in the process of market making under Chapter IX of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018;

(c) such funds shall be exempt from sub-regulations (1) and (2) of regulation 3 and sub-regulation (1) of regulation 4 of the Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015 in respect of investment in companies listed on the SME exchange or SME segment of an exchange pursuant to due diligence of such companies subject to the following conditions:

(i) the fund shall disclose any trading in securities pursuant to such due-diligence, within two trading days of such trading, to the stock exchanges where the investee company is listed;

(ii) such investment shall be locked in for a period of one year from the date of investment.

4. The following conditions shall apply to social impact funds in addition to the conditions laid down in sub-regulation (1):

(a) at least seventy-five per cent of the investable funds shall be invested in unlisted securities or partnership interests of social ventures or in units of social ventures or in securities of social enterprises:

Provided that an existing social impact fund may invest the remaining investable funds in securities of not for profit organizations registered or listed on a social stock exchange with the prior consent of atleast 75% of the investors by value of their investment;]

(b) such funds may accept grants, provided that such utilization of such grants shall be restricted to clause (a):

However, the amount of grant that may be accepted by the fund from any person shall not be less than ten lakh rupees:

It is further stated that the minimum amount of grant shall not apply to accredited investors and that no profits or gains shall accrue to the provider of such grants.

(c)Notwithstanding the provisions of clauses (a) and (b), a social impact fund or schemes of a social impact fund launched exclusively for a not for profit organization registered or listed on a social stock exchange, shall be permitted to deploy or invest hundred percent of the investable funds in the securities of not for profit organizations registered or listed on a social stock exchange.

(d) such funds may give grants to social ventures or social enterprises, provided that appropriate disclosure is made in the placement memorandum.

5. The following conditions shall apply to Infrastructure Funds in addition to conditions laid down in sub-regulation (1):

(a) at least seventy-five per cent of the investable funds shall be invested in unlisted securities or units or partnership interest of venture capital undertaking or investee companies or special purpose vehicles, which are engaged in or formed for the purpose of operating, developing or holding infrastructure projects or in units of Category II Alternative Investment Funds which invest primarily in such venture capital undertakings or investee companies or special purpose vehicles;

(b) notwithstanding clause (a) of sub-regulation (5), such funds may also invest in listed securitized debt instruments or listed debt securities of investee companies or special purpose vehicles, which are engaged in or formed for the purpose of operating, developing or holding infrastructure projects.

Conditions for Category II Alternative Investment Funds

The following investment conditions shall apply to Category II Alternative Investment Funds:

a) Category II Alternative Investment Funds shall invest in investee companies or in the units of Category I or other Category II Alternative Investment Funds as may be disclosed in the placement memorandum;

Category II Alternative Investment Fund shall invest primarily in unlisted companies directly or through investment in units of other Alternative Investment Funds;;

b) Category II Alternative Investment Funds may not borrow funds directly or indirectly and shall not engage in leverage except for meeting temporary funding requirements for not more than thirty days, not more than four occasions in a year and not more than ten per cent of the investable funds;

c) Notwithstanding clause (c), Category II Alternative Investment Funds may engage in hedging, subject to guidelines as specified by the Board from time to time;

d) Category II Alternative Investment Funds may buy or sell credit default swaps in terms of the conditions as may be specified by the Board from time to time.

e) Category II Alternative Investment Funds may enter into an agreement with merchant bankers to subscribe to the unsubscribed portion of the issue or to receive or deliver securities in the process of market making under Chapter IX of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018.

f) Category II Alternative Investment Funds shall be exempt from sub-regulations (1) and (2) of regulation 3 and sub-regulation (1) of regulation 4 of the Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015 in respect of investment in companies

listed on the SME exchange or SME segment of an exchange pursuant to due diligence of such companies subject to the following conditions:

(i) the fund shall disclose any trading in securities pursuant to such due-diligence, within two trading days of such trading, to the stock exchanges where the investee company is listed;

(ii) such investment shall be locked in for a period of one year from the date of investment.

Conditions for Category III Alternative Investment Funds

The following investment conditions shall apply to Category III Alternative Investment Funds:

a) Category III Alternative Investment Funds may invest in securities of listed or unlisted investee companies, derivatives, units of other Alternative Investment Funds or complex or structured products;;

b) Category III Alternative Investment Funds may deal in goods received in delivery against physical settlement of commodity derivatives;

c) Category III Alternative Investment Funds may buy or sell credit default swaps in terms of the conditions as may be specified by the Board from time to time. [27]

d) Category III Alternative Investment Funds may engage in leverage or borrow subject to consent from the investors in the fund and subject to a maximum limit, as may be specified by SEBI. Provided that such funds shall disclose information regarding the overall level of leverage employed, the level of leverage arising from the borrowing of cash, the level of leverage arising from the position held in derivatives or in any complex product and the main source of leverage in their fund to the investors and to the Board periodically, as may be specified by SEBI.

e) Category III Alternative Investment Funds shall be regulated through issuance of directions regarding areas such as operational standards, conduct of business rules, prudential requirements, restrictions on redemption and conflict of interest as may be specified by SEBI.

Other Alternative Investment Fund

SEBI may lay down framework for Alternative Investment Funds other than the Funds falling in the categories specified in these regulations.

12.7.5 General Obligations of AIF

General Obligations

(1) Alternative Investment Fund, key management personnel of the Alternative Investment Fund, trustee, trustee company, directors of the trustee company, designated partners or directors of the Alternative Investment Fund, as the case may be, managers and key management personnel of managers shall abide by the Code of Conduct as specified in the Fourth Schedule.

[27] https://www.sebi.gov.in/legal/circulars/jan-2023/participation-of-aifs-in-credit-default-swaps_67264.html

Explanation.– For the purpose of this sub-regulation, 'key management personnel' shall have the meaning as specified by the Board from time to time.

(2) The Manager and either the trustee or trustee company or the Board of Directors or the designated partners of the Alternative Investment Fund, as the case may be, shall ensure compliance by the Alternative Investment Fund with the Code of Conduct as specified in the Fourth Schedule.

(3) All Alternative Investment Funds shall have detailed policies and procedures, as approved jointly by the Manager and the trustee or trustee company or Board of Directors or designated partners of the Alternative Investment Fund, as the case may be, to ensure that all the decisions of the Alternative Investment Fund are in compliance with the provisions of these regulations, terms of the placement memorandum, agreements made with investors, other fund documents and applicable laws.

(4) All Alternative Investment Funds shall review the policies and procedures laid down in terms of sub regulation (3) of this regulation, other internal policies, if any, and their implementation, on a regular basis or as a result of business developments, to ensure their continued appropriateness.

(5) The Manager shall be responsible for every decision of the Alternative Investment Fund, including ensuring that the decisions are in compliance with the provisions of these regulations, terms of the placement memorandum, agreements made with investors, other fund documents and applicable laws.

(6) The Manager shall be responsible for ensuring that every decision of the Alternative Investment Fund is in compliance with the policies and procedures laid down for the Alternative Investment Fund in terms of sub regulation (3) of this regulation and other internal policies of the Alternative Investment Fund, as applicable.

(7) The Manager may constitute an Investment Committee (by whatever name called), to approve the decisions of the Alternative Investment Fund and such constitution shall be subject to such conditions as specified by the Board from time to time.

(8) The members of the Investment Committee shall be responsible for ensuring that the decisions of the Investment Committee are in compliance with the policies and procedures laid down in terms of sub regulation (3) of this regulation:

(9) Provided that sub-regulation (8) of this regulation shall not apply to an Alternative Investment Fund in which each investor other than the Manager, Sponsor, employees or directors of the Alternative Investment Fund or employees or directors of the Manager, has committed to invest not less than seventy crore rupees (or an equivalent amount in currency other than Indian rupees) and has furnished a waiver to the Alternative Investment Fund in respect of compliance with the said sub-regulation, in the manner as may be specified by the Board.

(10) The members of the Investment Committee shall abide by the Code of Conduct applicable to them as specified in Fourth Schedule.

(11) The external members of the Investment Committee whose names are not disclosed in the placement memorandum or in the agreement made with the investor or any other fund document at the time of on-boarding investors shall be appointed to the Investment Committee only with the consent of at least seventy five percent of the investors by the value of their investment in the Alternative Investment Fund or scheme.

(12) The Sponsor or Manager of the Alternative Investment Fund shall appoint a custodian registered with the Board for safekeeping of the securities if the corpus of the Alternative Investment Fund is more than five hundred crore rupees:

Provided that the Sponsor or Manager of a Category III Alternative Investment Fund shall appoint such a custodian, irrespective of the size of the corpus of the Alternative Investment Fund:

Provided further that the custodian appointed by Category III Alternative Investment Fund shall keep the custody of the securities and goods received in delivery against the physical settlement of commodity derivatives.

Provided further that the Sponsor or Manager of the Category I and Category II Alternative Investment Fund transacting in credit default swaps shall appoint a custodian registered with the Board and comply with such terms and conditions as may be specified by the Board.

(13) All Alternative Investment Funds shall inform the Board in case of any material change from the information provided by the Alternative Investment Fund at the time of application for registration.

(14) In case of change of Sponsor or Manager or change in control of the Alternative Investment Fund, Sponsor or Manager, prior approval from the Board shall be taken by the Alternative Investment Fund subject to levy of fees and any other conditions as may be specified by the Board from time to time.

(15) The books of accounts of the Alternative Investment Fund shall be audited annually by a qualified auditor.

(16) The manager shall not provide advisory services to any investor other than the clients of Co-investment Portfolio Manager as specified in the Securities and Exchange Board of India (Portfolio Managers) Regulations, 2020, for investment in securities of investee companies where the Alternative Investment Fund managed by it makes investment.

(17) The Manager and either the trustee or the trustee company or the Board of Directors or designated partners of the Alternative Investment Fund, as the case may be, shall ensure that the assets and liabilities of each scheme of an Alternative Investment Fund are segregated

and ring-fenced from other schemes of the Alternative Investment Fund; and bank accounts and securities accounts of each scheme are segregated and ring-fenced.

Conflict of Interest

- The Sponsor and Manager of the Alternative Investment Fund shall act in a fiduciary capacity towards its investors and shall disclose to the investors, all conflicts of interests as and when they arise or seem likely to arise.
- Manager shall establish and implement written policies and procedures to identify, monitor and appropriately mitigate conflicts of interest throughout the scope of business.
- Managers and Sponsors of Alternative Investment Fund shall abide by high-level principles on avoidance of conflicts of interest with associated persons, as may be specified by SEBI from time to time.

Transparency

- All Alternative Investment Funds shall ensure transparency and disclosure of information to investors on the following:
  a. financial, risk management, operational, portfolio, and transactional information regarding fund investments shall be disclosed periodically to the investors;
  b. any fees ascribed to the Manager or Sponsor; and any fees charged to the Alternative Investment Fund or any investee company by an associate of the Manager or Sponsor shall be disclosed periodically to the investors;
  c. any inquiries/ legal actions by legal or regulatory bodies in any jurisdiction, as and when occurred;
  d. any material liability arising during the Alternative Investment Fund's tenure shall be disclosed, as and when occurred;
  e. any breach of a provision of the placement memorandum or agreement made with the investor or any other fund documents, if any, as and when occurred;
  f. change in control of the Sponsor or Manager or Investee Company.
  g. Alternative Investment Fund shall provide at least on an annual basis, within 180 days from the year-end, reports to investors including the following information, as may be applicable to the Alternative Investment Fund:

     A. Financial information of investee companies.
     B. Material risks and how they are managed which may include:
        i. concentration risk at fund level;
        ii. foreign exchange risk at fund level;
        iii. (iii)leverage risk at fund and investee company levels;

iv. realization risk (i.e., change in exit environment) at fund and investee company levels;
v. strategy risk (i.e., change in or divergence from business strategy) at investee company level;
vi. reputation risk at investee company level;
vii. extra-financial risks, including environmental, social and corporate governance risks, at fund and investee company level.

h. Category III Alternative Investment Fund shall provide quarterly reports to investors in respect of clause (g) within 60 days of the end of the quarter;

i. Any significant change in the key investment team shall be intimated to all investors;

j. Alternative Investment Funds shall provide, when required by SEBI, information for systemic risk purposes (including the identification, analysis and mitigation of systemic risks).

Valuation

- The Alternative Investment Fund shall provide to its investors, a description of its valuation procedure and of the methodology for valuing assets.
- Category I and Category II Alternative Investment Funds shall undertake valuation of their investments, at least once in every six months, by an independent valuer appointed by the Alternative Investment Fund. Provided that such period may be enhanced to one year on approval of at least seventy-five per cent of the investors by the value of their investment in the Alternative Investment Fund.
- Category III Alternative Investment Funds shall ensure that calculation of the net asset value (NAV) is independent of the fund management function of the Alternative Investment Fund and such NAV shall be disclosed to the investors at intervals not longer than a quarter for close-ended Funds and at intervals not longer than a month for open-ended funds.

Obligation of Manager

The Manager shall be obliged to:

(a) address all investor complaints;
(b) provide to SEBI any information sought SEBI;
(c) maintain all records as may be specified by SEBI;
(d) take all steps to address conflict of interest as specified in these regulations;
(e) ensure transparency and disclosure as specified in the regulations.

Dispute Resolution

An Alternative Investment Fund, by itself or through the Manager or Sponsor, shall lay down the procedure for resolution of disputes between the investors, Alternative Investment Fund,

Manager or Sponsor through arbitration or any such mechanism as mutually decided between the investors and the Alternative Investment Fund.

Maintenance of Records

(1) The Manager or Sponsor shall be required to maintain the following records describing:

(a) the assets under the scheme/fund;

(b) valuation policies and practices;

(c) investment strategies;

(d) particulars of investors and their contribution;

(e) rationale for investments made.

(2) The records under sub-regulation (1) shall be maintained for a period of five years after the winding up of the fund.

Submission of reports to SEBI

SEBI may at any time call upon the Alternative Investment Fund to file such reports, as SEBI may desire, with respect to the activities carried on by the Alternative Investment Fund.

Obligation of Alternative Investment Fund on inspection

(1) It shall be the duty of every officer of the Alternative Investment Fund in respect of whom an inspection has been ordered under regulation 30 and any other associated person who is in possession of relevant information pertaining to conduct and affairs of such Alternative Investment Fund including Manager, if any, to produce to the Inspecting Authority such books, accounts and other documents in his custody or control and furnish him with such statements and information as the said Authority may require for the purposes of the inspection.

(2) It shall be the duty of every officer of the Alternative Investment Fund and any other associated person who is in possession of relevant information pertaining to conduct and affairs of the Alternative Investment Fund including the manager to give to the Inspecting Authority all such assistance and shall extend all such co-operation as may be required in connection with the inspection and shall furnish such information as sought by the Inspecting Authority in connection with the inspection.

(3) The Inspecting Authority shall, for the purposes of inspection, have the power to examine on oath and record the statement of any employees, directors or person responsible for or connected with the activities of Alternative Investment Fund or any other associated person having relevant information pertaining to such Alternative Investment Fund.

(4) The Inspecting Authority shall, for the purposes of inspection, have the power to obtain authenticated copies of documents, books, accounts of Alternative Investment Fund, from any person having control or custody of such documents, books or accounts

Liability for action in case of default

An Alternative Investment Fund which does any of the following shall be dealt with in the manner provided by SEBI Intermediaries Regulations, 2008 in case of any of the following events —

(a) contravenes any of the provisions of the Act or these regulations;

(b) fails to furnish any information relating to its activity as an Alternative Investment Fund as required by the SEBI;

(c) furnishes to the SEBI information which is false or misleading in any material particular

(d) does not submit periodic returns or reports as required by the SEBI;

(e) does not co-operate in any enquiry, inspection or investigation conducted by the SEBI

(f) fails to resolve the complaints of investors or fails to give a satisfactory reply to the SEBI

SEBI vide its circular dated February 05, 2020 informed AIF's on disclosure standards to be met. The circular stated the following

a) Templates for PPM - to ensure that a minimum standard of disclosure is made available in the PPM, mandated a template for the Private Placement Memorandum (PPM) providing a certain minimum level of information in a simple and comparable format. AIFs are also permitted to provide additional information in their PPM. PPM is a primary document in which all the necessary information about the AIF is disclosed to prospective investors. The Template prescribed has two parts viz., Part A – Section for minimum disclosures and Part B – Supplementary section to allow flexibility to Fund in order to provide any additional information, which it deems fit. Further, in order to ensure audit compliance with the terms of PPM, shall be conducted at the end of each Financial Year and the findings of audit along with corrective steps, if any, shall be communicated to the Trustee or Board or Designated Partners of the AIF, Board of the Manager and SEBI, within 6 months from the end of the Financial Year. Further, the requirement of audit of compliance with terms of PPM shall not apply to AIFs which have not raised any funds from their investors. However, such AIFs shall submit a Certificate from a Chartered Accountant to the effect that no funds have been raised, within 6months from the end of the Financial Year.[28]

[28]https://www.sebi.gov.in/legal/circulars/jun-2020/clarifications-with-respect-to-circular-dated-february-05-2020-on-disclosure-standards-for-alternative-investment-funds-aifs-_46847.html

b) Performance Benchmarking of AIFs – Introduction of mandatory benchmarking of performance of AIFs (including Venture Capital Funds) and AIF Industry and framework for facilitating the use of data collected by Benchmarking Agencies to provide customized performance reports

Case 12.3: SEBI v/s SREI Multiple Asset Investment Trust (SMIT), Srei Alternative Investment Managers Ltd (SAIML)

Facts of the case:

a) SEBI inspected to examine various compliance requirements including KYC, due diligence norms followed by SMIT and SAIML. Violation of regulation 2(1)(b), 7(1)a, 7(1)b, 10(d),15(1)(c) of SEBI AIF Regulations

b) Issues under consideration were

i)Whether the SMIT/SAIML had used the amount contributed by the investors for the purpose of giving loans to the various companies instead of investing the same as per the definition of "AIF" prescribed under regulation 2(1)(b) of AIF Regulations

ii)Whether SMIT/SAIML had invested in an investee company of more than 25%of the total investible funds collected from the investors in violation of regulation 15(1)(c) of AIF Regulations

iii)whether SMIT/SAIML had not acted in accordance with the decisions of IC and also not allowed the investment strategy as specified in PPM in respect of amount of portfolio investment?

iv)Whether SMIT/SAIL/sponsor/manager had failed to maintain specified continuing interest as per regulation 10(d) of AIF regulations

Findings of the case:

a) PPM specifically covered the investment in the form of finance/loans to various kinds of companies. It is established that the amount contributed by the investors have been used for the purpose of giving a loan to various companies in accordance of PPM. Therefore, violation of 2(1)(b) of AIF Regulations is not established

b) SMIT/SAIML submission portraying practical complexity cannot override the statutory requirement so specified especially taking into account the protection of investor's interest in such Fund. It is established that the investment of more than 25% of the investible fund in a single investee company at two instance was made by SMIT/SAIML and accordingly have violated 15(1)(c) of AIF Regulations

c) Contention of SMIT/SAMIL cannot be accepted as a specific range of investment between 50 cr to 200 cr has been mentioned in PPM and therefore it is not an indicative figure but an investment strategy that has been specified. Loan given of Rs 229 cr and Rs 222 cr was not in accordance with the limit specified in PPM and failed to comply with the SEBI circular of October 1, 2015.

d) SAMIL contributed Rs 5 crores initially which was reduced to 3.13 crores and not in accordance with 10(d) of AIF regulations. From the records amount raised was Rs 790 crore after June 30, 2015 and sponsor/manager was required to have interest/contribution of at least 5 cr which they failed to keep

Order:

a) Penalty of Rs 10 lakhs on SMIT under section 15HB of SEBI Act, 1992 for violation of regulation 15(1)(c) of AIF Regulations

b) Penalty of Rs 10 lakhs on SMIAL under section 15HB of SEBI Act, 1992 for violation of regulation 10(d) of AIF Regulations

c) Penalty of Rs 10 lakhs on SMIAL under section 15HB of SEBI Act, 1992 for violation of regulation SEBI circular of October 1, 2015

12.8 SEBI (Portfolio Managers) Regulations, 2020

12.8.1 Introduction to Portfolio Manager

As per the Regulation:

(a) Portfolio manager means a body corporate, which pursuant to a contract with a client, advises or directs or undertakes on behalf of the client (whether as a discretionary portfolio manager or otherwise) the management or administration of a portfolio of securities or goods or funds of the client, as the case may be. However, the Portfolio Manager may deal in goods received in delivery against physical settlement of commodity derivatives.

(b) Discretionary portfolio manager means a portfolio manager who under a contract relating to portfolio management, exercises or may exercise, any degree of discretion as to the investment of funds or management of the portfolio of securities of the client, as the case may be;

(c) Portfolio means the total holdings of securities and goods belonging to any person;

(d) Principal officer means an employee of the portfolio manager who has been designated as such by the portfolio manager and is responsible for (i) the decisions made by the portfolio

manager for the management or administration of a portfolio of securities or the funds of the client, as the case may be; and (ii) all other operations of the portfolio manager.

The regulation also specifies that no person shall act as portfolio manager unless he holds a certificate of registration granted by SEBI under these regulations:

12.8.2 Application for grant of certificate

An application by a portfolio manager for the grant of a certificate shall be made to SEBI in prescribed forms and shall be accompanied by a non-refundable application fee.

While considering the application for a certificate of registration, apart from all matters which the SEBI deems relevant to activities related to portfolio management, it will also consider whether:

(a) the applicant is a body corporate;

(b) the applicant has the necessary infrastructure like adequate office space, equipment and the manpower to effectively discharge the activities of a portfolio manager;

(c) the applicant has appointed a compliance officer;

(d) the principal officer of the applicant has -

- a professional qualification in finance, law, accountancy or business management from a university or an institution recognized by the Central Government or any State Government or a foreign university or a professional qualification by completing a Post Graduate Program in the Securities Market (Portfolio Management) from NISM of a duration not less than one year or a professional qualification by obtaining a CFA charter from the CFA institute;
- experience of at least five years in related activities in the securities market including in a portfolio manager, stock broker, investmentadvisor, research analyst or as a fund manager; and
- the relevant NISM certification as specified by SEBI from time to time.

  Provided that at least 2 years of relevant experience is in portfolio management or investment advisory services or in the areas related to fund management.

It is further stated that a portfolio manager, who was granted a certificate of registration prior to the commencement of the SEBI (Portfolio Managers) Regulations, 2020, shall comply with the provisions of the regulation within thirty-six months from such commencement. Provided further that a fresh NISM certification shall be obtained before expiry of the validity of the existing

certification to ensure continuity in compliance with the certification requirements. Provided further that the Co-investment Portfolio Manager may designate a member of the Key Investment Team of the Manager as the principal officer who fulfils either of the criteria specified in clause (g) of regulation 4 of the Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012, and in that case the requirement under clause (d) shall not apply to the principal officer so appointed;

(e) In addition to the Principal Officer and Compliance Officer, the applicant has in its employment at least one person with the following qualifications:

i. graduation from a university or an institution recognized by the Central Government or any State Government or a foreign university; and

ii. an experience of at least two years in related activities in the securities market including in a portfolio manager, stockbroker, investment advisor or as a fund manager:

However, any employee of the Portfolio Manager who has decision-making authority related to funding management shall have the same minimum qualifications, experience, and certification as specified for the Principal Officer in the regulations.

It is further stated that a portfolio manager, who was granted a certificate of registration prior to the commencement of the SEBI (Portfolio Managers) Regulations, 2020, shall comply with regulatory clauses within twelve months from such commencement . However, the requirement under clause(e) above shall not apply to Co-investment Portfolio Manager;

(f) any disciplinary action has been taken by SEBI against a person directly or indirectly connected with the applicant under the Act or the rules or the regulations made thereunder;

(g) the applicant fulfils the net worth requirement as specified in the regulation. Provided that the requirement under clause(g) shall not apply to the Co-investment Portfolio Manager;

(h) the applicant, its director or partner, principal officer, compliance officer or the employee as specified in clause (e) is involved in any litigation connected with the securities market that has an adverse bearing on the business of the applicant;

(i) the applicant, its director or partner, principal officer, compliance officer or the employee as specified in clause (e) has at any time been convicted for any offence involving moral turpitude or has been found guilty of any economic offence;

(j) the applicant is a fit and proper person;

(k) the grant of certificate to the applicant is in the interest of investors.

The net worth requirement shall be not less than Rs.5 crores

SEBI on being satisfied that the applicant fulfils the requirements specified in regulation 6 shall send an intimation to the applicant and on receipt of the payment of registration fees grant the certificate.

12.8.3 Conditions of registration:

The certificate of registration granted under the regulation shall, inter alia, be subject to the following conditions, namely: -

(a) the portfolio manager shall abide by the provisions of the Act and these regulations; the Portfolio manager shall obtain prior approval of SEBI in case of change in control in such manner as may be specified by SEBI.

(b) the portfolio manager shall forthwith inform SEBI in writing, if any information or particulars previously submitted to SEBI are found to be false or misleading in any material particular or if there is any material change in the information already submitted;

(c) the portfolio manager shall pay the fees for registration in the manner provided in these regulations;

(d) the portfolio manager shall take adequate steps for the redressal of grievances of the investors within one month of the date of the receipt of the complaint and keep SEBI informed about the number, nature and other particulars of the complaints received; and

(e) the portfolio manager shall maintain the net worth specified in regulation at all times during the period of the certificate with a condition that the requirement under clause(e) shall not apply to Co-investment Portfolio Manager

The certificate of registration granted under regulation 10 shall be valid unless it is suspended or cancelled by the Board.

12.8.4 Applicability of the regulations

Regulation 16 states the applicability of the SEBI PMS Regulation.

(1) The provisions of this Chapter shall apply to eligible fund managers exclusively, pertaining to their activities as portfolio managers to eligible investment funds.

(2) All other provisions of these regulations and the guidelines and circulars issued thereunder, unless the context otherwise requires or is repugnant to the provisions of this chapter, shall apply to eligible fund managers in relation to their activities as portfolio managers to eligible investment funds.

Procedure to be followed by an existing Portfolio Manager has been specified in Regulation 17. An existing portfolio manager may act as a portfolio manager to an eligible investment fund if:

(a) it fulfils all the conditions specified in subsection (4) of Section 9A of the Income-tax Act, 1961;

and

(b) it shall intimate SEBI prior to undertaking such activity and submit declarations accordingly.

12.8.5 Obligation and Responsibilities of Eligible Fund Managers

Eligible fund manager is required to:

1. comply with the requirements specified under Section 9A of the Income-tax Act, 1961 or any amendment, notification, clarification, guideline issued thereunder;
2. offer discretionary or non-discretionary or advisory services or a combination thereof to eligible investment funds;
3. operate in accordance to its mutually agreed contract with the eligible investment funds;
4. provide all material disclosures to eligible investment funds;
5. segregate funds and securities of each eligible investment fund;
6. segregate the funds and securities of eligible investment funds from those of its other clients;
7. maintain and segregate its books and accounts pertaining to its activities as a portfolio manager to eligible investment funds and other clients;
8. appoint a custodian. However, the requirement of compliance with this sub-regulation would not arise in case an eligible investment fund has already appointed a custodian under the applicable act or regulations;
9. keep the funds of eligible investment funds in scheduled commercial banks. However, requirement of compliance with this sub-regulation would not arise in case an eligible investment fund does not intend to invest in Indian securities;
10. maintain any additional records as may be specified by the Board and disclose the same to SEBI as and when required;
11. provide quarterly reports to SEBI;
12. ensure compliance with the PMLA 2002 and rules and regulations made thereunder;
13. abide by the provisions in these regulations and circulars/guidelines issued by SEBI from time to time.

12.8.6 General Obligations and Responsibilities

12.8.6.1 Contract with client and disclosures

(1) (a) The portfolio manager shall, before taking up an assignment of management of funds or portfolio of securities on behalf of a client, enter into an agreement in writing with such client

clearly defining the inter se relationship, and setting out their mutual rights, liabilities and obligations relating to the management of funds or portfolio of securities containing the details as specified in the regulations: Provided that the contents of agreement specified under Schedule IV of these regulations shall not apply to the agreement between the portfolio managers and the large value accredited investors.

(b) The portfolio manager may make investments in the securities of its related parties or its associates only after obtaining the prior consent of the client in such manner as may be specified by the Board from time to time:

Provided that the requirement for obtaining consent shall not apply to such portfolio managers as may be specified by the Board.

(2) The agreement between the portfolio manager and the client shall, inter alia, include the following:-

(a) the investment objectives and the services to be provided

(b) period of the contract and provision of early termination, if any;

(c) investment approach, areas of investment and restrictions, if any, imposed by the client with regard to the investment in a particular company or industry; 29

(d) type of instruments and proportion of exposure;

(e) tenure of portfolio investments;

(f) terms for early withdrawal of funds or securities by the clients;

(g) attendant risks involved in the management of the portfolio;

(h) amount to be invested subject to the restrictions provided under these regulations;

(i) procedure of settling client's account including form of repayment on maturity or early termination of the contract;

(j) fees payable to the portfolio manager;

(k) the quantum and manner of fees payable by the client for each activity for which service is rendered by the portfolio manager directly or indirectly (where such service is outsourced);

(l) custody of securities;

(m) in case of a discretionary portfolio manager; a condition that the liability of a client shall not exceed his investment with the portfolio manager;

[29] An investment approach is a broad outlay of the type of securities and permissible instruments to be invested in by the portfolio manager for the customer, taking into account factors specific to clients and securities.

(n) accounting terms, audit and furnishing of the reports to the clients as per the provisions of these regulations; and

(o) other terms of portfolio investment subject to these regulations.

However, in case of the Co-investment Portfolio Manager, the terms of co-investment in an investee company by a co-investor, shall not be more favourable than the terms of investment of the Alternative Investment Fund:

It is stated further that in case of the Co-investment Portfolio Manager, the terms of exit from the Co-investment in an investee company including the timing of exit shall be identical to the terms applicable to that of exit of the Alternative Investment Fund:

Further in case of the Co-investment Portfolio Manager, the early withdrawal of funds by the co-investors with respect to Co-investment in investee companies shall be allowed to the extent that the Alternative Investment Fund has also made an exit from respective investment in such investee companies.

12.8.6.2 Disclosure Document

The portfolio manager shall provide to the client, the Disclosure Document along with a certificate as specified in regulation (Schedule I), prior to entering into an agreement with the client.

1. The Disclosure Document is required to contain the following:

   a) the quantum and manner of payment of fees payable by the client for each activity for which service is rendered by the portfolio manager directly or indirectly (where such service is outsourced);

   b) portfolio risks including risk specific to each investment approach offered by the portfolio manager;

   c) complete disclosures of transactions with related parties as per the accounting standards specified by the Institute of Chartered Accountants of India;

   d) details of conflicts of interest related to services offered by group companies or associates of the portfolio manager;

      a. the details of investment of client's funds by the portfolio manager in the securities of its related parties or associates;

      b. the details of diversification policy of the portfolio manager:

         Provided that the requirements specified above at clauses (da) and (db) above shall not apply to such portfolio managers as may be specified by SEBI:

         Provided further that SEBI may specify disclosure requirements other than the requirements specified at clauses (da) and (db) above;

e) the performance of the portfolio manager [30]. The portfolio manager may be allowed to disclose performance segregated on the basis of investment approach. the performance of the Co-investment Portfolio Manager shall be calculated in the manner as agreed between the Co-investment Portfolio Manager and the client ;

f) the audited financial statements of the portfolio manager for the immediately preceding three years.

2. The contents of the Disclosure Document shall be certified by an independent chartered accountant.
3. The portfolio manager shall file with the Board, a copy of the Disclosure Document before it is circulated to any client or whenever any material change including change in the investment approach is effected, along with the certificate (Form C in Schedule I). The portfolio manager shall file the disclosure document with the material change within 7 working days from the date of the changes.
4. The portfolio manager shall file a disclosure document along with the certificate (Form C in Schedule I).
5. The portfolio manager shall disclose a change in the identity of the Principal Officer to the Board and the clients within 7 working days of effecting the change.
6. The portfolio manager shall report its performance uniformly in the disclosures to the Board, marketing materials and reports to the clients and on its website.
7. The portfolio manager shall charge an agreed fee from the clients for rendering portfolio management services without guaranteeing or assuring, either directly or indirectly, any return and the fee so charged may be a fixed fee or a return-based fee or a combination of both. However, no up-front fees shall be charged by the portfolio manager directly or indirectly to the clients.
8. The portfolio manager shall disclose the range of fees charged under various heads in the disclosure document.

12.8.6.3 General responsibilities of a Portfolio Manager

Regulation 23 of the SEBI PMS Regulation states the general responsibilities of a Portfolio Manager. The portfolio manager shall-

1. individually and independently manage the funds of each client in accordance with the needs of the client, in a manner which does not partake the character of a Mutual Fund, whereas

[30] The performance of a discretionary portfolio manager shall be calculated using 'Time Weighted Rate of Return' for the immediately preceding three years and in such cases performance indicators shall also be disclosed.

the non-discretionary portfolio manager shall manage the funds in accordance with the directions of the client.

2. not accept from the client, funds or securities worth less than fifty lakh rupees. However, the minimum investment amount per client shall be applicable for new clients and fresh investments by existing clients: It is further stated that existing investments of clients, as on the date of notification of the SEBI (Portfolio Managers) Regulations, 2020, may continue as such till maturity of the investment or as specified by the Board. The requirement of minimum investment amount per client shall not apply to the Co-investment Portfolio Manager
3. act in a fiduciary capacity with regard to the client's funds.
4. segregate each client's holding in securities in separate accounts.
5. keep the funds of all clients in a separate account to be maintained by it in a Scheduled Commercial Bank. For the purposes of this sub-regulation, the expression 'Scheduled Commercial Bank' means any bank included in the Second Schedule to the Reserve Bank of India Act, 1934 (2 of 1934).
6. transact in securities within the limitation placed by the client himself with regard to dealing in securities under the provisions of the Reserve Bank of India Act, 1934 (2 of 1934).
7. not derive any direct or indirect benefit out of the client's funds or securities.
8. not borrow funds or securities on behalf of the client.
9. not lend securities held on behalf of the clients to a third person except as provided under these regulations.
10. ensure proper and timely handling of complaints from his clients and take appropriate action immediately.
11. ensure that any person or entity involved in the distribution of its services is carrying out the distribution activities in compliance with these regulations and circulars issued thereunder from time to time.

12.8.6.4 Management or administration of clients' portfolio

(1) (a) The money or securities accepted by the portfolio manager shall not be invested or managed by the portfolio manager except in terms of the agreement between the portfolio manager and the client.

(b) Any renewal of portfolio on maturity of the initial period shall be deemed as a fresh placement. This clause shall not apply to Co-investment Portfolio Manager.

(2) Notwithstanding anything contained in the agreement as referred in the regulation, the funds or securities can be withdrawn by the client before the maturity of the contract under the following circumstances, namely;

a) voluntary or compulsory termination of portfolio management services by the portfolio manager or the client. This clause shall not apply to Co-investment Portfolio Manager.;
b) suspension or cancellation of the certificate of registration of the portfolio manager by SEBI;
c) bankruptcy or liquidation of the portfolio manager.

(3) The discretionary portfolio manager shall invest funds of his clients in the securities listed or traded on a recognized stock exchange, money market instruments,[31] units of Mutual Funds and other securities as specified by SEBI from time to time, on behalf of their clients. Further to this;

a. The portfolio manager shall ensure compliance with the prudential limits on investments as may be specified by SEBI
b. The prudential limits, shall be applicable at the client level at the time of making investments by the portfolio managers
c. The portfolio manager shall not be allowed to invest clients' funds in unrated securities of their related parties or their associates[32]
d. The portfolio manager shall put in place an alert based system to monitor compliance with the prudential limits on investments
e. The portfolio manager shall ensure investment of its clients' funds on the basis of the credit rating of securities as may be specified by the Board

(4) The portfolio manager offering non-discretionary or advisory services to clients may invest or provide advice for investment up to 25% of the assets under management of such clients in unlisted securities, in addition to the securities permitted for discretionary portfolio management.

(4A) The portfolio manager may offer discretionary or non-discretionary or advisory services for investment up to hundred percent of the assets under management of the large value accredited investors in unlisted securities, subject to appropriate disclosures in the disclosure document and the terms agreed between the client and the portfolio manager.

(4B) The Co-investment Portfolio Manager shall invest hundred percent of the assets under management in unlisted securities of investee companies where Category I and Category II Alternative Investment Funds managed by it as Manager, make investment;

(5) Portfolio Managers may invest in units of Mutual Funds only through the direct plan.

(6) The portfolio manager while investing in units of Mutual Funds through a direct plan shall not charge any kind of distribution-related fees to the client.

[31] "Money market instruments" includes commercial paper, trade bill, treasury bills, certificate of deposit and usance bills

[32] Associate means a body corporate in which a director or partner of the portfolio manager holds, either individually or collectively, more than twenty percent of its paid-up equity share capital or partnership interest, as the case may be; or a body corporate which holds, either individually or collectively, more than twenty percent of the paid-up equity share capital or partnership interest, as the case may be of the portfolio manager.

(7) The portfolio manager shall not leverage the portfolio of its clients for investment in derivatives.

(8) The portfolio manager shall not deploy the clients' funds in bill discounting, badla financing or for the purpose of lending or placement with corporate or non-corporate bodies.

(9) The portfolio manager shall not invest the clients' funds in the portfolio managed or administered by another portfolio manager.

(10) The portfolio manager shall not invest client's fund based on the advice of any other entity.

(11) The portfolio manager shall not while dealing with clients' funds indulge in speculative transactions i.e., it shall not enter into any transaction for purchase or sale of any security which is periodically or ultimately settled otherwise than by actual delivery or transfer of security except the transactions in derivatives.

(12) The portfolio manager shall ordinarily purchase or sell securities separately for each client. However, in the event of aggregation of purchases or sales for the economy of scale, inter se allocation shall be done on a pro-rata basis and at the weighted average price of the day's transactions. The portfolio manager shall not keep any open position in respect of allocation of sales or purchases effected in a day.

(13) The portfolio manager shall not execute off-market transfers in the client's account except:
(a) for settlement of the clients' own trades;
(b) for providing margin/ collateral for clients' own positions;
(c) for dealing in unlisted securities in accordance with the regulations;
(d) with the specific consent of the client for each transaction;
(e) for any other reason specified by the Board from time to time.

(14) The portfolio manager shall segregate each clients' funds and portfolio of securities and keep them separately from his own funds and securities and be responsible for the safekeeping of clients' funds and securities.

(15) The portfolio manager shall not hold the securities belonging to the portfolio account, in its own name on behalf of its clients either by virtue of contract with clients or otherwise.

(16) The portfolio manager may, subject to authorization by the client in writing, participate in securities lending.

(17) Foreign portfolio investors may avail of the services of a portfolio manager. Every portfolio manager shall appoint a custodian in respect of securities managed or administered by it, however, this regulation shall not apply to a portfolio manager who provides only advisory services provided further that this regulation shall not apply to a Co-investment Portfolio Manager.

12.8.6.5 Maintenance of books of accounts, records, etc.

(1) Every portfolio manager shall keep and maintain the following books of accounts, records and documents namely:

(a) a copy of the balance sheet at the end of each accounting period;
(b) a copy of the profit and loss account for each accounting period;
(c) a copy of the auditor's report on the accounts for each accounting period;
(d) a statement of financial position and;
(e) records in support of every investment transaction or recommendation which will indicate the data, facts and opinion leading to that investment decision.

(2) Every portfolio manager shall intimate to SEBI the place where the books of accounts, records and documents are maintained.

(3) Without prejudice to sub-regulation (1) (stated above), every portfolio manager shall, after the end of each accounting period, furnish to SEBI copies of the balance sheet, profit and loss account and such other documents as are mentioned in any of the regulations for any other preceding five accounting years when required by SEBI.

12.8.6.6 Submission of net worth certificate

Every portfolio manager shall furnish to SEBI a net worth certificate issued by a chartered accountant as and when required by SEBI.

12.8.6.7 Maintenance of books of accounts, records and other documents

The portfolio manager shall preserve the books of account and other records and documents mentioned in any of the regulations for a minimum period of five years.

12.8.6.8 Accounts and audit

(1) (a) The portfolio manager shall maintain separate client-wise accounts.
(b) The funds received from the clients, investments or disinvestments, all the credits to the account of the client like interest, dividend, bonus, or any other beneficial interest received on the investment and debits for expenses, if any, shall be properly accounted for and details thereof shall be properly reflected in the client's account.
(c) The tax deducted at source as required under the provisions of the Income-Tax Act, 1961, (43 of 1961) shall be recorded in the portfolio account.

(2) The books of account will be audited yearly by a qualified auditor to ensure that the portfolio manager has followed proper accounting methods and procedures and that the portfolio manager has performed his duties in accordance with the law. A certificate to this effect shall, if so specified, be submitted to SEBI within six months of the close of the portfolio manager's accounting period.

(3) The portfolio accounts of the portfolio manager shall be audited annually by an independent chartered accountant and a copy of the certificate issued by the chartered accountant shall be given to the client.

(4) The client may appoint a chartered accountant to audit the books and accounts of the portfolio manager relating to his transactions and the portfolio manager shall co-operate with such chartered accountant in course of the audit.

12.8.6.9 Reports to be furnished to the client

(1) The portfolio manager shall furnish periodically a report to the client, as agreed in the contract, but not exceeding a period of six months and as and when required by the client and such report shall contain the following details, namely:

(a) the composition and the value of the portfolio, description of securities and goods, number of securities, value of each security held in the portfolio, units of goods, the value of goods, cash balance and aggregate value of the portfolio as on the date of the report;

(b) transactions are undertaken during the period of the report including date of transaction and details of purchases and sales;

(c) beneficial interest received during that period in the form of interest, dividend, bonus shares, rights shares, etc.;

(d) expenses incurred in managing the portfolio of the client;

(e) details of risk foreseen by the portfolio manager and the risk relating to the securities recommended by the portfolio manager for investment or disinvestment;

(f) default in payment of coupons or any other default in payments in the underlying debt security and downgrading to default rating by the rating agencies, if any;

(g) details of commission paid to the distributor(s) for the particular client.

(2) The report referred to in sub-regulation (1) may be made available on the website of the portfolio manager with restricted access to each client.

(3) On termination of the contract, the portfolio manager shall give a detailed statement of accounts to the client and settle the account with the client as agreed in the contract.

(4) The client shall have the right to obtain details of his portfolio from the portfolio managers.

The portfolio manager shall take steps to rectify the deficiencies made out in the auditor's report within two months from the date of the auditor's report as specified.

12.8.6.10 Disclosures to the Board

A portfolio manager shall disclose to SEBI as and when required the following information namely:

(i) particulars regarding the management of a portfolio;

(ii) any change in the information or particulars previously furnished, which have a bearing on the certificate granted to him;

(iii) the names of the clients whose portfolio he has managed;

(iv) particulars relating to the net worth requirement.

12.8.6.11 Appointment of a Compliance Officer

Every portfolio manager shall appoint a compliance officer who shall be responsible for monitoring the compliance of the Act, rules and regulations, notifications, guidelines, instructions etc., issued by SEBI or the Central Government and for redressal of investors' grievances.

However, the role of compliance officer shall not be assigned to the principal officer or the employee of the portfolio manager. In case of the Co-investment Portfolio Manager, the role of compliance officer may be assigned to the principal officer appointed in terms of clause (d) of sub-regulation (2) of regulation 7. The compliance officer shall immediately and independently report to SEBI any non-compliance observed by him.

12.8.7 Code of conduct for a Portfolio Manager

The Code of conduct for the portfolio manager is specified in the Schedule III of the SEBI PMS Regulation.

1. A portfolio manager shall, in the conduct of his business, observe high standards of integrity and fairness in all his dealings with his clients and other portfolio managers.

2. The money received by a portfolio manager from a client for an investment purpose should be

deployed by the portfolio manager as soon as possible for that purpose and money due and payable to a client should be paid forthwith.

3. A portfolio manager shall render at all times high standards of service, exercise due diligence, ensure proper care and exercise independent professional judgment. The portfolio manager shall either avoid any conflict of interest in his investment or disinvestment decision, or where any conflict of interest arises, ensure fair treatment to all his customers. It shall disclose to the clients, the possible source of conflict of interest while providing unbiased services. A portfolio manager shall not place his interest above those of his clients.

4. A portfolio manager shall not execute any trade against the interest of the clients in its proprietary account.

5. A portfolio manager shall not make any statement or indulge in any act, practice or unfair competition, which is likely to be harmful to the interests of other portfolio managers or is likely to place such other portfolio managers in a disadvantageous position in relation to the portfolio manager himself, while competing for or executing any assignment.

6. A portfolio manager shall not make any exaggerated statement, whether oral or written, to the client either about the qualification or the capability to render certain services or his achievements in regard to services rendered to other clients.

7. At the time of entering into a contract, the portfolio manager shall obtain in writing from the client, his interest in various corporate bodies which enables him to obtain unpublished price-sensitive information of the body corporate.

8. A portfolio manager shall not disclose to any clients, or press any confidential information about his client, which has come to his knowledge.

9. The portfolio manager shall where necessary and in the interest of the client take adequate steps for the transfer of the clients' securities and for claiming and receiving dividends, interest payments and other rights accruing to the client. It shall also take necessary action for conversion of securities and subscription for/renunciation of rights in accordance with the clients' instruction.

10. A portfolio manager shall endeavour to – (a). ensure that the investors are provided with true and adequate information without making any misguiding or exaggerated claims and are made aware of attendant risks before any investment decision is taken by them; (b). render the best possible advice to the client having regard to the client's needs and the environment, and his

own professional skills; (c). ensure that all professional dealings are affected in a prompt, efficient and cost-effective manner.

11. A portfolio manager shall not be a party to – (a). creation of a false market in securities; (b). price rigging or manipulation of securities; (c). passing of price-sensitive information to brokers, members of the recognized stock exchanges and any other intermediaries in the capital market or take any other action which is prejudicial to the interest of the investors.

No portfolio manager or any of its directors, partners or manager shall either on their own or through their associates or family members or relatives enter into any transaction in securities of companies on the basis of unpublished price sensitive information obtained by them during the course of any professional assignment.

12. (a) A portfolio manager or any of its employees shall not render, directly or indirectly any investment advice about any security in the publicly accessible media, whether real-time or non-realtime, unless disclosure of his long or short position in the said security has been made while rendering such advice.
(b) In case an employee of the portfolio manager is rendering such advice, he shall also disclose the interest of his dependent family members and the employer including their long or short position in the said security while rendering such advice.

13. (a)The portfolio manager shall abide by the Act, Rules, and regulations made thereunder and the Guidelines / Schemes issued by the Board.
(b) The portfolio manager shall comply with the code of conduct specified in the SEBI (Prohibition of Insider Trading) Regulations, 2015.
(c) The portfolio manager shall not use his status as any other registered intermediary to unduly influence the investment decision of the clients while rendering portfolio management services.

SEBI vide its circular dated February 13, 2020 informed guidelines for Portfolio Managers (PM) including the following
A) Fees and Charges – No upfront fees shall be charged by the PM, either directly or indirectly, to the clients. Charges for all transactions in a financial year (Broking, Demat, Custody etc.) through self or associates shall be capped at 20% by value per associate (including self) per service.

B) Direct onboarding of clients by PM – PM shall prominently disclose in its Disclosure Documents, marketing material and on its website, about the option for direct on-boarding. At the time of on-boarding of clients directly, no charges except statutory charges shall be levied.

C) Nomenclature 'Investment Approach' – Any description of investment approach provided by PM shall, inter-alia, include :

(j) investment objective

(ii) description of types of securities e.g., equity or debt, listed or unlisted, convertible instruments, etc.

(iii) basis of selection of such types of securities as part of the investment approach

(iv)allocation of portfolio across types of securities

(v)appropriate benchmark to compare performance and basis for the choice of benchmark

(vi)indicative tenure or investment horizon

(vii)risks associated with the investment approach

(viii)other salient features, if any

D)Periodic Reporting by PM – PM to submit to SEBI (i) certificate from Chartered Accountant certifying net worth as on March 31, every year on audited account within 6 months from the end of the financial year (ii) A certificate of compliance with PMS Regulation and circulars issued there under, within 60 days of the end of each financial year

E) Reporting of performance by PM – Firm-level performance data of PM shall be audited annually. Confirmation of compliance laid down in the circular of February 13, 2020 shall be reported to SEBI within 60 days of the end of the financial year.

H) Disclosure Documents – Material change for the purpose of Regulation 22 (7) of PMS Regulations shall include change in control of the Portfolio Manager, Principal Officer, fees charged, charges associated with the services offered, investment approaches offered (along with the impact of such change) and such other changes as specified by SEBI from time to time.

G) Supervision of Distributors – Utilize services of only such distributors (whether known as Channel Partners, Agents, Referral Interfaces or by any other name) who have a valid AMFI Registration Number or have cleared NISM-Series -V -A exam. Pay fees or commission to distributors Only on a trial basis. Further, any fees or commission paid shall be only from the fees received by PM.

Case 12.4: SEBI v/s P N Vijay Financial Services (new name Varanim Capital Advisor)

Facts of the case:

a) Inspection of books of accounts of PNV conducted by SEBI, noted following
It is alleged that PNV had no agreement with the Stockbroker Trustline Securities Ltd (hereinafter referred to as 'TSL'), regarding the control over the client's funds/ trading account/ demat account.

b) It is alleged that PNV had no control over funds and securities of its clients to determine whether the minimum investment limit, to be maintained in a portfolio management account, has been adhered to or not.

c) It is alleged that the Know Your Client (hereinafter referred to as 'KYC') forms of the clients of PNV were not in compliance with the requirements stipulated in the SEBI (Portfolio Managers) Regulations, 1993 (hereinafter referred to as 'PMS Regulations').

d) It is alleged that PNV had not made complete disclosures in its Disclosure Document (hereinafter referred to as 'DD').

e) PNV is alleged to have not exercised high standards of services and due diligence while entering into agreements with its clients.

Findings of the case:
a) Not having control over PNV's clients' funds and securities- statement of PNV, itself shows that it relied more on business relationships with TSL for having control over its clients' funds and securities rather than having agreements in place, as stipulated in the PMS Regulations. PNV was not accepting the funds and securities of its client and the same was done directly by TSL. By allowing its designated broker to directly accept its clients' funds/securities and by not directly taking up the assignment of the management of funds and portfolio of securities on behalf of its clients, PNV has violated provisions of Regulations 16(1)(a) and 14(1)(a) of the PMS Regulations.

b) Deficiencies in KYC forms and PMS agreements- having clauses for making client liable for timely payment regarding securities and by asking the client to ensure proper transfer of securities purchased and by not providing adequate details in the KYC documents and the PMS agreements, PNV has violated provisions of the Regulations 16(1)(a) and 14(1)(a) of the PMS Regulations.

c) Deficiencies in Disclosure Documents: PNV did inform its clients through the Disclosure Document that it may enter into the agreement with the designated broker as an Authorised

Person however, the complete details were not provided in the DD. details regarding the brokerage to be paid to the designated broker was also not provided. In this regard, I am of the view that even if the brokerage that PNV was entitled to revive from TSL was fluctuating, PNV ought to have mentioned the percentage range of brokerage that it would receive. However, it was not mentioned in the DD. PNV has violated Schedule V read with Regulation 14 of the PMS Regulations.

d) Not providing details of fee schedules in the agreements with clients. - PNV has inter alia, admitted that it inadvertently missed to procure the undertaking from its client in his / her own writing that they have understood the fees / charge structure. Therefore, PNV has violated the provisions stipulated in the SEBI Circular no. Cir./IMD/DF/13/2010 dated October 05, 2010.

e) Not clearly mentioned the type of service provided by PNV - PNV has, inter alia, admitted to the fact that its disclosure documents have inadvertently missed to mention, the different portfolio services it provides to its clients. PNV did mention the kind of services provided by it to its clients. PNV has violated provisions of Regulation 14 (1)(a) of the PMS Regulations

f) Investor Complaints - As regards the complaint of Mr Vishnu Sahai, PNV has assured Mr Sahai of a guaranteed return, as evident from the submission of the PNV. Therefore, I conclude that PNV has not violated the provisions of the Code of Conduct as specified in Schedule III read with Regulation 13 and Regulation 14(3) (a) of PMS Regulations. As regards the complaint of Mr Khandelwal. PNV has submitted that it made attempts to help Mr Khandelwal in providing early pay-out of funds to him by repeatedly writing to the designated broker. Hence no adverse findings.

Order:

a) As a SEBI registered Portfolio Manager, PNV is expected to act in a diligent and prudent manner and comply with all the relevant regulations and circulars, to protect the interest of its client. A Portfolio Manager is an intermediary which manages and controls the investments of its clients in the complex securities markets. SEBI has laid down various provisions in PMS Regulations and has issued various circulars related to PMS services so that the interests of the investors are protected and the primary responsibility in this regard has been entrusted to the Portfolio Managers.

b) Lenient view on account of corrective action taken and penalty of Rs 5 lakhs imposed.

Review Questions

1. Is the Stockbroker required to pre-intimate SEBI about shifting the location where it keeps its books of account? State Yes, or No?

   (a) Yes

   (b) No

2. A stockbroker when dealing with a client must disclose whether it is acting as a principal /agent. State whether True or False?

   (a) True

   (b) False

3. Category I and II Alternative Investment Funds shall invest what portion of the investable fund in one Investee Company?

   1) Not more than 50 per cent

   2) Not more than 45 per cent

   3) Maximum 10 per cent

   4) Not more than 25 per cent

4. The portfolio manager shall disclose a change in the identity of the Principal Officer to the SEBI and the clients within _____working days of effecting the change.

   a) 15

   b) 7

   c) 10

   d) 21

CHAPTER 13: SEBI (MERCHANT BANKERS) REGULATIONS 1992, SEBI (DELISTING OF EQUITY SHARES) REGULATIONS, 2009, SEBI (SUBSTANTIAL ACQUISITION OF SHARES & TAKEOVERS) REGULATIONS, 2011

LEARNING OBJECTIVES:

After studying this chapter, you should know about some salient features of:

- SEBI (Merchant Bankers) Regulations, 1992
- SEBI (Substantial Acquisition of Shares & Takeovers) Regulations, 2011
- SEBI (Delisting of Equity Shares) Regulations, 2021
- SEBI (Buy Back of Securities) Regulations, 2018
- SEBI (Bankers to an Issue) Regulations, 1994
- Role of Merchant Bankers as per the Regulations stated above

13.1 Introduction

The primary activity of Merchant Bankers is to provide fee-based advice to corporations and governments on the issue of securities. Merchant bankers these days however perform a variety of other activities such as financing foreign trade, underwriting of equity issues, portfolio management and undertaking foreign security business as well as foreign loan business, project appraisal etc.

Since the functions are very similar to those of Investment Bankers, they are often thought to be the same. The term 'Investment Banking' has a much wider connotation and is gradually becoming more of an inclusive term to refer to all types of capital market activity, both fund-based and non-fund based. Besides the above, the investment banks also provide a host of specialized corporate advisory services in the areas of project advisory, business and financial advisory and mergers and acquisitions.

In this chapter we will also discuss briefly the role of merchant banker and the compliances so required in case of takeovers and buy-backs of securities as given in the SEBI (Substantial Acquisition of Shares & Takeovers) Regulations, 2011 and SEBI (Buy-Back of Securities) Regulations, 2018 respectively and in the Delisting of securities from stock exchanges as per provisions given under the SEBI (Delisting of Equity Shares) Regulations, 2021 and the certain compliances of Listing Obligations and Disclosure Requirements Regulations (LODR).

13.2 SEBI (Merchant Bankers) Regulations, 1992

The SEBI (Merchant Bankers) Regulations, 1992 lists out the different provisions as given under its various Regulations for an intermediary who wants to get registered as a merchant banker with SEBI. The Merchant Banking function though long existent was first regulated by the introduction of the SEBI (Merchant Bankers) Regulation, 1992.

13.2.1 Definition of a Merchant Banker

Merchant Banker as defined in the Regulation means "*any person who is engaged in the business of issue management either by making arrangements regarding selling, buying or subscribing to securities or acting as manager, consultant, adviser or rendering corporate advisory service in relation to such issue management*".

13.2.2 Registration as a Merchant Banker

An application for the grant of certificate of registration as merchant bankers needs to be submitted to SEBI as per the provisions of the SEBI (Merchant Bankers) Regulations. The regulation states that an application for registration made under this regulation shall be accompanied by a non-refundable application fee of Rs. 50,000/- and can be made only for Category I Merchant Banker.

"(a) Category I, that is—

(I) to carry on any activity of the issue management, which will, inter alia, consist of preparation of prospectus and other information relating to the issue, determining financial structure, a tie-up of financiers and final allotment and refund of the subscriptions; and

(ii) to act as an adviser, consultant, manager, underwriter, portfolio manager;

However, an applicant can carry on the activity as portfolio manager only if he obtains a separate certificate of registration under the SEBI (Portfolio Manager) Regulations, 1993.

13.2.3 Eligibility Criteria for Grant of Certificate

An applicant seeking registration as Merchant Banker shall comply with the requirements such as the Capital Adequacy Requirements, Registration Fees, and Criteria for fit and proper person etc. which would be discussed in the following sections.

13.2.3.1 Consideration of Application

As per Regulation 6, SEBI shall consider grant of a certificate of merchant banker to an applicant who complies with the following requirements as mentioned below:

(a) An applicant shall be a body corporate other than NBFC, *provided* that the merchant banker who has been granted registration by the RBI to act as Primary or Satellite Dealer may carry on such activity subject to the condition that it shall not accept or hold public deposit.
(b) The applicant should have the necessary infrastructure like adequate office space, equipment and manpower to effectively discharge his activities.
(c) The applicant should have in his employment a minimum of two persons who have the experience to conduct the business of merchant bankers.
(d) A person directly or indirectly connected with the applicant has not been granted registration by SEBI[33].
(e) The applicant, his partner, director or principal officer are not involved in any litigation connected with the securities market which has an adverse bearing on the business of the applicant;
(f) The applicant, his director, partner or principal officer have not been at any time been convicted for any offence involving moral turpitude or has been found guilty of any economic offence;
(g) The applicant has the professional qualification from an institution recognized by the Government in finance, law or business management;
(h) Grant of certificate to the applicant is in the interest of investors;
(i) The applicant satisfies the capital adequacy requirements and is a fit and proper person.

13.2.3.2 Capital Adequacy Requirements

The regulation 7 of the SEBI (Merchant Bankers) Regulations specifies the capital adequacy requirements for applicants seeking registration as Merchant Bankers. It states that applicants shall have a net worth of not less than five crore rupees. Net worth here means the sum of paid-up capital and free reserves of the applicant at the time of making an application.

13.2.3.3 Fit and Proper Person

Regulation 6A of the SEBI (Merchant Bankers) Regulations states that for purpose of granting registration to an applicant, SEBI takes into account the "Criteria for fit and proper person" as given under the SEBI (Intermediaries) Regulations 2008.

(1)The applicant or intermediary shall meet the criteria, as provided in the respective regulations applicable to such an applicant or intermediary including:

(a) the competence and capability in terms of infrastructure and manpower requirements; and

(b) the financial soundness, which includes meeting the net worth requirements.

[33] The expression 'directly or indirectly connected' means any person being an associate, subsidiary or inter-connected or group company of the applicant in case of the applicant being a body corporate.

(2) The 'fit and proper person' criteria shall apply to the following persons:

(a) the applicant or the intermediary;

(b) the principal officer, the directors or managing partners, the compliance officer and the key management persons by whatever name called; and

(c) the promoters or persons holding controlling interest or persons exercising control over the applicant or intermediary, directly or indirectly:

Provided that in case of an unlisted applicant or intermediary, any person holding twenty percent or more voting rights, irrespective of whether they hold controlling interest or exercise control, shall be required to fulfill the 'fit and proper person' criteria.

Explanation– For the purpose of this sub-clause, the expressions "controlling interest" and "control" in case of an applicant or intermediary, shall be construed with reference to the respective regulations applicable to the applicant or intermediary.

(3) For the purpose of determining as to whether any person is a 'fit and proper person', the Board may take into account any criteria as it deems fit, including but not limited to the following:

(a) integrity, honesty, ethical behaviour, reputation, fairness and character of the person;

(b) the person not incurring any of the following disqualifications:

i. criminal complaint or information under section 154 of the Code of Criminal Procedure, 1973 (2 of 1974) has been filed against such person by the Board and which is pending;

ii. charge sheet has been filed against such person by any enforcement agency in matters concerning economic offences and is pending;

iii. an order of restraint, prohibition or debarment has been passed against such person by the Board or any other regulatory authority or enforcement agency in any matter concerning securities laws or financial markets and such order is in force;

iv. recovery proceedings have been initiated by the Board against such person and are pending;

v. an order of conviction has been passed against such person by a court for any offence involving moral turpitude;

vi. any winding up proceedings have been initiated or an order for winding up has been passed against such person;

vii. such person has been declared insolvent and not discharged;

viii. such person has been found to be of unsound mind by a court of competent jurisdiction and the finding is in force;

ix. such person has been categorized as a wilful defaulter;

x. such person has been declared a fugitive economic offender; or

xi. any other disqualification as may be specified by the Board from time to time.

(4) Where any person has been declared as not 'fit and proper person' by an order of the Board, such a person shall not be eligible to apply for any registration during the period provided in the said order or for a period of five years from the date of effect of the order, if no such period is specified in the order.

(5) At the time of filing of an application for registration as an intermediary, if any notice to show cause has been issued for proceedings under these regulations or under section 11(4) or section 11B of the Act against the applicant or any other person referred in clause (2), then such an application shall not be considered for grant of registration for a period of one year from the date of issuance of such notice or until the conclusion of the proceedings, whichever is earlier.

(6) Any disqualification of an associate or group entity of the applicant or intermediary of the nature as referred in sub-clause (b) of clause (3), shall not have any bearing on the 'fit and proper person' criteria of the applicant or intermediary unless the applicant or intermediary or any other person referred in clause (2), is also found to incur the same disqualification in the said matter:
Provided that if any person as referred in sub-clause (b) of clause (2) fails to satisfy the 'fit and proper person' criteria, the intermediary shall replace such person within thirty days from the date of such disqualification failing which the 'fit and proper person' criteria may be invoked against the intermediary:
Provided further that if any person as referred in sub-clause (c) of clause (2) fails to satisfy the 'fit and proper person' criteria, the intermediary shall ensure that such person does not exercise any voting rights and that such person divests their holding within six months from the date of such disqualification failing which the 'fit and proper person' criteria may be invoked against such intermediary.

(7) The 'fit and proper person' criteria shall be applicable at the time of application of registration and during the continuity of registration and the intermediary shall ensure that the persons as referred in sub-clauses (b) and (c) of clause (2) comply with the 'fit and proper person' criteria.]

13.2.3.4 Furnishing of Information, Clarification and Personal Representation

Regulation 5 of SEBI (Merchant Bankers) Regulations states;

1) SEBI may require the applicant to furnish further information or clarification regarding matters relevant to the activity of a merchant banker for the purpose of disposal of the application.
2) The applicant or its principal officer shall, if so required, appear before SEBI for personal representation.

13.2.4 Registration, Renewal Fees & Validity

SEBI, on being satisfied that the applicant is eligible for registration as a merchant banker, shall grant the certificate. On being intimated of the grant of this certificate the merchant banker has to pay the requisite fees within 15 days of receipt of such intimation from SEBI.

Every Merchant Banker is required to pay a sum of Rs. 20 lakhs as registration fees at the time of grant of certificate of registration. To keep the registration in force, the registered Merchant Bankers need to pay a fee of Rs. 9 lakhs every three years from the sixth year from the date of grant of certificate of registration or from the date of grant of certificate of initial registration granted prior to the commencement of the SEBI (Change in Conditions of Registration of Certain Intermediaries) (Amendment) Regulations, 2016, as the case may be. The fee for keeping the registration in force shall be paid by the merchant banker one month before the expiry of the block for which the fee has been paid.

13.2.5 Conditions of Registration

Any certificate which has been granted to the merchant banker under the SEBI (Merchant Bankers) Regulation shall be subject to the following conditions as mentioned below:

a) Where the merchant banker proposes a change in control, it shall obtain prior approval of SEBI for continuing to act as such after the change;

b) The merchant banker shall pay the fees for registration in the manner as provided in these regulations;

c) The merchant banker shall take adequate steps for the redressal of investor grievances within one month of the date of receipt of the complaint and keep SEBI informed about the number, nature and other particulars of the complaints received;

d) The merchant banker shall maintain capital adequacy requirements at all times during the period of the certificate;

e) The merchant banker shall abide by the regulations made under the SEBI Act, 1992 in respect of the activities carried on by it as a merchant banker.

f) The merchant banker shall immediately intimate the Board, details of changes that have taken place in the information that was submitted while seeking registration.

g) Where the merchant banker is acting as an underwriter, it shall enter into a valid agreement with the body corporate on whose behalf it is acting as an underwriter and shall abide by the regulations made under the Act in respect of activities carried on by it as an underwriter.

13.2.6 Refusal to Grant Certificate

SEBI can refuse to grant the certificate of registration of the certificate to an applicant as per Regulation 10 of the SEBI (Merchant Bankers) Regulation:

i. Where an application for a grant of a certificate does not satisfy the conditions as laid down in the Regulation 6 of this Regulation, SEBI may reject the application after giving an opportunity of being heard.

ii. SEBI should communicate the refusal to grant registration within thirty days of such refusal to the applicant stating therein the grounds on which the application has been rejected.

iii. Applicant who is aggrieved by the decision of SEBI to not grant registration may apply to SEBI, within a period of thirty days from the date of receipt of such intimation from SEBI, for reconsideration of its decision.

iv. SEBI shall reconsider an application made as per the provisions laid down in the SEBI (Merchant Bankers) Regulations and communicate its decision as soon as possible in writing to the applicant.

Regulation 11 states that any applicant, whose application for grant of a permanent registration has been refused by SEBI on and from the date of the receipt of the communication, should cease to carry on any activity as a merchant banker. *Provided* that SEBI may, in the interest of investors in the securities market, permit the merchant banker to carry on activities undertaken prior to the receipt of the intimation of refusal subject to such condition as SEBI may specify.

13.2.7 Suspension of Certificate

As per Regulation 12, the merchant banker who has been granted a certificate of registration has to pay the prescribed fees as given in the Regulations[34]. When the merchant banker fails to pay the prescribed annual fees, SEBI may suspend the registration certificate, upon which the merchant banker will not be allowed to carry on with its business till the time he remains suspended.

13.2.8 General Obligations and Responsibilities

13.2.8.1 Code of Conduct

Regulation 13 provides that each merchant banker registered with SEBI should follow the prescribed code of conduct as given under the Schedule III of the SEBI (Merchant Bankers), Regulation. The code of conduct impresses heavily the importance of integrity, honesty and ethical behaviour expected from merchant bankers. As a client and investor-driven business,

[34]Refer to section 13.2.4 of this chapter OR Schedule II of the SEBI (Merchant Banking) Regulations, 1992.

merchant bankers are expected to keep in mind the interests of the investors at all times and redress any grievances immediately while keeping SEBI informed of the same. The code of conduct prescribes that a merchant banker shall:

1. make all efforts to protect the interests of investors.
2. maintain high standards of integrity, dignity and fairness in the conduct of its business.
3. fulfil its obligations in a prompt, ethical, and professional manner.
4. at all times exercise due diligence, ensure proper care and exercise independent professional judgment.
5. endeavour to ensure that (a) Inquiries from investors are adequately dealt with; (b) Grievances of investors are redressed in a timely and appropriate manner; (c) Where a complaint is not remedied promptly, the investor is advised of any further steps which may be available to the investor under the regulatory system.
6. ensure that adequate disclosures are made to the investors in a timely manner in accordance with the applicable regulations and guidelines to enable them to make a balanced and informed decision.
7. endeavour to ensure that the investors are provided with true and adequate information without making any misleading or exaggerated claims or any misrepresentation and are made aware of the attendant risks before making any investment decision.
8. endeavour to ensure that copies of the prospectus, offer document, letter of offer or any other related literature is made available to the investors at the time of issue or the offer.
9. not discriminate amongst its clients, save and except on ethical and commercial considerations.
10. not make any statement, either oral or written, which would misrepresent the services that the merchant banker is capable of performing for any client or has rendered to any client.
11. avoid conflict of interest and make adequate disclosure of its interest.
12. put in place a mechanism to resolve any conflict-of-interest situation that may arise in the conduct of its business or where any conflict of interest arises, shall take reasonable steps to resolve the same in an equitable manner.
13. make appropriate disclosure to the client of its possible source or potential areas of conflict of duties and interest while acting as merchant banker which would impair its ability to render fair, objective and unbiased services.
14. always endeavour to render the best possible advice to the clients having regard to their needs.

15. not divulge to anybody either orally or in writing, directly or indirectly, any confidential information about its clients which has come to its knowledge, without taking prior permission of its clients, except where such disclosures are required to be made in compliance with any law for the time being in force.

16. ensure that any change in registration status/any penal action taken by SEBI or any material change in the merchant banker's financial status, which may adversely affect the interests of clients/investors is promptly informed to the clients and any business remaining outstanding is transferred to another registered intermediary in accordance with any instructions of the affected clients.

17. not indulge in any unfair competition, such as weaning away the clients on assurance of higher premium or advantageous offer price or which is likely to harm the interests of other merchant bankers or investors or is likely to place such other merchant bankers in a disadvantageous position while competing for or executing any assignment.

18. maintain an arms-length relationship between its merchant banking activity and any other activity.

19. have internal control procedures and financial and operational capabilities which can be reasonably expected to protect its operations, its clients, investors and other registered entities from financial loss arising from theft, fraud, and other dishonest acts, professional misconduct or omissions.

20. not make an untrue statement or suppress any material fact in any documents, reports or information furnished to SEBI.

21. maintain an appropriate level of knowledge and competence and abide by the provisions of the Act, regulations made thereunder, circulars and guidelines, which may be applicable and relevant to the activities carried on by it. The merchant banker shall also comply with the award of the Ombudsman passed under the SEBI (Ombudsman) Regulations, 2003.

22. ensure that SEBI is promptly informed about any action, legal proceedings, etc., initiated against it in respect of material breach or non-compliance by it, of any law, rules, regulations, and directions of SEBI or any other regulatory body.

23. (a) A merchant banker or any of its employees shall not render, directly or indirectly, any investment advice about any security in any publicly accessible media, whether real-time or non-real-time, unless disclosure of his interest including a long or short position, in the said security has been made, while rendering such advice.

    (b) In the event of an employee of the merchant banker rendering such advice, the merchant banker shall ensure that such employee shall also disclose the interests, if any, of himself, his dependent family members and the employer merchant banker, including their long or short position in the said security, while rendering such advice.

24. demarcate the responsibilities of the various intermediaries appointed by it clearly so as to avoid any conflict or confusion in their job description.

25. provide adequate freedom and powers to its compliance officer for the effective discharge of the compliance officer's duties.

26. develop its own internal code of conduct for governing its internal operations and laying down its standards of appropriate conduct for its employees and officers in carrying out their duties. Such a code may extend to the maintenance of professional excellence and standards, integrity, confidentiality, objectivity, avoidance or resolution of conflict of interests, disclosure of shareholdings and interests, etc.

27. ensure that good corporate policies and corporate governance are in place.

28. ensure that any person it employs or appoints to conduct business is fit and proper and otherwise qualified to act in the capacity so employed or appointed (including having relevant professional training or experience).

29. ensure that it has adequate resources to supervise diligently and does supervise diligently persons employed or appointed by it in the conduct of its business, in respect of dealings in the securities market.

30. be responsible for the acts or omissions of its employees and agents in respect of the conduct of its business.

31. ensure that the senior management, particularly decision-makers have access to all relevant information about the business on a timely basis.

32. not be a party to or instrument for— (a) creation of false market; (b) price rigging or manipulation; or (c) passing of unpublished price sensitive information in respect of securities which are listed and proposed to be listed in any stock exchange to any person or intermediary in the securities market.

33. A merchant banker or any of the directors, partners or manager having the management of the whole or substantially the whole of affairs of the business, shall not either through its account or their respective accounts or through their associates or family members, relatives or friends indulge in any insider trading.

34. A merchant banker acting as an underwriter shall not make any statement, either oral or written, which would misrepresent—

    (a) the services that the underwriter is capable of performing for its client, or has rendered to any other issuer company;

    (b) his underwriting commitment.

35. A merchant banker acting as an underwriter shall not indulge in any unfair competition, which is likely to be harmful to the interest of other entities acting as underwriters carrying on the

business of underwriting or likely to place such other underwriters in a dis-advantageous position in relation to the underwriter while competing for, or carrying out any assignment.

13.2.8.2 Restriction on Business

The SEBI (Merchant Bankers) Regulations restricts the association of merchant bankers with any business other than that of the securities market. The regulation 13A of the SEBI (Merchant Bankers) Regulations states:

"No merchant banker, other than a bank or a public financial institution, who has been granted a certificate of registration under these regulations, shall after June 30th, 1998 carry on any business other than that in the securities market.

However, notwithstanding anything contained above, a merchant banker who prior to the date of notification of the SEBI (Merchant Bankers) Amendment Regulations, 1997, has entered into a contract in respect of a business other than that of the securities market may, if so desires to discharge his obligations under such contract.

Provided that a merchant banker who has been granted a certificate of registration to act as primary or satellite dealer by Reserve Bank of India may carry on such business as may be permitted by Reserve Bank of India.

Provided further that a merchant banker, who has been granted a certificate of registration under these regulations, may ensure market-making in accordance with SEBI (ICDR) Regulations, 2009.

13.2.8.3 Maintenance of books of account, records etc.

The solvency and financial stability of merchant banks are of prime importance to the merchant banking business. Keeping this in mind, SEBI has prescribed the following under regulation 14 which a merchant banker shall comply with:

(1) Every merchant banker is required to keep and maintain the following books of account, records and documents namely:

(a) a copy of balance sheet as at the end of each accounting period;

(b) a copy of profit and loss account for that period;

(c) a copy of the auditor's report on the accounts for that period;

(d) a statement of financial position.

(e) records and documents pertaining to due diligence exercised in pre-issue and post-issue activities of issue management and the case of takeover, buyback and delisting of securities.

(2) Every merchant banker shall intimate to SEBI the place where the books of account, records and documents are maintained.

(3) Every merchant banker shall also after the end of each accounting period furnish to SEBI copies of the balance sheet, profit and loss account and such other documents for any other preceding five accounting years when required by SEBI.

The above documents need to be maintained for a minimum period of 5 years (regulation 16) and if required by SEBI, a merchant banker must furnish unaudited half-yearly financial results (regulation 15).

(4) Every merchant banker acting as an underwriter shall also maintain the following records with respect to—

i. details of all agreements entered with a body corporate on whose behalf it is acting as an underwriter;
ii. total amount of securities of each body corporate subscribed to in pursuance of an agreement;
iii. statement of capital adequacy requirements;
iv. such other records as may be specified by the Board from time to time.

13.2.9 Responsibilities as Lead Merchant Banker

As given in Regulation 20, when a merchant banker is appointed as the lead manager for any issue, he shall agree to manage or be associated with the issue, only when his responsibilities relating to the issue i.e., of disclosures, allotment and refund are clearly defined, allocated and determined. A statement specifying the responsibilities of the lead manager should be furnished to SEBI, one month prior to the opening of the issue for a subscription.

In cases, where there is more than one lead merchant banker to the issue, the responsibilities of each of such lead merchant bankers shall be furnished to SEBI, at least one month prior to the opening of the issue for a subscription.

A merchant banker as per Regulations 21 and 21A, should not be associated with any issue if a merchant banker who is not holding a certificate of registration is associated with the issue. It shall further not lead or manage any issue or be associated with any activity undertaken under any regulations made by SEBI if the merchant banker is himself the promoter or a director or an associate of the issuer of securities or of any person making the offer to sell or purchase securities in terms of any regulations made by SEBI.

As per regulation 26, no merchant banker or any of its directors, partner or manager or principal officer shall either on their respective accounts or through their associates or relatives enter into any transaction in securities of body corporates on the basis of unpublished price sensitive information obtained by them during the course of any professional assignment either from the clients or otherwise.

The merchant banker shall under Regulation 27, submit to SEBI complete particulars of any transaction for the acquisition of securities of any corporation whose issue is being managed by that merchant banker within 15 days from the date of entering into such transaction. Further the complete particulars of any transaction for the acquisition of securities made in pursuance of underwriting or market-making obligations in accordance with Chapter XA of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 shall be submitted to the Board on quarterly basis..

13.2.10 Disclosures to SEBI

A merchant banker shall disclose to SEBI, as and when SEBI requires the following information:

i. The merchant banker's responsibilities with regard to the management of the issuer;
ii. Any change in the information or particulars previously furnished, which have a bearing on the certificate granted to it;
iii. The names of the body corporate whose issues the merchant banker has managed or has been associated with;
iv. The particulars relating to the breach of the capital adequacy requirements as mentioned in the regulation;
v. Any information relating to the merchant banker's activities as a manager, underwriter, consultant or adviser to an issue.

The merchant banker is required to submit a periodic report in such a manner as may be specified by SEBI from time to time. SEBI has prescribed the following:

The Boards of Merchant Bankers are required to review the report and record its observations on (i) the deficiencies and non-compliances, (ii) corrective measures initiated to avoid such instances in future, (iii) pre-issue and post-issue due diligence process followed and whether they are satisfied and (iv) track record of past issues managed. The compliance officer shall immediately and independently report to the SEBI any non-compliance observed by him and ensure that the observations made or deficiencies pointed out by the Board on/in the draft prospectus or the letter of offer as the case may be, do not recur.

13.2.11 Obligations of merchant banker on inspection by SEBI

SEBI holds the right to inspection of the intermediaries who are registered with it as per provisions given under regulation 31 of the SEBI (Merchant Bankers) Regulation. The following are the obligations of the merchant bankers on inspection:

i. It shall be the duty of every director, proprietor, partner, officer and employee of the merchant banker, who is being inspected, to produce to the inspecting authority such books, accounts and other documents in his custody or control. They shall also furnish with the statements and information relating to his activities as a merchant banker as the inspecting authority may seek.

ii. The merchant banker should also allow the inspecting authority to have reasonable access to the premises occupied by such merchant banker or by any other person on his behalf. It also shall extend reasonable facility for examining any books, records, documents and computer data in the possession of the merchant banker or any such other person. Further, it should also provide copies of documents or other materials which, in the opinion of the inspecting authority are relevant for the purposes of the inspection.

iii. The inspecting authority, in the course of the inspection, shall be entitled to examine or record the statement of any principal officer, director, partner, proprietor and employee of the merchant banker.

iv. The merchant banker shall render to the inspecting authority any kind of assistance that may be required in the course of the inspection.

13.2.12 Compliance Officer

As per Regulation 28A, the merchant banker is required to appoint a compliance officer who shall be responsible for monitoring the compliance of the SEBI Act, rules and regulations, notifications, guidelines, instructions, etc., issued by SEBI or the Central Government and for redressal of investors' grievances. The roles of the compliance officer have been discussed in detail in chapter 3 of this workbook.

Case 13.1: SEBI v/s Inventure Merchant Banker Services Pvt Ltd

Facts of the case:

a) SEBI conducted a special-purpose inspection of Inventure with a focus on the complaint reference and Investor Grievance Redressal Mechanism with regard to the SME Issue relating to M/s Aanchal Ispat Limited (hereinafter referred to as Aanchal or AIL or Company) wherein, Inventure was the Lead Manager to the Issue.

b) It was alleged that Inventure

i. did not call for additional documents which resulted in the understatement of loan liability of Aanchal Collections Limited (ACL), a group company of Aanchal Ispat Limited (Issuer Company).

ii. not obtained a certificate with respect to the legal vetting of the IPO (Initial Public Offering) of AIL

iii. Inventure in the Prospectus had presented a factually incorrect and misleading estimate of the cost of plant and machinery and civil works etc.

iv. Inventure had not submitted a half-yearly periodic report for the half-year ending September 2015 and also that the Inventure did not provide webpage /weblink in respect of its track record of the public issue on its website

v. there were material discrepancies in the information with respect to the compliance officers and Key Managerial Personnel (KMP) provided by the Inventure

Findings of the case:

a) Inventure has violated provisions of Regulation 57(1) and 64(1) of SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 and Regulation 28(2) of SEBI (Merchant Bankers) Regulations, 1992 and Clauses 3, 4, 6, 20 and 21 of the Code of Conduct prescribed under Schedule III read with Regulation 13 f SEBI (Merchant Bankers) Regulations, 1992

b) Inventure has not exercised proper due diligence with respect to all aspects of the issue including the veracity and adequacy of the disclosures in the offer documents.

c) Merchant Banker should take a little extra effort than usual in ensuring that disclosure made in the offer documents are true, without any misleading or exaggerated claims or any misrepresentation. The above also requires independent verification and independent professional judgements with respect to the information contained in the offer documents. Inventure has not been able to demonstrate any active efforts undertaken by it to ensure that whether all material aspects pertaining to the promoters/directors / its group companies/ have been incorporated in the offer documents/Prospectus and whether what has not been included are material enough to have any adverse implication on the investment's decision of the investors.

d) There was a lack of due diligence, if not active concealment, on the part of Inventure with respect to ensuring that true and adequate information without making any misleading or exaggerated claims or any misrepresentation are made available to the investors in a timely manner in accordance with the applicable regulations and guidelines so as to enable them to make a balanced and informed investment decision

e) there are not enough material/documents available on record to conclude that Inventure lacked knowledge and competence as stipulated in clause 21 of Schedule III under Regulation 13 of the SEBI (Merchant Bankers) Regulations, 1992

Order:

Monetary penalty of Rs 10 lakhs on Inventure under section 15HB of the SEBI Act, 1992 for the violation of the provisions of Regulation 57(1) and 64(1) of SEBI (ICDR) Regulations, 2009 and Regulation 28(2) of SEBI (Merchant Bankers) Regulations, 1992 and Clauses 4, 6, and 20 of the Code of Conduct prescribed under Schedule III read with Regulation 13 of SEBI (Merchant Bankers) Regulations, 1992

13.3 SEBI (Substantial Acquisition of Shares & Takeovers) Regulations, 2011

These regulations apply to direct and indirect acquisition of shares or voting rights in, or control over the target company. These regulations do not apply to direct and indirect acquisition of shares or voting rights in, or control over a company listed without making a public issue, on the Innovators Growth Platform of a recognised stock exchange. In this section, we are going to discuss very briefly the specific role of the Merchant Banker and the compliances required to be adhered to as per the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011. The acquirer[35] company is required to appoint a SEBI registered Merchant Banker, as a manager to the open offer before making the public announcement. The merchant banker, however, should not be an associate of or group of the acquirer or the target company. The rules governing offer price specified in Regulation 8 of the SAST Regulations require determination of the same by the acquirer as well as the merchant banker.

The public announcement for a proposed acquisition of shares or voting rights in or control over the target company shall be made by the merchant banker on the date of the first such acquisition, provided the acquirer discloses in the public announcement the details of the proposed subsequent acquisitions. The public announcement for a voluntary offer shall be made on the same day as the date on which the acquirer takes the decision to voluntarily make a public announcement of an open offer for acquiring shares of the target company. Post the public announcement, a detailed public statement shall be published by the acquirer within a stipulated time as prescribed in regulations.

The public announcement shall be sent to all the stock exchanges on which the shares of the target company are listed, and the stock exchanges shall forthwith disseminate such information to the public. The copy of the public announcement made shall also be submitted to SEBI and the

[35] acquirer means any person who, directly on indirectly acquires or agrees to acquire whether by himself, or through, or with persons acting in concert with him, shares or voting rights in, or control over a target company.

target company at its registered office through the Merchant Banker within one working day of the date of the public announcement.

Further, within 5 working days from the date of public statement, the merchant banker shall file the draft of the letter of offer with SEBI along with a non-refundable fee as prescribed in regulations.

13.3.1 General Obligations of the Merchant Banker

The merchant banker shall-

1. Ensure the following before the public announcement of the offer is made-
   - Acquirer is able to implement the offer;
   - Provisions relating to escrow account has been made;
   - Firm arrangements for funds and money for payment through verifiable means to fulfil the obligations under the offer are in place;
   - Public announcement of offer to be made, are in terms of the regulations;
   - Merchant banker's shareholding, if any in the target company should be disclosed in the public announcement and the letter of offer.
2. Furnish to SEBI a due diligence certificate which shall be attached to the draft letter of offer.
3. Ensure that the public announcement, the detailed public statement and the letter of offer are filed with SEBI, the target company and also sent to all the stock exchanges on which the shares of the target company are listed in accordance with the regulations.
4. Ensure that the contents of the public announcement of the offer, the detailed public statement as well as the letter of offer are true, fair and adequate and based on reliable sources, quoting the source wherever necessary.
5. Shall not deal on his own account in the shares of the target company during the offering period.
6. Ensure compliance with the regulations and any other laws or rules as may be applicable in this regard.
7. Shall file a report with SEBI within 15 working days from the expiry of the tendering period, in such form as may be specified, confirming status of completion of various open offer requirements.

13.3.2 Disclosure Requirements

Disclosure of acquisition and disposal (event-based disclosures) (Regulation 29)

Sr. No	Particulars	Disclosure to be	Disclosure intimate to	Time Limit

		intimated by		
1	Regulation 29 (1) Acquirer together with Persons Acting In Concert (PAC) acquiring shares or voting rights in a target company, which taken together aggregates to five per cent or more of the shares of such target company, shall disclose their aggregate shareholding and voting rights in such target company in such form as may be specified: However, in case of listed entity which has listed its specified securities on Innovators Growth Platform, any reference to "five per cent" shall be read as "ten per cent"	Acquirer/ PAC	i. Stock Exchange(s) wherever shares are listed ii. Target Company at its Registered Office	Within 2 working days of the receipt of intimation of allotment of shares or disposal or acquisition of shares or voting rights.
2	Regulation 29 (2) Any person together with PAC with him, holds shares or voting rights entitling them to 5% or more of the shares or voting rights in a target company, shall disclose the number of shares or voting rights held and change in shareholding or voting rights, even if such change results in shareholding falling below five per cent if there has been a change in such holdings from the last disclosure made under sub-regulation (1) or under this sub-regulation; and such change exceeds two per cent of	Acquirer/ PAC	i. Stock Exchange(s) wherever shares are listed ii. Target Company at its Registered Office	Within 2 working days of the receipt of intimation of allotment of shares or disposal or acquisition of shares or voting rights

	total shareholding or voting rights in the target company However, in case of listed entity which has listed its specified securities on Innovators Growth Platform, any reference to “five per cent” shall be read as “ten per cent” and any reference to “two per cent” shall be read as “five per cent”.			

Disclosure of shares encumbered/pledged/lien etc (Regulation 31)

Sr.No	Particulars	Disclosure to be intimated by	Disclosure intimate to	Time Limit
1	The Promoter shall disclose details of shares in such target company encumbered by him or by PAC’s with him in such form as may be specified. The aforesaid disclosure requirement shall not be applicable where such encumbrance is undertaken in a depository.	Promoter	i. Stock Exchange(s) wherever shares are listed ii. Target Company at its registered office	Within 7 working days from the creation of an encumbrance
2	A Promoter shall disclose details of invocation of such encumbrance or release of such encumbrance of shares in such form as may be specified. The aforesaid disclosure requirement shall not be applicable where such encumbrance is undertaken in a depository	Promoter	i. Stock Exchange(s) wherever shares are listed ii. Target Company at its registered office	Within 7 working days from the invocation or release of encumbrance as the case may be

The promoter of every target company shall declare on a yearly basis that he, along with persons acting in concert, has not made any encumbrance, directly or indirectly, other than those already disclosed during the financial year. The declaration shall be made within seven working days from the end of each financial year to –
(a) every stock exchange where the shares of the target company are listed; and
(b) the audit committee of the target company

13.4 SEBI (Bankers to an Issue) Regulations 1994

Banker to an Issue means a scheduled bank or such other banking company as may be specified by SEBI from time to time that carries out any of the following activities,

including :—

i. acceptance of application and application monies;
ii. acceptance of allotment or call monies;
iii. refund of application monies;
iv. payment of dividend or interest warrants;

13.4.1 Registration as Banker to an Issue

An application to SEBI for grant of certificate of registration as Banker to an Issue needs to be made in the format as specified in the Regulations and grant of certificate by SEBI would be subject to fulfilment of the following requirements:

- The applicant has the necessary infrastructure, communication and data processing facilities and manpower to effectively discharge its activities;
- The applicant or any of its directors is not involved in any litigation connected with the securities market and which has an adverse bearing on the business of the applicant or has not been convicted of any economic offence;
- The applicant is a scheduled bank or such other banking company as specified by the Board;
- The applicant is a fit and proper person;

Grant of certificate to the applicant is in the interest of investors.

The application for grant of certificate of registration shall be accompanied by a non-refundable application fee of Rs. 50 thousand as specified in the Regulations.

The certificate of registration as Banker to an Issue shall be valid unless it is suspended or cancelled by SEBI. Every Banker to an Issue is required to pay a sum of Rs. 20 lakh as registration fees at the time of the grant of certificate by SEBI. To keep the registration in force, the registered Banker to an issue shall pay the renewal fee is Rs. 9 lakh every three years from the sixth year from the date of grant of certificate of registration.

13.4.2 General Obligations and Responsibilities of Banker to an Issue

13.4.2.1 Maintenance of books of account, records and the documents

Every banker to an issue shall maintain the following records for a minimum period of 8 years:

a. the number of applications received, the names of the investors, the dates on which the applications were received and the amount so received from the investors;
b. the time within which the applications received from the investors were forwarded to the body corporate or registrar to an issue, as the case may be;
c. dates and amount of refund monies paid to the investors;
d. dates, names and amount of dividend/interest warrant paid to the investors.

Each banker to an issue shall also keep SEBI informed about the place where the records and documents mentioned above are kept. These records are required to be kept for a minimum period of 8 years.

13.4.2.2 Furnishing of Information to SEBI

Every banker to an issue shall furnish to SEBI the following information when the same is sought from them, namely:

a. the number of issues for which he was engaged as a banker to an issue;
b. the number of applications and details of the application monies received by the banker to an issue;
c. the dates on which the applications received from the investors were forwarded to the body corporate or registrar to an issue;
d. the dates on which and the amount refunded to the investors;
e. the payment of dividends/or interest warrants to the investors.

Every banker to an issue shall appoint a Compliance Officer who shall be responsible for monitoring the compliance of the Act, rules and regulations, notifications, guidelines, instructions, etc., issued by SEBI or the Central Government and for redressal of investors' grievances. The compliance officer shall immediately and independently report to the Board any non-compliance observed by him.

Every banker to an issue shall inform SEBI about any disciplinary action taken by the Reserve Bank of India against the banker to an issue only in relation to issue payment work, provided that if as a result of any such action, the banker to an issue is prohibited from carrying on the activities, the certificate shall be deemed to have been suspended or cancelled as the case may be.

13.4.2.3 Agreement with body corporate

Every banker to an issue shall enter into an agreement with the body corporate for which it is acting as banker to an issue. The agreement shall contain the following clauses:

a. The number of centres at which the applications and application monies of an issue of a body corporate will be collected from the investors;

b. The time within which the statement regarding the applications and application monies received from the investors investing in an issue of a body corporate will be forwarded to the registrar to an issue or the body corporate, as the case may be;
c. That a daily statement will be sent by the designated controlling branch of the bankers to the issue to the registrar to an issue indicating the number of applications received on that date from the investors investing in the issue of a body corporate, and the amount of application money received.

13.4.3 Code of Conduct for Bankers to an Issue

SEBI regulations have prescribed a certain code of conduct for bankers to an issue. Each banker to an issue shall:

- Make all efforts to protect the interests of investors;
- Observe high standards of integrity and fairness in the conduct of its business;
- Fulfil its obligations in a prompt, ethical and professional manner.
- At all times exercise due diligence, ensure proper care and exercise independent professional judgments.
- Not at any time act in collusion with other intermediaries or the issuer in a manner that is detrimental to the investor.
- Endeavour to ensure that (a) inquiries from investors are adequately dealt with;(b) grievances of investors are redressed in a timely and appropriate manner; (c) where a complaint is not remedied promptly, the investor is advised of any further steps which may be available to the investor under the regulatory system.
- Not (a) allow blank application forms bearing brokers stamp to be kept at the bank premises or peddled anywhere near the entrance of the premises; (b) accept applications after office hours or after the date of closure of the issue or on bank holidays; (c) after the closure of the public issue accept any instruments such as cheques/demand drafts/stock invests from any other source other than the designated Registrar to the Issue; (d) part with the issue proceeds until listing permission is granted by the stock exchange to the body corporate; (e) delay in issuing the final certificate pertaining to the collection figures to the Registrar to the Issue, the lead manager and the body corporate and such figures should be submitted within seven working days from the issue closure date.
- Be prompt in disbursing dividends, interests, or any such accrual income received or collected by him on behalf of his clients.
- Not make any exaggerated statement, whether oral or written to the client, either about its qualification or capability to render certain services or its achievements in regard to services rendered to other clients.
- Always endeavour to render the best possible advice to the clients having regard to the clients' needs and the environments and his own professional skill.

- Not divulge to anybody either orally or in writing, directly or indirectly, any confidential information about its clients which has come to its knowledge, without taking prior permission of its clients except where such disclosures are required to be made in compliance with any law for the time being in force.
- Avoid conflict of interest and make adequate disclosure of his interest.
- Put in place a mechanism to resolve any conflict-of-interest situation that may arise in the conduct of its business or where any conflict of interest arises, shall take reasonable steps to resolve the same in an equitable manner.
- Make appropriate disclosure to the client of its possible source or potential areas of conflict of duties and interest while acting as a banker to an issue which would impair its ability to render fair, objective and unbiased services.
- Not indulge in any unfair competition, which is likely to harm the interests of other bankers to an issue or investors or is likely to place such other bankers to an issue in a disadvantageous position while competing for or executing any assignment.
- Not discriminate amongst its clients, save and exception ethical and commercial considerations.
- Ensure that any change in registration status/any penal action taken by SEBI or any material change in financials which may adversely affect the interests of clients/investors is promptly informed to the clients and any business remaining outstanding is transferred to another registered person in accordance with any instructions of the affected clients/investors.
- Maintain an appropriate level of knowledge and competency and abide by the provisions of the Act, regulations, circulars and guidelines of SEBI. The banker to an issue shall also comply with the award of the Ombudsman passed under the Securities and Exchange Board of India (Ombudsman) Regulations, 2003.
- Ensure that SEBI is promptly informed about any action, legal proceedings, etc., initiated against it in respect of any material breach or non-compliance by it, of any law, rules, regulations, and directions of SEBI or any other regulatory body.
- Not make any untrue statement or suppress any material fact in any documents, reports, papers or information furnished to SEBI.
- Not neglect or fail or refuse to submit to SEBI or other agencies with which it is registered, such books, documents, correspondence, and papers or any part thereof as may be demanded/requested from time to time.
- Abide by the provisions of such acts and rules, regulations, guidelines, resolutions, notifications, directions, circulars and instructions as may be issued from time to time by the Central Government, the Reserve Bank of India, the Indian Banks Association or SEBI and as may be applicable and relevant to the activities carried on by the banker to an issue.
- (a) Not render, directly or indirectly, any investment advice about any security in the publicly accessible media, whether real-time or non-real-time, unless disclosure of its interest including long or short position in the said security has been made, while rendering such

advice, (b) In case, an employee of the banker to an issue is rendering such advice, the banker to an issue shall ensure that he discloses his interest, the interest of his dependent family members and that of the employer including employer's long or short position in the said security while rendering such advice.

- A banker to an issue or any of its directors, or employee having the management of the whole or substantially the whole of affairs of the business, shall not, either through its account or their respective accounts or through their family members, relatives or friends indulge in any insider trading.
- Have internal control procedures and financial and operational capabilities which can be reasonably expected to protect its operations, its clients, investors and other registered entities from financial loss arising from theft, fraud, and other dishonest acts, professional misconduct or omissions.
- Provide adequate freedom and powers to its compliance officer for the effective discharge of its duties.
- Develop its own internal code of conduct for governing its internal operations and laying down its standards of appropriate conduct for its employees and officers in the carrying out of their duties as a banker to an issue and as a part of the industry. Such a code may extend to the maintenance of professional excellence and standards, integrity, confidentiality, objectivity, avoidance of conflict of interests, disclosure of shareholdings and interests, etc.
- Ensure that any person it employs or appoints to conduct a business is fit and proper and otherwise qualified to act in the capacity so employed or appointed (including having relevant professional training or experience).
- Ensure that it has adequate resources to supervise diligently and does supervise diligently persons employed or appointed by it to conduct business on its behalf.
- Be responsible for the acts or omissions of its employees and agents in respect to the conduct of its business.
- Ensure that the senior management, particularly decision-makers have access to all relevant information about the business on a timely basis.
- If the banker to an issue is registered with SEBI in other capacity shall endeavour to ensure that arms-length relationship is maintained in terms of both manpower and infrastructure between the activities carried out as banker to an issue and other permitted activities.
- Not be a party to or instrumental for (a) creation of false market; (b) price rigging or manipulation; or (c) passing of unpublished price sensitive information in respect of securities which are listed and proposed to be listed in any stock exchange to any person or intermediary.

Review Questions

1. The SEBI (Merchant Banking) Regulations, 1992 provides for _____.
   (a) Registration of merchant bankers
   (b) General obligations of merchant bankers
   (c) General responsibilities of merchant bankers
   (d) All of the above

2. The applicant for merchant banker should have necessary infrastructure like _____.
   (a) Office space as per SEBI criteria
   (b) Equipment in place
   (c) Skilled and relevant manpower
   (d) All of the above

3. The applicant for merchant banker should necessarily fulfil the capital adequacy requirement as specified in the SEBI (Merchant Bankers) Regulation. State whether True or False?
   (a) **True**
   (b) False

4. Every Banker to an Issue is required to pay a sum of Rs. _____lakh as registration fees at the time of the grant of certificate by SEBI.
   (a) 10
   (b) 20
   (c) 25
   (d) 30

CHAPTER 14: SEBI (ISSUE OF CAPITAL AND DISCLOSURE REQUIREMENTS) REGULATIONS 2018

Learning Objectives:

After studying this chapter, you should know about the:

- Applicability of ICDR Regulations
- Specific Provisions related to Public Issues and Rights Issues
- Role of merchant banker as an advisor
- Role of a merchant banker as an underwriter
- General obligation of merchant bankers with respect to public and rights issue

SEBI (Issue of Capital and Disclosure Requirements) Regulations lays down general conditions for capital market issuances like public and rights issuances; eligibility requirements; general obligations of the issuer and intermediaries in public and rights issuances; regulations governing preferential issues, qualified institutional placements and bonus issues by listed companies; the issue of IDRs. ICDR Regulations also has detailed requirements laid out with respect to disclosure and process requirements for capital market transactions by listed and unlisted companies.

While the eligibility and disclosure obligations are applicable to the Issuer, in capital market transactions, the role of the merchant banker/ lead manager/ book runner is extremely important since they perform the role of agents in capital market transactions and are registered entities with SEBI. In fact, SEBI holds the merchant banker responsible and accountable for any deficiencies/ lapses in such capital market transactions.

14.1 Applicability of ICDR Regulations

SEBI ICDR applies to the following: (a) an initial public offer by an unlisted issuer; (b) a rights issue by a listed issuer; where the aggregate value of the issue is fifty crore rupees or more; (c) a further public offer by a listed issuer; (d) a preferential issue by a listed issuer; (e) a qualified institutions placement by a listed issuer; (f) an initial public offer of Indian depository receipts; (g) a rights issue of Indian depository receipts; (h) an initial public offer by a small and medium enterprise; (i) a listing on the innovators' growth platform through an issue or without an issue; and (j) a bonus issue by a listed issuer.

However, in case of a rights issue of size less than fifty crore rupees, the issuer shall prepare the letter of offer in accordance with requirements as specified in these regulations and file the same with the SEBI for information and dissemination on the SEBI's website.

It is further stated that the ICDR regulations shall not apply to the issue of securities under specified regulation[36] of SEBI SAST Regulations 2011.
The various compliances which are required to be adhered to and are of high importance from a regulatory perspective are discussed in the subsequent sections.

14.2 Initial Public Offer (IPO) and Rights Issue

Chapter II and III specifies the conditions for Public Issues and Rights Issues.

Regulation 5 of SEBI ICDR states that an issuer shall not be eligible to make an initial public offer, if - (a) the issuer, any of its promoters, promoter group or directors or selling shareholders are debarred from accessing the capital market by the Board; (b) any of the promoters or directors of the issuer is a promoter or director of any other company which is debarred from accessing the capital market by the Board; (c) the issuer or any of its promoters or directors is a wilful defaulter or a fraudulent borrower; (d) any of its promoters or directors is a fugitive economic offender. Further, it states that an issuer shall not be eligible to make an initial public offer if there are any outstanding convertible securities or any other right which would entitle any person with any option to receive equity shares of the issuer.

Further, regulation 61 states that an entity shall not be eligible to make a rights issue of specified securities, if – (a) if the issuer, any of its promoters, promoter group or directors of the issuer are debarred from accessing the capital market by the Board; (b) if any of the promoters or directors of the issuer is a promoter or director of any other company which is debarred from accessing the capital market by the Board and (c) if any of its promoters or directors is a fugitive economic offender.

14.2.1 Allocation of Responsibilities

The lead merchant bankers are required to make inter-se allocation of responsibilities pertaining to the activities or sub-activities to be carried out under these regulations and disclose the same in the offer document. These are notified under ***Schedule I of the ICDR regulations*** which is as given below and should also be read with regulations 23(2), 69(2), 121(2), 184(2) and 245(2).

[36] Regulation 9, sub-regulation 1, clause (b), (d) and (e) of SEBI SAST Regulations, 2011.

(1) The lead manager(s) shall prepare a schedule, listing the activity-wise allocation of responsibilities relating to the issue, the name of the lead manager responsible for each set of activities or sub-activities, and disclose the same in the offer document.

(2) Where circumstances warrant the joint and several responsibilities of the lead manager(s) for any particular activity, a co-ordinator designated from amongst the lead manager(s) shall furnish to SEBI when called for, information, report, rationales, etc. on matters relating to such activity.

(3) The activities and sub-activities may be grouped on the following lines:

a. Capital structuring with the relative components and formalities such as the composition of debt and equity, type of instruments, etc.

b. Drafting and design of the offer document, application form and abridged prospectus, and of the advertisement or publicity material including newspaper advertisements.

c. Selection of various intermediaries/agencies connected with the issue, such as registrars to the issue, printers, advertising agencies, bankers to the issue, collection centres as per schedule XII, etc.

d. Marketing of the issue, which shall cover, inter alia, formulating marketing strategies, preparation of publicity budget, arrangements for the selection of (i) media, (ii) centres for holding conferences of media, stockbrokers, investors, etc., (iii) brokers to the issue, and (iv) underwriters and underwriting arrangement, quantum and distribution of publicity and issue material including offer documents, application form and abridged prospectus.

e. Post-issue activities, including essential follow-up with bankers to the issue and self-certified syndicate banks to get quick estimates of subscription and advising the issuer about the closure of the issue, finalisation of the basis of allotment after weeding out multiple applications, a listing of instruments, the despatch of certificates or Demat credit and refunds/unblocking and co-ordination with various agencies connected with the post-issue activity such as registrars to the issue, bankers to the issue, self-certified syndicate banks and underwriters.

(4) The designated lead manager shall be responsible for ensuring compliance with these regulations and other requirements and formalities specified by the Registrar of Companies, the Board and the stock exchanges.

(5) The designated lead manager shall be responsible for ensuring that all intermediaries fulfil their obligations and functions as specified in their agreements with the issuer.

(6) In case of under-subscription in an issue, the lead manager responsible for underwriting arrangements shall be responsible for invoking underwriting obligations and ensuring that the

notice for devolvement containing the obligations of the underwriters is issued in terms of these regulations.

14.2.2 Disclosures in Offer document and letter of offer

Public Issues

As per Regulation 24, the draft offer document and offer document shall contain all material disclosures which are true and adequate to enable the applicants to take an informed investment decision. The lead manager(s) shall exercise due diligence and satisfy themselves about all aspects of the issue including the veracity and adequacy of disclosure in the draft offer document and the offer document. The lead manager(s) shall call upon the issuer, its promoters and its directors or in case of an offer for sale, also the selling shareholders, to fulfil their obligations as disclosed by them in the draft offer document and the offer document and as required in terms of these regulations. The lead manager(s) shall ensure that the information contained in the draft offer document and offer document and the particulars as per restated audited financial statements in the offer document are not more than six months old from the issue opening date.

The draft offer document and offer document shall be made available to the public for comments for a period of at least twenty-one days from the date of filing, by hosting it on the websites of the SEBI, stock exchanges where specified securities are proposed to be listed and lead manager(s) associated with the issue [Regulation 26 of ICDR Regulation].

Rights Issue

Regulation 70 states that:

1) The draft letter of offer and letter of offer shall contain all material disclosures which are true and adequate to enable the applicants to take an informed investment decision.
2) Without prejudice to the generality of sub-regulation (1), the draft letter of offer and letter of offer shall contain disclosures as per Part B or Part B-1 of Schedule VI of ICDR, as applicable.
3) The lead manager(s) shall exercise due diligence and satisfy themselves about all aspects of the issue including the veracity and adequacy of disclosure in the draft letter of offer and the letter of offer.
4) The lead manager(s) shall call upon the issuer, its promoters and its directors to fulfil their obligations as disclosed by them in the draft letter of offer and letter of offer and as required in terms of these Regulations.

5) The lead manager(s) shall ensure that the information contained in the draft letter of offer and letter of offer and the particulars as per audited financial statements in the letter of offer are not more than six months old from the issue opening date.

6) An issuer shall make disclosures in the draft letter of offer, letter of offer and abridged letter of offer, if the issuer or any of its promoters or directors is a wilful defaulter or a fraudulent borrower.

As per Regulation 71:

(1) Prior to making a rights issue, the issuer shall, except in case of a fast-track issue, file a draft letter of offer, with the Board, along with fees with the Board and with the stock exchange(s), through the lead manager(s).

(2) The lead manager(s) shall submit the following to SEBI along with the draft letter of offer:

a) a certificate, confirming that an agreement has been entered into between the issuer and the lead manager(s) in accordance with Schedule II;

b) a due diligence certificate as per Form A of Schedule V;

c) in case of an issue of convertible debt instruments, a due diligence certificate from the debenture trustee as per Form B of Schedule V;

d) A certificate confirming compliance of the conditions specified in Part F of Schedule VI, if applicable.

(3) The issuer shall also file the draft letter of offer with the stock exchange(s) and shall submit to such stock exchange(s), the Permanent Account Number, bank account number and passport number of its promoters where they are individuals, and Permanent Account Number, bank account number, company registration number or equivalent and the address of the Registrar of Companies with which the promoter is registered, where the promoter is a body corporate.

14.2.3 Pricing

Public Issue

The issuer shall determine the price of equity shares, and in case of convertible securities, the coupon rate and the conversion price, in consultation with the lead manager(s) or through the book-building process, as the case may be. They shall undertake the book building process in the manner specified in Schedule XIII of the regulation.

The issuer may mention a price or a price band in the offer document (in case of a fixed price issue) and a floor price or a price band in the red herring prospectus (in case of a book-built issue) and determine the price at a later date before filing the prospectus with the Registrar of Companies. However, the prospectus filed with the Registrar of Companies shall contain only one price or the specific coupon rate, as the case may be. The cap on the price band, and the coupon

rate in case of convertible debt instruments, shall be less than or equal to one hundred and twenty per cent of the floor price. The cap of the price band shall be at least one hundred and five percent of the floor price. The floor price or the final price shall not be less than the face value of the specified securities.

Differential Pricing

The Issuer may offer its specified securities at different prices, subject to the following:

a) retail individual investors or retail individual shareholders or employees entitled for reservation made under regulation 33 may be offered specified securities at a price not lower than by more than ten per cent of the price at which net offer is made to other categories of applicants, excluding anchor investors;

b) in case of a book-built issue, the price of the specified securities offered to the anchor investors shall not be lower than the price offered to other applicants;

c) In case the issuer opts for the alternate method of book building, the issuer may offer the specified securities to its employees at a price not lower than by more than ten per cent of the floor price.

Rights Issue (Regulation 73)

The Issuer shall decide the issue price, in consultation with the lead manager(s), before determining the record date, which shall be determined in consultation with the designated stock exchange. The issue price shall not be less than the face value of the specified securities. The issuer shall disclose the issue price in the letter of offer filed with SEBI and the stock exchange(s).

14.2.4 Availability of letter of offer and other issue materials

Public Issue

Regulation 36 states that the lead manager(s) shall ensure availability of the offer document and other issue material including application forms to stock exchanges, syndicate members, registrar to issue, registrar and share transfer agents, depository participants, stockbrokers, underwriters, bankers to the issue, and Self Certified Syndicate Banks (SCSBs) before the opening of the issue.

Rights Issue

Regulation 77 states that-

(1) The lead manager(s) shall ensure availability of the letter of offer and other issue material including application forms with stock exchanges, registrar to issue, registrar and share transfer agents, depository participants, stockbrokers, underwriters, bankers to the issue, investors 'associations and self-certified syndicate banks before the opening of the issue.

(2) The abridged letter of offer, along with application form, shall be dispatched through registered post or speed post or by courier service or by electronic transmission to all the existing shareholders at least three days before the date of opening of the issue.

(3) The letter of offer shall also be provided by the issuer or lead manager(s) to any existing shareholder who makes a request in this regard.
Further Regulation 77A states the requirements with respect to Credit of Rights Entitlements and allotment of specified securities.
(1) The rights entitlements shall be credited to the Demit account of the shareholders before the date of opening of the issue.
(2) Allotment of specified securities shall be made in the dematerialized form only.

Public Issue

If the issuer makes a public issue through the book-building process,
(a) the issue shall be underwritten by a lead manager(s) and syndicate member(s), provided that at least seventy-five per cent of the net offer proposed to be compulsorily allotted to QIBs for the purpose of compliance with the eligibility conditions cannot be underwritten.
b) the issuer shall, prior to filing the prospectus, enter into an underwriting agreement with the lead manager(s) and syndicate member(s), indicating therein the number of specified securities which they shall subscribe to at the predetermined price in the event of under-subscription in the issue.
c) if the syndicate member(s) fail to fulfil their underwriting obligations, the lead manager(s) shall fulfil the underwriting obligations.
d) the lead manager(s) and syndicate member(s) shall not subscribe to the issue in any manner except for fulfilling their underwriting obligations.
e) in case of every underwritten issue, the lead manager(s) shall undertake minimum underwriting obligations as specified in the SEBI (Merchant Bankers) Regulations, 1992.
f) where the issue is required to be underwritten, the underwriting obligations should at least to the extent of minimum subscription.

Rights Issue

(1) If the issuer desires to have the issue underwritten, it shall appoint merchant bankers or stock brokers, registered with the Board, to act as underwriters. However, the issue can be underwritten only to the extent of entitlement of shareholders other than the promoters and promoter group.

(2) In case of every underwritten issue, the lead manager(s) shall undertake minimum underwriting obligations as specified in the SEBI (Merchant Bankers) Regulations, 1992.

14.2.6 Post issue Advertisement

The lead manager(s) shall ensure that an advertisement giving details relating to subscription, basis of allotment, number, value and percentage of all applications including ASBA, number, value and percentage of successful allottees for all applications including ASBA, date of

completion of dispatch of refund orders, as applicable, or instructions to self-certified syndicate banks by the Registrar, date of dispatch of certificates or date of credit of specified securities, as applicable, and date of filing of listing application, etc. is released within ten days from the date of completion of the various activities in at least one English national daily newspaper with wide circulation, one Hindi national daily newspaper with wide circulation and one regional language daily newspaper with wide circulation at the place where the registered office of the issuer is situated.

Aforementioned details are also required to be placed on the websites of the stock exchanges where the securities are listed.

14.2.7 Post-issue responsibilities of the lead manager(s)

(1) The responsibility of the lead manager(s) shall continue until completion of the issue process and for any issue related matter thereafter.
(2) The lead manager(s) shall regularly monitor redressal of investor grievances arising from any issue related activities.
(3) The lead manager(s) shall continue to be responsible for post-issue activities till the applicants have received, credit to their Demat account or refund of application monies and listing or trading permission is obtained.
(4) The lead manager(s) shall be responsible for and coordinate with the registrars to the issue and with various intermediaries at regular intervals after the closure of the issue to monitor the flow of applications from self-certified syndicate banks, processing of the applications including an application form for ASBA and other matters till the basis of allotment is finalised, credit of the specified securities to the dematerialised accounts of the allottees, as applicable and unblocking of ASBA accounts/ dispatch of refund orders are completed and securities are listed, as applicable.

Considering that ASBA has been mandated for all applicants in the public issue, the application money is not transferred but only blocked in the account of the investor and is debited only upon allotment and unblocked if there is no/part allotment. Further post introduction of Unified Payment Interface (UPI) mechanism in the public issue, intermediaries are responsible to compensate the investors for any delay in unblocking of amounts in the ASBA accounts exceeding 4 working days from the bid/issue closing date, SEBI vide its circular no.
SEBI/HO/CFD/DIL1/CIR/P/2021/47dated has directed refunds to investors to be made within 4 working days.
(5) Any act of omission or commission on the part of any of the intermediaries noticed by the lead manager(s) shall be duly reported by them to SEBI.

(6) In case there is a devolvement on underwriters, the lead manager(s) shall ensure that the notice for devolvement containing the obligation of the underwriters is issued within ten days from the date of closure of the issue.
(7) In case of undersubscribed issues that are underwritten, the lead manager(s) shall furnish information to SEBI in respect of underwriters who have failed to meet their underwriting devolvement in SEBI specified format.

14.2.8 Post-issue reports

Public Issues (Regulation 55)

The lead manager(s) shall submit a final post-issue report as per the specified format, along with a due diligence certificate as per the format specified (in Form F of Schedule V), within seven days of the date of finalization of basis of allotment or seven days of refund of money in case of failure of issue.

Rights Issue (Regulation 96)

The lead manager(s) shall submit post-issue reports as follows:
a) initial post-issue report within three working days of closure of the issue;
b) final post-issue report within fifteen days of the date of finalization of basis of allotment or within fifteen days of refund of money in case of failure of the issue.

14.3 Role as Advisors

The merchant banker(s) advises the Issuer Company on all matters related to the public issue, including but not limited to the activities mentioned in the inter-se allocation of responsibilities. It is the responsibility of the issuer company to appoint one or more merchant bankers, at least one of whom is the lead merchant banker and also appoint other intermediaries in consultation with the lead merchant banker, to carry out the obligations relating to the issue.

14.3.1 Drafting of the Offer Document, abridged prospectus etc.

The merchant banker is responsible for carrying out due diligence on the issuer company and ensure that the disclosures made in the offer document are true, fair, accurate and complete. The merchant banker(s) also files due diligence certificates with SEBI at various stages during the issue process to confirm that due diligence has been carried out by the merchant banker(s) on the issuer company, its promoters, directors, group entities and relates to all aspects including business, legal and financial diligence. The formats of the due diligence certificates at each stage

are given as Forms in the regulations[37]. Some of the key activities, where the merchant banker has to exercise its due diligence are listed below:

- Provide the Issuer Company with a detailed due diligence checklist based on ICDR requirements and information that is important for investors to receive through the prospectus (using his own judgement and also as required by the SEBI ICDR Regulations). It includes inputs from the legal counsels and other experts, if any, assisting in the process of diligence. It also includes formats of certificates that the merchant banker(s) seeks from the Company, formats of consents from all intermediaries involved, details from the group and associate companies, promoters, directors etc. The due disclosure requirements in the offer document, abridged prospectus and abridged letter of offer are given in the Schedule VIII of the ICDR.
- The merchant banker(s) is also required to keep a tab on the public communications, publicity materials, advertisements and any research report by the issuer company. Any issuer company intending to come out with a public issue needs to adhere to the publicity restrictions as given under ICDR and the merchant banker to the issue has to confirm that the same has been adhered to. All publicity material, public communications etc. need to be approved by the lead merchant banker responsible for the marketing of the issue. The idea is that all advertisements should be truthful and fair and should not be manipulative or deceptive or distorted and should not contain any statement, promise or forecast which is untrue or misleading. There should be no "conditioning" of the market. All advertising by the issuer company should be consistent with past practices.
- As an integral part of the financial due diligence, the merchant banker(s) meet with the auditors of the issuer company and discuss information required to be disclosed in the offer document. In accordance with requirements under Schedule VI of the ICDR, the information required includes audited consolidated or unconsolidated financial statements
- A site visit, if relevant, is also generally undertaken by the merchant banker(s) at the beginning of the diligence process. The objectives of the site visit are to get an appreciation of the business of the company, the manufacturing process, machinery and equipment, plant layout, environment issues etc.
- Based on the documents compiled by the Issuer and perusal of key documents such as board minutes, shareholder meeting minutes, land and property agreements, e-forms of the directors under Companies Act, loan documents, agreements with shareholders, agreements with customers, litigation-related documents, documents filed with the ROC etc.; discussions with the promoters and management, the drafting of the Draft Prospectus is undertaken.

As per SEBI circular CIR/MIRSD/1/2012 dated January 10, 2012, the merchant bankers shall disclose the track record of the performance of the public issues managed by them. The track

[37] Schedule V of the SEBI (ICDR) Regulations, 2018 gives the format of the form.

record shall be disclosed for a period of three financial years from the date of listing for each public issue managed by the merchant banker. This information should be made available on the website and a reference to the same should be made in the offer document.

SEBI has issued a General Order – SEBI (Framework for rejection of Draft Offer Documents), 2012 vide Circular No. CIR/CFD/DIL/15/2012 dated October 15, 2012 notifying the broad framework followed by SEBI for rejection of Offer Documents. It is necessary for Merchant Bankers to take note of the same and take due care before filing the draft offer document with SEBI.

14.3.2 Drafting of Letter of Offer

As per regulation 70, the draft letter of offer and letter of offer shall contain all material disclosures which are true and adequate to enable the applicants to take an informed investment decision.

The lead manager(s) shall exercise due diligence and satisfy themselves about all aspects of the issue including the veracity and adequacy of disclosure in the draft letter of offer and the letter of offer.

The lead manager(s) shall call upon the issuer, its promoters and its directors to fulfil their obligations as disclosed by them in the draft letter of offer and letter of offer and as required in terms of these Regulations.

The lead manager(s) shall ensure that the information contained in the draft letter of offer and letter of offer and the particulars as per audited financial statements in the letter of offer are not more than six months old from the issue opening date.

An issuer shall make disclosures in the draft letter of offer, letter of offer and abridged letter of offer, if the issuer or any of its promoters or directors is a wilful defaulter or a fraudulent borrower.

14.4 Due Diligence and Compliances

14.4.1 Documents to be submitted before the opening of the issue

In order to maintain maximum possible transparency in the issue process and to safeguard the interests of the investors, SEBI requires the lead merchant banker to submit documents regarding the issue process and the issuer's financial health.

Public Issues

Regulation 25 of the SEBI ICDR Regulations provides the details of the documents which are required to be submitted to SEBI before the opening of the issue. The lead merchant banker shall submit the following to SEBI along with the draft offer document:

- A certificate, confirming that an agreement has been entered into between the issuer and the lead merchant bankers as per the format specified in SEBI ICDR Regulations**;**
- A due diligence certificate as per the format prescribed in the SEBI ICDR Regulation;
- A due diligence certificate from the debenture trustee in case of an issue of convertible debt instruments as per the prescribed format provided in the Regulations.

Once SEBI has made its observations on the draft offer document or even after the expiry of the stipulated period if SEBI has not issued any observation, the lead merchant banker is required to submit the following documents to SEBI:

- Statement certifying that all changes, suggestions and observations made by SEBI have been incorporated in the offer document;
- Due diligence certificate at the time of filing the prospectus with the Registrar of Companies;
- Copy of the resolution passed by the board of directors of the issuer for allotting specified securities to promoters towards amount received against promoters' contribution, before the opening of the issue;
- Certificate from a statutory auditor, before opening of the issue, certifying that promoters' contribution has been received in accordance with these regulations, accompanying therewith the names and addresses of the promoters who have contributed to the promoters' contribution and the amount paid and credited to the issuer's bank account by each of them towards such contribution;
- a due diligence certificate as per the regulations, in the event the issuer has made a disclosure of any material development by issuing a public notice.

The issuer while filing a draft offer document with the recognized stock exchange where the specified securities are proposed to be listed, submit the Permanent Account Number (PAN), bank account number and passport number of its promoters to such stock exchange.

The post-issue merchant banker shall be responsible for the post-issue activities till the subscribers have received the securities certificates, credit to their Demat account / refund of the application money and till the listing agreement is entered into by the issuer with the stock exchange and the listing / trading permission is obtained.

The responsibility of the lead merchant banker shall continue even after the completion of the issue process. The issuer is required to appoint a compliance officer, who shall in addition to the compliance officer of the merchant banker be responsible for monitoring the compliance of the securities law and investor grievances redressal.

Rights Issue

1. Prior to making a rights issue, the issuer shall, except in case of a fast-track issue, file a draft letter of offer, with the concerned regional office of SEBI under the jurisdiction of which the registered office of the issuer company is located, along with fees as specified, with the Board and with the stock exchange(s), through the lead manager(s). However, the issuer shall, in case of a fast-track issue, file a letter of offer and pay fees as specified in Schedule III with the Board.

2. The lead manager(s) shall submit the following to SEBI along with the draft letter of offer:

a) a certificate, confirming that an agreement has been entered into between the issuer and the lead manager(s) and includes content specified in Schedule II;

b) a due diligence certificate;

c) in case of an issue of convertible debt instruments, a due diligence certificate from the debenture trustee;

d) a certificate confirming compliance of the conditions specified in Part F of Schedule VI, if applicable.

3. The Board may specify changes or issue observations, if any, on the draft letter of offer within thirty days from the later of the following dates:

(a) the date of receipt of the draft letter of offer; or

(b) the date of receipt of satisfactory reply from the lead manager(s), where SEBI has sought any clarification or additional information from them; or

(c) the date of receipt of clarification or information from any regulator or agency, where SEBI has sought any clarification or information from such regulator or agency; or

(d) the date of receipt of a copy of the in-principle approval letter issued by the stock exchanges.

4. If the Board specifies any changes or issues observations on the draft letter of offer the issuer and lead manager(s) shall carry out such changes in the draft letter of offer and shall submit to the Board an updated draft letter of offer complying with the observations issued by the Board and highlighting all changes made in the draft letter of offer before filing the letter of offer with the stock exchanges.

5. Copy of the letter of offer shall also be filed with the Board and the stock exchanges through the lead manager simultaneously with the filing of the letter of offer with the designated stock

exchange. The draft letter of offer and letter of offer shall also be furnished to the Board in a soft copy.

14.4.2 Draft offer document to be made public

Public Issues

The draft offer document submitted to SEBI has to be made public, for comments if any, by hosting it on the website of SEBI, the recognized Stock Exchanges on which the issue is to be listed and the website of the merchant bankers associated with the issue for at least 21 days from the date of the filing.

The lead merchant bankers shall, after the expiry of the stipulated period, file with SEBI a statement giving information of the comments received by them or the issuer on the draft offer document during that period and the consequential changes, if any, to be made in the draft offer document.

The issuer within two days of filing the draft offer document with SEBI shall make a public announcement in one English national daily newspaper with wide circulation, one Hindi national daily newspaper with wide circulation and one regional language newspaper with wide circulation at the place where the registered office of the issuer is situated, disclosing to the public the fact of filing of draft offer document with SEBI and inviting the public to give their comments to SEBI, the issuer or the lead manager(s) in respect of disclosures made in the draft offer document.

The issuer and the lead manager(s) shall ensure that the offer documents are hosted on the websites as required under these regulations and its contents are the same as the versions as filed with the Registrar of Companies, SEBI and the stock exchanges, as applicable.

The lead manager(s) and the stock exchanges shall provide copies of the offer document to the public as and when requested and may charge a reasonable sum for providing a copy of the same.

Rights Issues

(1)The draft letter of offer filed with the Board shall be made public for comments, if any, for a period of at least twenty-one days from the date of filing, by hosting it on the websites of the Board, stock exchanges where specified securities are proposed to be listed and the lead manager(s) associated with the issue.

(2) The issuer shall, within two days of the filing of the draft letter of offer with the Board, make a public announcement in one English national daily newspaper with wide circulation, one Hindi

national daily newspaper with wide circulation and one regional language newspaper with wide circulation at the place where the registered office of the issuer is situated, disclosing to the public the fact of filing of the draft letter of offer with the Board and inviting the public to provide their comments to the Board, the issuer or the lead manager(s) in respect of the disclosures made in the draft letter of offer.

(3) The lead manager(s) shall, after the expiry of the period stipulated in sub-regulation (1), file with the Board, details of the comments received by them or the issuer from the public, on the draft offer document, during that period and the consequential changes, if any, that are required to be made in the draft offer document.

(4) The issuer and the lead manager(s) shall ensure that the letters of offer are hosted on the websites as required under these regulations and its contents are the same as the versions as filed with the Board and the stock exchanges, as applicable.

(5) The lead manager(s) and the stock exchanges shall provide copies of the draft letter of offer to the public as and when requested and may charge a reasonable sum for providing a copy of the same.

14.4.3 Dispatch of Issue Material

The lead merchant bankers are responsible for ensuring the availability of the issue material to all the parties concerned. This involves the offer document and other issue material including application forms to stock exchanges, syndicate members, registrar to issue, registrar and share transfer agents, depository participants, stockbrokers, underwriters, bankers to the issue, and self-certified syndicate banks before the opening of the issue.

14.5 Role as an Underwriter

One of the most important roles of the merchant banks involved in the process of issue management is that of the underwriting of the issue. Underwriting is an agreement with or without conditions to subscribe to the securities of an issuer when the existing shareholders of such issuer or the public do not subscribe to the securities offered to them and Underwriters are person who engages in the business of underwriting of an issue of securities of a body corporate. When the issuer makes a public issue (other than through the book-building process) or rights issue and desires to have the issue underwritten, it has to appoint merchant bankers or stock brokers, registered with the Board, to act as underwriters. In case the issuer makes a public issue through the book-building process, such issue shall be underwritten by the lead manager(s) and syndicate members, provided that seventy-five per cent of the net offer to public proposed to be compulsorily allotted to qualified institutional buyers (QIBs) for the purpose of compliance of the eligibility conditions as specified in the Regulation cannot be underwritten.

The issuer shall, prior to filing the prospectus, enter into an underwriting agreement with the lead manager(s) and syndicate member(s), indicating therein the number of specified securities which they shall subscribe to at the predetermined price in the event of under-subscription in the issue. In case where the syndicate member fails to fulfil its underwriting obligation, the lead manager(s) shall fulfil the underwriting obligations. The lead manager(s) and syndicate members shall not subscribe to the issue in any manner except for fulfilling their underwriting obligations.

In case of every underwritten issue, the lead manager(s) shall undertake minimum underwriting obligations as specified in the SEBI (Merchant Bankers) Regulations, 1992. Where the issue is required to be underwritten, the underwriting obligations should at least to the extent of minimum subscription.

14.5.1 Minimum Subscription

In order to prevent any wrongdoing in the issue of securities and to safeguard the interests of the investors, SEBI ICDR has issued some minimum subscription limits for every issue as per Regulation 45.

(1) The minimum subscription to be received in an issue shall be at least ninety per cent of the offer through offer document except in case of an offer for sale of specified securities; *Provided* that the minimum subscription to be received is subject to allotment of the minimum number of specified securities as specified in SCRR 1957.

(2) In the event of non-receipt of minimum subscription as referred to above, all application moneys received shall be refunded to the applicants forthwith, but not later than four days of the closure of the issue.

Regulation 86(1) of ICDR Regulations require that the minimum subscription to be received in the right issue shall be at least ninety per cent of the offer through the offer document, the said limit was temporally relaxed to 75% by the April 2020 Circular.

The amendment dated September 28, 2020 removes the mandatory requirement of a minimum 90% subscription in case the issue is for the purpose of financing other than capital expenditure for a project, provided that the promoters undertake to subscribe fully to their portion of rights entitlement.

14.6 SEBI Circular on Rights Issue

SEBI has issued Circular No. SEBI/HO/CFD/DIL2/CIR/P/2020/13 dated January 22, 2020 regarding streamlining the process of rights issue. Accordingly, the following changes have been made in the process of rights issue:

- The period for advance notice to stock exchange(s) under Regulation 42(2) of LODR Regulations has been reduced from at least 7 working days to at least 3 working days (excluding the date of intimation and the record date), for the purpose of rights issue.
- Issuance of newspaper advertisement disclosing the date of completion of dispatch and intimation of same to the stock exchanges for dissemination on their websites, as per Regulation 84 (1) of ICDR Regulations, shall be completed by the issuer at least 2 days before the date of opening of the issue.
- Dematerialized Rights Entitlements (REs) – (a) In the letter of offer and the abridged letter of offer, the issuer shall disclose the process of credit of REs in the Demat account and renunciation thereof; (b) REs shall be credited to the Demat account of eligible shareholders in dematerialized form; (c) In REs process, the REs with a separate ISIN shall be credited to the Demat account of the shareholders before the date of opening of the issue, against the shares held by them as on the record date; (d) Physical shareholders shall be required to provide their Demat account details to Issuer / Registrar to the Issue for credit of REs not later than two working days prior to the issue closing date, such that credit of REs in their Demat account takes place at least one day before the issue closing date.
- Trading of dematerialized REs on stock exchange platform – (a) REs shall be traded on the secondary market platform of Stock exchanges, with T+2 rolling settlement, similar to the equity shares. Trading in REs on the secondary market platform of stock exchanges shall commence along with the opening of the issue and shall be closed at least three working days prior to the closure of the rights issue;[38] (b) Investors holding REs in dematerialized mode shall be able to renounce their entitlements by trading on stock exchange platform or off-market transfer. Such trades will be settled by transferring dematerialized REs through a depository mechanism, in the same manner as done for all other types of securities.
- Payment mode - Application for a rights issue shall be made only through the ASBA facility.
- No withdrawal of application shall be permitted by any shareholder after the issue closing date.

Procedures on the Rights Issue process

A. Application Form

a. The issuer shall dispatch a common application form to its shareholders as on the record date. Along with the application form, the issuer shall also send the details of the rights entitlements of the shareholder separately.
b. This application form can be used both by shareholders or renouncee.

[38] https://www.sebi.gov.in/legal/circulars/may-2022/streamlining-the-process-of-rights-issue_59023.html

c. Registrar to the issue shall also upload the application forms on its website.
d. Applicants can use the application form available on the website of the registrar to the issue or printed forms sourced from the issuer, merchant bankers or registrars to the issue.
e. In terms of Regulation 78 of the ICDR Regulations, the investor also has the option to make an application in writing on plain paper.

B. Credit of Rights Entitlements ("REs") in dematerialized form

a. The depositories shall put necessary procedures in place for issue and credit of REs in Demat mode.
b. The issuer making a rights issue of specified securities shall ensure that it has made necessary arrangements with depositories to issue and credit the REs in Demat mode in the Demat accounts of shareholders holding shares as on the record date.
c. A separate ISIN shall be obtained by the issuer for credit of REs.
d. Issuer shall specify the ISIN for REs while announcing the record date. [39]
e. Based on the rights entitlement ratio; the issuer shall credit REs in dematerialized mode through corporate action to shareholders holding shares as on record date. The ISIN of REs shall be kept frozen (for debit) in the depository system till the date of opening of the issue.
f. Physical shareholders shall be required to provide their Demat account details to Issuer / Registrar to the Issue for credit of REs not later than two working days prior to issue closing date, such that credit of REs in their Demat account takes place at least one day before issue closing date.
g. In case of fractional entitlements of REs, the fractional part shall be ignored by rounding down the entitlement.
h. The issuer shall submit details of total REs credited to the stock exchanges immediately after completing the corporate action for the same and shall obtain requisite trading approval from the stock exchanges.
i. The details with respect to shareholder entitlement shall be made available on the website of the Registrar to the issue and the investors shall be able to check their respective entitlements on the website of the Registrar by keying their details, after adequate security controls to ensure that investors' information is made available only to the particular investor. Issuer shall also carry these links on their website.
j. If the Demat account of a shareholder is frozen or Demat account details are not available, including shares held in an unclaimed suspense account or the account of IEPF Authority, then REs shall be credited in a suspense escrow Demat account of the Company and an intimation should be sent to such shareholder by the issuer /Registrar to the issue.

[39] However, for issues where the record date is announced before February 14, 2020, and the letter of offer is filed with the stock exchanges on or after February 14, 2020, the Issuer shall file the letter of offer with the stock exchanges only after it has obtained ISIN for REs.

k. The issuer shall intimate issue closing date to the depositories at least one day before the issue closing date, and the depositories shall suspend the ISIN of REs for transfers, from the issue closing date.
l. REs which are neither renounced nor subscribed by the shareholders shall lapse after the closure of the Rights Issue.
m. Issuer Company shall ensure that REs that are lapsed are extinguished from the depository system once securities are allotted pursuant to Rights Issue. Once the allotment is done, the ISIN for REs shall be permanently deactivated in the depository system by the depositories.

C. Renunciation process and trading of REs on stock exchange platform:

a. The stock exchanges shall put necessary procedures in place for the trading of REs on the stock exchange platform.
b. REs credited to Demat account can be renounced either by sale of REs using stock exchanges platform or off-market transfer and such trades will be settled by transferring dematerialized REs through depository mechanism in the same manner as done for all other types of securities.
c. For the sale of REs through the stock exchange, investors can place an order for the sale of REs only to the extent of REs available in the Demat account of the investor. Trading in REs on the secondary market platform of Stock exchanges will happen electronically on a T+2 rolling settlement basis where T being the date of trading. The transactions will be settled on a trade-for-trade basis.
d. Issuer shall inform the dates of issue opening and closing to the stock exchanges and the depositories at the time of filing the letter of offer with the stock exchanges.
e. Trading in REs shall commence on the date of opening of the issue and shall be closed at least four days prior to the closure of rights issue.

D. Submission of Application form in Rights Issue

a. All investors (including renouncee) shall submit application forms using the ASBA facility through the Self Certified Syndicate Banks (SCSB) network during the issue period.
b. Investor shall submit only one application form for REs available in a particular Demat account.

E. Allotment process in the rights issue

a. Facility for correction of bid data as collated by the SCSBs after issue closing shall be provided for a period of one day i.e., on the next working day after issue closing.
b. Registrar shall obtain demographic details of all applicants from depositories.
c. Registrar shall obtain details of holders of REs as on issue closing date, from the depositories.

d. After reconciliation of valid ASBA applications, funds blocked and REs Demat holding list, the registrar shall finalise allocation of securities offered through a rights offering.
e. Registrar shall credit the shares to the respective demat accounts of the applicants based on basis of allotment approved by the designated stock exchange and shall issue instructions to unblock bank accounts wherever necessary.

14.7 General Obligations of Merchant Bankers with respect to Public and Rights Issue

ICDR Regulations prescribes general obligations of Issuers and other intermediaries who are related with the process of issue management. However, we will here only discuss those obligations which are pertaining to Merchant Bankers only.

1. Prohibition on payment of incentives: Any person connected with the issue, shall not offer any incentive, whether direct or indirect, in any manner, whether in cash or kind or services or otherwise to any person for making an application in the rights issue, except for fees or commission for services rendered in relation to the issue.

2. Public Communications / Research reports: All public communication, publicity materials, advertisements and research reports shall comply with the provisions of Schedule IX of ICDR. Any public communication including advertisements, publicity material and research reports (referred to as public communication) issued or made by the issuer or its associate company, or by the lead manager(s) or their associates or any other intermediary connected with the issue or their associates, shall contain only such information as contained in the draft offer document/offer document and shall comply with the following:

(a) It shall be truthful, fair and shall not be manipulative or deceptive or distorted and it shall not contain any statement, promise or forecast which is untrue or misleading.

(b) if it reproduces or purports to reproduce any information contained in the draft offer document or draft letter of offer or offer document, as the case may be, it shall reproduce such information in full and disclose all relevant facts not to be restricted to select extracts relating to that information;

(c) it shall be set forth in a clear, concise and understandable language;

(d) it shall not include any issue slogans or brand names for the issue except the normal commercial name of the issuer or commercial brand names of its products already in use or disclosed in the draft offer document or draft letter of offer or offer document, as the case may be;

(e) it shall not contain slogans, expletives or non-factual and unsubstantiated titles;

(f) if it presents any financial data, data for the past three years shall also be included along with particulars relating to revenue, net profit, share capital, reserves / other equity (as the case may be), earnings per share, dividends and the book values, to the extent applicable;

(g) issue advertisements shall not use technical, legal or complex language and excessive details which may distract the investor;

(h) issue advertisements shall not contain statements which promise or guarantee rapid increase in revenue or profits;

(i) issue advertisements shall not display models, celebrities, fictional characters, landmarks, caricatures or the likes;

(j) issue advertisements on television shall not appear in the form of crawlers (advertisements which run simultaneously with the programme in a narrow strip at the bottom of the television screen) on television;

(k) issue advertisements on television shall advise the viewers to refer to the draft offer document or offer document, as the case may be, for the risk factors;

(l) an advertisement or research report containing highlights shall advise the readers to refer to the risk factors and other disclosures in the draft offer document or the offer document, as the case may be, for details in not less than point seven sizes;

(m) an issue advertisement displayed on a billboard/banners shall contain information as specified in Part D of Schedule X;

(n) an issue advertisement that contains highlights or information other than the details contained in the formats as specified in Schedule X shall prominently advise the viewers to refer to the draft offer document and offer document for details and risk factors.

During the period the issue is open for subscription, no advertisement shall be released giving an impression that the issue has been fully subscribed or oversubscribed, or indicating investors' response to the issue.

The lead manager(s) shall submit a compliance certificate in the format specified in Part E of Schedule X for the period between the date of filing the draft offer document / draft letter of offer and the date of closure of the issue, in respect of news reports appearing in any of the following media:

a) newspapers mentioned in these regulations;

b) print and electronic media controlled by a media group where the media group has a private treaty or shareholders' agreement with the issuer or promoters of the issuer.

An announcement regarding the closure of the issue should be made only after the lead merchant banker is satisfied that at least 90 per cent of the offer through the offer document have been subscribed and a certificate regarding that have been obtained from the registrar to the issue. However, such announcement should not be made before the issue closure date except for the issue closing advertisement made in the format prescribed in these regulations.

3. Publicly available documents: The lead merchant banker along with the issuer shall ensure that the contents of offer documents hosted on the websites as required in the Regulation is the same as that of the printed copies filed with the RoC, SEBI and the stock exchanges. As and when required by any investor, the lead merchant banker and the stock exchange should furnish a copy of the draft offer document. However, a reasonable sum of money can be charged by the merchant banker or the stock exchange for the same.

4. Investor Grievances: The post-issue lead merchant bankers should look into the post-issue activities such as allotment, refund, dispatch and giving instructions to the syndicate members, Self-Certified Syndicate Banks and other intermediaries. The lead merchant banker is required to also look into and monitor the redress of the investor grievances if any.

5. Post-issue Reports: The lead merchant banker is required to submit the post-issue reports to SEBI as specified in the Regulations. In the public issue, the lead merchant banker shall submit final post-issue report alongwith a due diligence certificate as specified, within seven days of the date of finalization of the basis of allotment or seven days of refund of money in case of failure of issue. In rights issue, the lead merchant banker shall submit post-issue reports as follows:

(a) initial post issue report as specified, within three working days of closure of the issue;

(b) final post issue report as specified, within fifteen days of the date of finalization of basis of allotment or within fifteen days of refund of money in case of failure of the issue.

The lead merchant banker shall submit a due diligence certificate as per the format specified, along with the final post issue report.

6. Post-issue Advertisements: The merchant banker related to the post-issue activities shall ensure that advertisements giving details relating to subscription, basis of allotment, number, value and percentage of all applications including ASBA, number, value and percentage of successful allottees for all applications including ASBA, date of completion of despatch of refund

orders, as applicable, or instructions to self-certified syndicate banks by the Registrar, date of despatch of certificates or date of credit of specified securities, as applicable, and date of filing of listing application, etc. is released within ten days from the date of completion of the various activities in at least one English national daily newspaper with wide circulation, one Hindi national daily newspaper with wide circulation and one regional language daily newspaper with wide circulation at the place where the registered office of the issuer is situated

It is the responsibility of the post-issue merchant banker to ensure that the issuer company, advisors, brokers or any other entity connected with the issue do not publish any advertisements which state that issue has been over-subscribed. The advertisement should also not indicate the investor's response to the issue, during the period when the public issue is open for subscription by the public.

7. Co-ordination with other Intermediaries: The post-issue merchant banker has to maintain close coordination with the registrars to the issue and arrange to depute its officers to the offices of various intermediaries at regular intervals after the closure of the issue. This would enable the post-issue merchant banker to monitor (a) the flow of application from collecting bank branches; (b) processing of the applications including the application form for ASBA; (c) other related matters till the basis of allotment is finalized; (d) dispatch of security certificates and refund orders are completed and securities are listed.

In cases, where there is a devolvement on underwriters, the merchant banker has to ensure that the notice for devolvement containing the obligation of the underwriters is issued within a period of ten days from the date of closure of the issue. It is also the responsibility of the post-issue merchant banker to confirm to the bankers to issue that all formalities in connection with the issue have been completed and that the banker is free to release the money to the issuer or release the money for refund in case of failure of the issue.

8. Miscellaneous responsibilities: The merchant banker has to ensure that all the information contained in the offer document and the particulars as per the audited financial statements in the offer document are not more than 6 months old from the issue opening date. The post-issue merchant banker has to:

- Ensure that the dispatch of refund orders, allotment letters and share certificates are done by way of registered post or certificate of posting, whichever is applicable.
- Ensure payment of interest to the applicants for delayed dispatch of allotment letters, refund orders, etc. as per the disclosures made in the offer document.

There are also specific requirements with respect to a fast-track rights issue, further public offer, preferential issue, Qualified Institutional Placement, IPO of Indian Depository Receipts, Rights

Issue of Indian Depository Receipts, IPO by small and medium enterprises and Innovators Growth Platform which are required to be looked into when dealing with those issues.

Case 14.1 SEBI settlement order – M/s Network 18 Media

Facts of the case:

a) Sebi received a complaint in March 2017 against NW18, wherein it was alleged that the company failed to disclose IMT as a 'promoter' in its draft letter of offer and letter of offer filed way back in 2012.

b) SEBI observed that NW18 made a rights issue in 2012, wherein the draft letter of offer was dated March 1, 2012, and the letter of offer was dated August 31, 2012.

c) The company's promoter Raghav Bahl disclosed that the firm had entered into an arrangement with IMT, a trust set up for the benefit of Reliance Industries, to secure the funding required for this purpose.

Findings of the case:

a) IMT had indirectly acquired joint control over NW18 by way of Single Unit Agreement (SUA) in November 2011, whereby IMT along with the holding companies of NW18 and the promoters of NW18 had agreed to act as 'single unit' in managing the matters of NW18 and acquired the right to appoint the majority of the board of directors of the firm.

b) It was also observed that IMT and the promoter entities of NW18 entered into the SUA with the common objective of owning and controlling at least 51 per cent equity share capital of the company by agreeing to act as a single unit in managing the matters of the company and jointly having the right to appoint a majority of the board of directors of the firm.

c) IMT qualified to be a Person Acting in Concert (PAC) with the promoter entities of the company in terms of the SAST (Substantial Acquisition of Shares and Takeovers) norms pursuant to entering into the SUA, it added.

d) Further, DCPL, the trustee of IMT, was wholly-owned by Raghav Bahl and his wife Ritu Kapur, who were the promoters of the company, IMT qualified to be included in the promoter group of the firm as per ICDR (Issue of Capital and Disclosure Requirement) Regulations,

e) SEBI noted that IMT being a part of the promoter group was required to be disclosed, under the promoter category by the company in its draft letter of offer and letter of offer.

f) As the company had allegedly not disclosed IMT as part of the promoter group of the company in its draft letter of offer and letter of offer filed in 2012, it is alleged that the firm has violated the provisions of the ICDR Regulations,

g) Sebi issued a show-cause notice to the company in January 2020 in the matter

Order:

a) Pending adjudication proceedings, the company filed a settlement application in July 2020.

b) Following this, Sebi's High Powered Advisory Committee considered the proposed settlement terms and recommended the case for settlement upon payment of Rs 1.56 crore towards settlement charges and the same was approved by a panel of whole-time members of Sebi.

c) NW18 remitted the amount and accordingly, the regulator settled the matter, pertaining to alleged failure to disclose Independent Media Trust (IMT) as a promoter in the draft papers for the rights issue, after paying Rs 1.56 crore towards settlement charges.

Review Questions

1. Post issue activities, generally coordinated by Lead Merchant Banker, include which of the following?

   (a) Deciding on centres for holding conferences of stockbrokers, investors, etc.

   (b) Processing rematerialisation requests

   (c) Finalisation of the basis of allotment

   (d) All of the above

2. As per SEBI (ICDR) Regulation, only audited and consolidated financial statements need to be prepared in accordance with GAAP. State whether True or False.

   (a) True

   (b) False

3. As per SEBI (ICDR) Regulations, the minimum subscription to be received in an issue must be at least _____ of the offer through the offer document.

   (a) 65 per cent

   (b) 75 per cent

   (c) 80 per cent

   (d) 90 per cent

4. As per SEBI (ICDR) Regulation, an advertisement may be issued giving any impression that the issue has been fully subscribed or oversubscribed during the period the issue is open for subscription, with prior intimation to SEBI. State whether true or false?

   (a) True

   (b) False

CHAPTER 15: DEPOSITORIES ACT 1996

LEARNING OBJECTIVES:

After studying this chapter, you should know about:

- Rights and Obligations of depositories
- Enquiry and Inspection of depositories, DPs by SEBI
- Penalties applicable in case of infringement of the conditions laid down in the depositories act or related regulations.

15.1 Introduction

The Depositories Act, 1996 provides for the establishment of depositories in securities to ensure free transferability of securities with speed, accuracy and security by (a) making securities freely transferable subject to certain exceptions; (b) dematerialization of the securities in the depository mode; and (c) providing for the maintenance of ownership records in a book-entry form. In order to streamline the settlement process, the Act envisages the transfer of ownership of securities electronically by book entry. The Act has made the securities of all companies freely transferable in the depository mode, restricting the company's right to use discretion in effecting the transfer of securities. The other procedural and the transfer deed requirements stated in the Companies Act have also been dispensed with.

International Finance Securities Centre Authority Act, 2019 (IFSCA Act) read with Section 23 G of Depositories Act clarifies that the powers exercisable by SEBI under Depositories Act, 1996 shall not extend to International Finance Service Centres set up under 18(1) of Special Economic Zones Act, 2005. Powers under this Act, shall be exercisable by the International Finance Services Centres Authority established under section 4 (1) of IFSCA Act in so far as regulation of financial products, financial services and financial institutions are permitted in International Finance Services Centre are concerned.

15.2 Rights and Obligations of Depositories

- An entity intending to act as a depository participant should enter into an agreement with the Depository in the prescribed format.
- Every depository shall on receipt of intimation from a participant, register the transfer of security in the name of the transferee. If the beneficial owner or a transferee of any security seeks to have custody of such security the depository shall inform the issuer accordingly.
- Every person subscribing to securities shall have the option either to receive or hold securities certificates with a depository and if the person opts to hold with a depository, the issuer shall

intimate depository the details of allotment and on receipt of such information, the depository shall enter the name of allottee as the beneficial owner of the security.

- All securities held by a depository shall be dematerialized and shall be in fungible form.
- The register and index of beneficial owners maintained by a depository under Section 11 of the Depositories Act, 1996 shall be deemed to be the corresponding register and index under the Companies Act.
- Depository shall inform the issuer about the transfer of securities in the name of beneficial owners at such intervals and as prescribed by bye-laws.
- Depository shall be deemed to be the registered owner for the purpose of effecting transfer of ownership of security on behalf of a beneficial owner. However, Depository as a registered owner shall not have any voting rights or any other rights in respect of securities held by it.
- The beneficial owner shall be entitled to all rights and benefits and be subjected to all the liabilities in respect of his securities held by a depository.
- If a beneficial owner seeks to opt-out of a depository in case of any security, he shall inform the depository accordingly and then the depository shall make entry accordingly in its records and inform the issuer accordingly. The issuer on fulfilment of all conditions as per the regulations by the depository shall issue new certificates to the beneficial owner within thirty days of the receipt of information from the depository.
- When any loss is caused to the beneficial owner due to negligence of the depository or the participant, the depository shall indemnify the beneficial owner. Where such loss is indemnified by the depository, it can recover the same from the participant where such loss is due to the negligence of the participant.
- Where any loss due to the negligence of the participant is indemnified by the depository, the depository can recover the same from such participant.

15.3 Enquiry and Inspection

SEBI may call upon any issuer, depository, depository participant or beneficial owner to furnish in writing such information relating to the securities held in a depository as it may require or it may authorize any person to make an enquiry or inspection in relation to the affairs of the issuer, beneficial owner, depository participant who shall submit a report of such enquiry or inspection to it within such period. Every director, partner, manager, officer, employee or secretary of the depository or beneficial owner or issuer or participant shall produce all information and documents as per the requirement of the person conducting the enquiry or inspection. After making or causing to be made an enquiry, SEBI can issue appropriate directions to the depository participant as may be appropriate in the interest of investors or the securities market. It is hereby declared that the power to issue directions under this section shall include and always be deemed to have been included the power to direct any person, who made a profit or averted loss by indulging in any transaction or activity in contravention of the provisions of this Act or regulations

made thereunder, to disgorge an amount equivalent to the wrongful gain made or loss averted by such contravention.

15.3.1 Penalties

Section 19A of the Depositories Act lays down the penalties to be imposed for failure to furnish information, return etc. by any person who is required under this Act or any rules or regulation or bye-laws made thereunder;

1. Failure in furnishing any information, document, books, returns or report to SEBI or filing any return within the time specified thereof, or filing of false, incorrect or incomplete information, return, report, books or other documents, shall make him liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees.
2. For failure to maintain books of account or records – a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees;
3. For failure to enter into an agreement either by an intermediary or any issuer – a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees;
4. For failure to redress investors' grievances after having been called upon to do so by SEBI within the specified time period penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees;
5. For delay in dematerialization or issue of a certificate of securities – a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees;
6. For failure by any person to comply as per the directions of section 19 of the Depositories Act issued by SEBI Act within a specified time - a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees;
7. Penalty for failure to conduct business in a fair manner.

   Where a depository fails to conduct its business with its participants or any issuer or its agent or any person associated with the securities markets in a fair manner in accordance with the rules, regulations made by the Board or directions issued by the Board under this Act, it shall be liable to penalty which shall not be less than five crore rupees but which may extend to twenty-five crore rupees or three times the amount of gains made out of such failure, whichever is higher.

8. Without prejudice to the above penalties by adjudicating officer or SEBI, if any person contravenes or attempts to contravene or abets the contravention of the Depositories Act or rules or regulations or bye-laws made thereunder or fails to pay the penalty

imposed by the adjudicating officer or to comply with any of his directions or orders, then such person shall be punishable with imprisonment up to 10 years, or with fine up to Rs. 25 crores, or with both.

15.4 Miscellaneous Issues

15.4.1 Composition of Certain Offences

Notwithstanding anything contained in the Code of Criminal Procedures, any offence punishable under this Act, not being an offence punishable with imprisonment only, or with imprisonment and also with fine, may either before or after the institution of any proceeding, be compounded by the Securities Appellate Tribunal (SAT) or a court before which such proceedings are pending.

15.4.2 Power to Grant Immunity

Central Government may, on recommendation by SEBI and if satisfied, grant immunity from prosecution or penalty to a person, who is alleged to have violated Depositories Act or the rules or regulations made thereunder, if such person has made full and true disclosure of such alleged violation. This is provided that no such immunity may be granted where the prosecution proceedings have already been initiated before the receipt of an application for grant of immunity. The recommendation of SEBI under this sub-section is not binding upon the Central Government.

The government may also withdraw immunity given to a person if it is satisfied that such person had given false evidence and hence may be tried for the offence.

15.4.3 Appeals

Any person aggrieved by an order of the SEBI made under this Act or the regulations made thereunder may prefer an appeal to the Central Government within such time as may be prescribed.

Appeal to Securities Appellate Tribunal (SAT):

- Any person aggrieved by an order of the SEBI or Adjudicating Officer (AO) may prefer an appeal to the SAT.
- Every appeal shall be filed within a period of 45 days from the date on which a copy of the order made by SEBI or AO is received by the aggrieved party in such format and accompanied by such fees as prescribed.
- Provided that the SAT may entertain an appeal after the expiry of the said period of 45 days if it is satisfied that there was sufficient cause for not filing it within that period.
- On receipt of an appeal, the SAT may, after giving the parties to the appeal an opportunity of being heard, pass such orders thereon as it thinks fit, confirming, modifying or setting aside the order appealed against.

- The SAT shall send a copy of every order made by it to the SEBI, the parties to the appeal and the concerned AO.
- The appellant may either appear in person or authorize one or more chartered accountants or company secretaries or cost accountants or legal practitioners or any of its officers to present his or its case before the SAT.

Appeal to the Supreme Court:

Any person aggrieved by any decision or order of the SAT may file an appeal to the Supreme Court within 60 days from the date of communication of the SAT order to him on any question of law arising out of such order. Provided that the Supreme Court may, if it is satisfied, allow the appeal to be filed within a further period not exceeding 60 days.

Review Questions

1. Which Act provides for the establishment of depositories in the securities market?

   (a) SEBI Act

   (b) Companies Act

   (c) Depositories Act

   (d) Securities Contracts (Regulation) Act

2. The immunity can be granted by the Central Government on the recommendation of SEBI, under Depositories Act only if the person has made full disclosure of the violation. State whether True or False?

   (a) True

   (b) False

3. An entity intending to act as a depository participant should enter into an agreement with _____in the prescribed format.

   (a) Bank

   (b) Issuer

   (c) Depository

   (d) Broker

4. As per the Depositories Act, failure to furnish information or books or documents or reports by the depository or the depository participant of their functioning will carry a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of _____.

   (a) Rs. One Crore

   (b) Rs. Two Crore

   (c) Rs. Three Crore

   (d) Rs. Four Crores

CHAPTER 16: SEBI (DEPOSITORIES AND PARTICIPANTS) REGULATIONS 2018

LEARNING OBJECTIVES:

After studying this chapter, you should know about:

- Requirements for getting registered as a Depository Participant with SEBI
- Rights and obligation of a depository participant
- Manner of creation of Pledge or Hypothecation
- Cases which are considered as a default by a depository participant
- Code of conduct for depository participants

The relationship between the Depository Participants (DPs) and the depository is governed by an agreement made between the two under the Depositories Act, 1996, SEBI [Depositories and Participants] Regulations, 2018 and the Bye-laws of the Depository. Before commencing business as a depository participant, it has to get registered with the SEBI as a Depository Participant. The commencement, rights and obligations of the participants, issuers etc. are prescribed in the SEBI (Depositories and Participants) Regulations 2018. In this Unit, we try to give insights into this regulation; however, it is advised to refer to the regulation in detail.

16.1 Registration of a Depository Participant

- Depository Participants are required to be registered with SEBI. The application for registration should be routed through the Depository concerned. The certificate of registration granted shall be valid unless it is suspended or cancelled by SEBI.
- A SEBI registered stockbroker can become a depository participant provided stock broker shall have a networth of rupees three crores {within one year of the date of notification of the Securities and Exchange Board of India (Depositories and Participants) (Amendment) Regulations, 2022}, which shall be increased to rupees five crores {within two years of the date of notification of the Securities and Exchange Board of India (Depositories and Participants) (Amendment) Regulations, 2022}:
  Provided further that a self-clearing member fulfilling the networth requirements as provided under the Securities and Exchange Board of India (Stock Brokers) Regulations, 1992 shall also be eligible to register as a depository participant.
- Depository participant has to fulfil the criteria of fit and proper person for SEBI to grant registration.
- Depository participants shall always comply with the conditions of registration.
- Depository participants shall always comply with the Code of Conduct.

16.2 Rights and Obligations

- A Depository Participant should enter into an agreement in the prescribed format (as specified in the Depository's Bye-laws) with a beneficial owner before acting as a depository participant on his behalf.
- With effect from August 27, 2012, it has been made mandatory for all depository participants to make available a 'Basic Services Demat Account' with limited services as per the terms specified to retail individual investors.
- A separate account should be maintained for each beneficial owner and the securities of each beneficial owner should be segregated.
- Transfer to and from the accounts of the client should be made only on receipt of instructions from the beneficial owner and thereafter confirm the same to the beneficial owner.
- Every entry in the client's account shall be supported by electronic instructions or any other mode of instruction received from the beneficial owner.
- Every depository participant shall provide statements of account to the beneficial owner in such form and in such manner and at such time as provided in the agreement with the beneficial owner.
- Client should be allowed to withdraw or transfer securities from its account in a manner as specified in the agreement with the client.
- Depository Participant should maintain continuous connectivity with each depository for which it is a participant.
- Adequate mechanism for the purposes of reviewing, monitoring and evaluating the internal accounting controls should be in place.
- Depository Participants should submit periodic returns to SEBI and Depository in the specified format.
- Depository Participant should not delegate its functions to any other person without prior approval of the Depository.
- In case of a request for dematerialization, Depository Participant should, within 7 days of receipt of security certificate, furnish the same to the Issuer, who then within 15 days shall cancel the security certificate and substitute in its records the name of the Depository as the registered owner and shall send the details of the same to the Depository and to every stock exchange where the security is listed.
- A Depository Participant, on receiving the request for pledge or hypothecation from a beneficial owner/client, shall after satisfaction that the securities are available for pledge or hypothecation, forward the application to the Depository after necessary notings.

16.2.1 Record of Services

- Depository participants should maintain the following records:
  - Records of all transactions entered into with the Depository and with clients (beneficial owners).
  - Details of securities dematerialized and rematerialized on behalf of clients with whom it has entered into an agreement;
  - Records of instructions received from clients and statements of account provided to clients;
  - Records of approval, notice, entry and cancellation of pledge or hypothecation, as the case may be.
- Records and documents should be:
  - Preserved by the Depository Participant for a minimum of 8 years. However, if any enforcement agency has taken a copy of any documents and records, then the originals of such records (whether electronic or physical) should be maintained for such a period till the trial or investigation proceedings are over.
  - Maintained separately for each Depository, if a Depository Participant enters into an agreement with more than one Depository.
  - Reconciled by the Depository Participant with the Depository on a daily basis.
- The location of the records and documents should be intimated to SEBI.
- Where records are kept electronically, the depository participant should ensure that the integrity of the data processing systems is maintained and take adequate precautions against the records being lost, destroyed or tampered with and in the event of loss or destruction, ensure the availability of sufficient back up of records at all times at a different place.
- A depository participant should make available all records to the depository for inspection matters relating to the transfer of securities, maintenance of records of holders, handling of physical securities.

16.2.2 Redressal of Investor Grievances

Depository Participant should redress the grievances of the investors within 30 days of the receipt of complaint and keep the depository informed about the number and nature of grievances redressed by it and the number of grievances pending before it.

16.2.3 Investment Advice

A depository participant or any of its employees shall not render directly or indirectly, any investment advice about any security in the publicly accessible media, whether real-time or non-real-time, unless disclosure of his interest including a long or short position in the said security has been made while rendering such advice.

In case the depository participant is rendering such advice, he shall also disclose the interest of his dependent family members and the employer including their long or short position in the said security while rendering such advice.

16.2.4 Appointment of Compliance Officer

A depository participant shall appoint a compliance officer, who shall be responsible for monitoring the compliance of the Act, rules and regulations, notifications, guidelines, instructions etc. issued by SEBI or the central government and for redress of investor grievances. The Compliance Officer should immediately and independently report to SEBI any non-compliance observed by him.

16.2.5 Inspection

It shall be the duty of the depository participant whose affairs are being inspected or investigated to produce to the inspecting authority such books, accounts, securities, records and other documents in its custody or control and furnish him with such statements and information relating to his activities within a specified time period as the inspecting officer may specify.

16.3 Action in case of Default

A depository or a depository participant who –

- contravenes any of the provisions of the SEBI Act, the Depositories Act, the bye-laws, agreements or SEBI (Depositories and Participants) Regulations;
- fails to furnish any information relating to its activity as a depository or participant as required under these regulations;
- does not furnish the information called for by SEBI under the Depositories Act or furnishes false or misleading information;
- does not co-operate in any inspection or investigation or enquiry conducted by SEBI;
- fails to comply with any direction of SEBI issued under regulation 18 of the Depositories Act;
- fails to pay the annual fee;

shall be dealt with in the manner provided under Chapter V of the SEBI (Intermediaries) Regulations, 2008.

16.3.1 Manner of creation of pledge or hypothecation

- The Depository Participant within 15 days from receipt of the application, shall after concurrence of the pledgee through its participant, create and record the pledge and send intimation of the same to the participants of the pledgor and the pledgee.
- If the Depository does not create the pledge, it shall send along the with the reasons an intimation to the participants of the pledger and the pledgee.

- Basis the provision of pledge document, the pledgee may invoke the pledge and, on such invocation, the depository shall register the pledgee as the beneficial owner of such securities, amend its record and send intimation to participants, who in turn would intimate the pledgor and pledgee.
- The above applies mutatis mutandis in case of hypothecation.

16.4 Code of Conduct for Participants

The third schedule of the SEBI (Depositories and Participants) Regulations 2018 prescribes the Code of Conduct for Participants which are as given below:

- A Participant shall make all efforts to protect the interests of investors.
- A Participant shall always endeavour to -
  - render the best possible advice to the clients having regard to the clients' needs and the environments and his own professional skills;
  - ensure that all professional dealings are affected in a prompt, effective and efficient manner;
  - inquiries from investors are adequately dealt with;
  - grievances of investors are redressed without any delay.
- A Participant shall maintain high standards of integrity in all its dealings with its clients and other intermediaries, in the conduct of its business.
- A Participant shall be prompt and diligent in the opening of a beneficial owner account, dispatch of the Dematerialization Request Form (DRF), Rematerialisation Request Form (RRF) and execution of Debit Instruction Slip and in all the other activities undertaken by him on behalf of the beneficial owners.
- A Participant shall endeavour to resolve all the complaints against it or in respect of the activities carried out by it as quickly as possible and not later than one month of receipt.
- A Participant shall not increase charges / fees for the services rendered without proper advance notice to the Beneficial Owners.
- A Participant shall not indulge in any unfair competition, which is likely to harm the interests of other Participants or investors or is likely to place such other Participants in a disadvantageous position while competing for or executing any assignment.
- A Participant shall not make any exaggerated statement whether oral or written to the clients either about its qualifications or capability to render certain services or about its achievements in regard to services rendered to other clients.
- A Participant shall not divulge to other clients, press or any other person any information about its clients which has come to its knowledge except with the approval / authorization of the clients or when it is required to disclose the information under the requirements of any Act, Rules or Regulations.
- A Participant shall co-operate with SEBI as and when required.

- A Participant shall maintain the required level of knowledge and competency and abide by the provisions of the Act, Rules, Regulations and circulars and directions issued by SEBI. The Participant shall also comply with the award of the Ombudsman passed under SEBI (Ombudsman) Regulations, 2003.
- A Participant shall not make any untrue statement or suppress any material fact in any documents, reports, papers or information furnished to SEBI.
- A Participant shall not neglect or fail or refuse to submit to SEBI or other agencies with which it is registered, such books, documents, correspondence, and papers or any part thereof as may be demanded / requested from time to time.
- A Participant shall ensure that SEBI is promptly informed about any action, legal proceedings etc., initiated against it in respect of material breach or non-compliance by it, of any law, rules, regulations, directions of SEBI or any other regulatory body.
- A Participant shall maintain a proper inward system for all types of mail received in all forms.
- A Participant shall follow the *maker-checker* concept in all of its activities to ensure the accuracy of the data and as a mechanism to check unauthorized transactions.
- A Participant shall take adequate and necessary steps to ensure that continuity in data and record-keeping is maintained and that the data or records are not lost or destroyed. It shall also ensure that for electronic records and data, up-to-date backup is always available with it.
- A Participant shall provide adequate freedom and powers to its compliance officer for the effective discharge of his duties.
- A Participant shall ensure that it has satisfactory internal control procedures in place as well as adequate financial and operational capabilities which can be reasonably expected to take care of any losses arising due to theft, fraud and other dishonest acts, professional misconduct or omissions.
- A Participant shall be responsible for the acts or omissions of its employees and agents in respect of the conduct of its business.
- A Participant shall ensure that the senior management, particularly decision-makers have access to all relevant information about the business on a timely basis.
- A Participant shall ensure that good corporate policies and corporate governance are in place.

Case 16.1: SEBI v/s Reliance Capital Ltd (RCL)

Facts of the case:

a) Inspection was conducted of RCL for period April 2010- March 2012 wherein majority period pertained to DP activities carried out by RCL before DP functions were transferred to Reliance Securities Ltd (RSL).

b) From the records it was established that RCL delegated its DP functions to RSL (prior to approval from depositories for transfer of DP operations).

c) In terms of regulation 52 of the DP Regulations, the DPs are restricted from delegating their functions as a participant to any other person, without the prior approval of the depository. RCL have violated the provisions of regulation 52 of DP Regulations and clause 2 of the Code of the Conduct specified under regulation 20AA of the DP Regulations.

d) the complaints were received at the DP's end on or after December 2010. Further, as mentioned before, the PoA had to be modified as mandated vide SEBI circulars dated April 23, 2010 and August 31, 2010 to be implemented by September 01, 2010. It is alleged that the authority/powers granted under PoA were utilized to debit shares from the client's Demat account to cover debit in a trading ledger which would not have been the case had the PoA been suitably amended as per indicated timeline of the circulars. RCL have violated 42(2) and 42(3) and clause 2 and 4 of the Code of Conduct as specified in the Third scheduled read with regulation 20AA of the DP Regulations

Findings of the case:

a) During the inspection SEBI observed that all the instances where rules and regulation of SEBI Act have been breached were during the major period of RCL carrying out the DP functions and the DP functions of RCL was transferred later on to RSL. Thereafter, an administrating warning was issued by SEBI vide letter dated March 21, 2014, to the RCL for the conduct which were rectifiable in nature and mainly on (a) No email id was specifically marked for DP related complaints, (b) Mismatch in a number of complaints submitted to SEBI vide pre-inspection questionnaire and CDSL vide Investor grievance reports and (c) the Wrong classification of complaints. The adjudication proceedings were initiated for the rest of its misconduct as per allegations made in the SCN. Therefore, these proceedings are in addition to and not in duplication of the charges for which Administrative Warning was issued.

b) As per regulation 42(2) and 42(3) RCL was obligated to transfer securities to or from beneficial owners account only on receipt of instruction from the beneficial owner. As alleged in the SCN and more specifically in para 5 of this order, RCL failed to provide any receipt of instruction (electronic or otherwise). Therefore, RCL has violated the provisions of regulation 42(2) and 42(3) of DP Regulations and clauses 2 and 4 of the Code of the Conduct specified under the Third schedule read with regulation 20AA of the DP Regulations.

c) Complaints would not have occurred in the first place if the RCL had revoked the PoA and implemented the circular dated April 23, 2020. Therefore, in view of the above, I am of the view

that RCL has violated the SEBI circular dated April 23, 2010 and August 31, 2010. SEBI circular dated April 23, 2010 read with circular dated August 31, 2010 relates to the execution of PoA by the client in favour of stockbroker & DP, and same were issued in the interest of the investors and to protect them from any misuse of the clauses under PoA. Any non-adherence of the same cannot be considered as mere technical omission.

Order:

Consolidated monetary penalty of Rs 1 lakh on RCL

Review Questions

1. For an entity to function as a Depository Participant, it is mandatory for it to be registered with SEBI as a Depository Participant. State True or False?

   (a) True

   (b) False

2. Every Depository Participant should put in place an adequate mechanism for _____ the internal accounting controls.

   (a) Reviewing

   (b) Monitoring

   (c) Evaluating

   (d) All of the above

3. As per the SEBI (Depositories and Participants) Regulations, the records and documents should be reconciled by the Depository Participant with each depository on a _____ basis.

   (a) Daily

   (b) Two-day

   (c) Weekly

   (d) Fortnightly

4. As per the SEBI (Depositories and Participants) Regulations, a Depository Participant shall not increase charges / fees for the services rendered without proper advance notice to the Beneficial Owners. State whether True or False?

   (a) True

   (b) False

CHAPTER 17: SEBI (REGISTRAR TO AN ISSUE AND SHARE TRANSFER AGENTS) REGULATIONS, 1993

LEARNING OBJECTIVES:

After studying this chapter, you should know about:

- Registrar to an Issue and Share Transfer Agent
- Comprehensive Policy Framework for QRTAs
- General Obligations and Responsibilities for RTAs
- Code of Conduct for RTAs

17.1 Who is Registrar to an Issue and Share Transfer Agent?

As defined in the SEBI regulations, "Registrar to an issue" means the person appointed by a body corporate or any person or group of persons to carry on the following activities on its or his or their behalf:

(i) collecting applications from investors in respect of an issue;
(ii) keeping a proper record of applications and monies received from investors or paid to the seller of the securities; and
(iii) assisting body corporate or person or group of persons in (a) determining the basis of allotment of securities in consultation with stock exchange; (b) finalising list of persons entitled to allotment; (c) processing and dispatching allotment letters, refund orders or certificates and other related documents in respect of an issue;

Further, as defined in the SEBI regulations, "Share transfer agent" means- (i) any person, who on behalf of anybody corporate, maintains the records of holders of securities issued by such body corporate and deals with all matters connected with the transfer and redemption of its securities; (ii) a department or division, by whatever name called, of a body corporate performing the activities referred in sub-clause (i) if at any time the total number of the holders of its securities issued exceed one lakh;

As per SEBI Circular No. SEBI/HO/MIRSD/DoP/CIR/P/2018/ 119 dated August 10, 2018, Registrars to an Issue and Share Transfer Agents (RTAs) servicing more than 2 crore folios referred to as "Qualified RTAs" or "QRTAs".

The QRTAs formulate and implement their comprehensive policy framework, which is approved by the respective Board of Directors ("BoD") of the QRTAs, which shall include the following aspects:

I. Risk Management Policy:

a. An integrated and comprehensive view of risks to the QRTAs including those emanating from vendors, third parties to whom activities are outsourced, clients, etc.;

b. List of all relevant risks, including Operational Risk, Fraud Risk, Technology Risk, Cyber Security Risk, and general business risks including Credit Risk, Market Risk, Legal Risk, Reputation Risk etc. as the BoD of QRTAs deems fit; and systems, policies and procedures to identify, assess, monitor and manage the risks that arise in or are borne by the QRTAs, including audit and reporting of the same to the BoD;
c. Responsibilities and accountability for risk decisions and decision-making process in crises and emergencies.

II. Business Continuity Plan:

QRTAs shall maintain a Business Continuity Plan (BCP) with a centre situated at a location other than the primary processing location (off-site), which is capable to take over operations without disruption in case of any service failure at the primary processing site.
QRTAs shall have written policy, protocols, processes and controls for BCP. QRTAs shall ensure business continuity and no adverse impact on investor servicing resultant of any data loss. The effectiveness of BCP is to be tested periodically, and the gap between two tests (mock drills, etc.) shall not be more than twelve months.

III. Manner of keeping records:

Where records are kept electronically by the QRTAs, they shall ensure that the integrity of the automatic data processing systems is maintained at all times. QRTAs shall also maintain accurate up to date records for investor servicing and take all precautions necessary to ensure that the records are not lost, destroyed or tampered with; and in the event of loss or destruction, ensure that sufficient backup of records is available at all times at a different place.

IV. Wind-down Plan:

Every QRTA shall have and maintain a wind-down plan. A 'wind-down plan' means a process or plan of action employed, for transfer of the entire operations of the QRTA to an alternative RTA/

QRTA registered with SEBI, that would take over the operations of the QRTA in scenarios such as erosion of net-worth of the QRTA or its insolvency or its inability to provide critical RTA operations or services.

V. Data Access and Data Protection Policy:

QRTAs shall extend all such co-operation to the investors, issuers, custodians of securities, depositories and other QRTAs as is necessary for effective and smooth investor servicing.
For this purpose, QRTAs shall lay down appropriate protocols, processes and controls for their activities and also for entities who wish to connect with the database of the QRTAs electronically. QRTAs shall also have written agreements, confidentiality contracts, security protocols and such other relevant procedures for data integrity while facilitating electronic access.

VI. Ensuring Integrity of Operations:

QRTAs shall maintain adequate human resources, systems and processes for smooth functioning. QRTAs also ensure that their database, servers, data storage media shall reside in India.
QRTAs shall lay down the minimum standards, protocol and procedures for smooth running of operations, to protect the investor data and maintain information security. Further, the QRTAs shall have a detailed operations manual explaining all aspects of its functioning, including the interface and method of transmission of information between the depository, issuers, and others. The QRTAs shall have a mechanism in place to have periodic replication of data with the concerned Mutual Funds / Issuer Companies / Real Estate Investment Trusts (REITs)/ Infrastructure Investment Trusts (InVITs).

VII. Scalable infrastructure:

The BoD of QRTAs shall approve a policy framework for the up-gradation of infrastructure and technology from time to time to ensure smooth functioning and scalability for delivering services to investors at all times. QRTAs shall at all times, maintain adequate technical capacity to process twice the peak transaction load encountered during past six months.

VIII. Board of Directors (BoD) / Committees of BoD of QRTAs:

The BoD of QRTAs shall seek reports on incidents having an impact on investor protection including data security breaches that can affect investor data, etc. QRTAs shall have Committees of the Board of Directors including Audit Committee, Nomination and Remuneration Committee and IT Strategy Committee.

The Audit Committee shall assist the BoD in fulfilling its corporate governance and overseeing responsibilities in relation to an entity's financial reporting, internal control system, and risk management system including the risk parameters. The Audit Committee shall also review the internal audit reports, compliance to SEBI Regulations, circulars and the reasonableness of the price being charged for investor services.

The Nomination and Remuneration Committee shall in accordance with the rules laid down, recommend to the BoD a policy, relating to the appointment, tenure and remuneration for the directors, key managerial personnel and other employees.

The IT Strategy Committee shall provide insight and advice to the BoD of QRTAs in various areas that may include developments in IT and alignments with the same from investor services perspective, scalability of operations, etc.

IX. Investor Services and Service Standards:

a. QRTAs, servicing Mutual Funds investors, must have Investor Service Center in at least 100 cities based on investor population pertaining to the Mutual Funds clients they service. As regards servicing of corporate, REIT, InvIT investors, QRTA shall maintain adequate investor service centers based on investor population. This shall be reviewed from time to time by SEBI.
b. QRTAs shall have online capabilities for investor queries, complaints and their redressal. The complaints redressal mechanism should be investor-friendly and convenient. The same should have capabilities of being retrieved easily by the complainant online through complaint reference number, e-mail id, mobile no. etc.
c. QRTAs, handling corporate registry functions, shall develop a facility for providing services for managing Shareholders General Meetings including shareholders voting / poll process and web streaming of all Annual General Meetings (AGMs) of all their listed client companies. QRTAs shall also look forward to providing other value-added services and when required by SEBI.
d. QRTAs must publish on their website, the service standards (e.g.: turnaround time for services rendered).
e. QRTAs should also carry out stakeholder/ investor satisfaction surveys annually, and the same should also be published on the website before March 31, every year.

X. Insurance against Risks:

All QRTAs shall take adequate insurance for omissions and commissions, frauds by employee/s to protect the interests of the investors.

The compliance report of the enhanced reporting norms shall be submitted to SEBI duly reviewed by the BoD of QRTAs, within 60 days of the expiry of each calendar quarter. This enhanced reporting would be in addition to half-yearly periodic reporting done by Registrars to an Issue and Share Transfer Agents as prescribed by SEBI vide circular dated July 05, 2012 on "Review of Regulatory Compliance and Periodic Reporting".

17.2 General Obligations and Responsibilities

Regulation 13 to 15A deals with this aspect as given below:

Abide by Code of Conduct (Reg 13) - Every registrar to an issue and share transfer agent holding a certificate shall at all times abide by the Code of Conduct.

Registrar to an Issue not to act as such for an associate – No registrar to an issue shall act as such registrar for any issue of securities in case he or she is an associate of the body corporate issuing the securities. For the purpose of this regulation, a registrar to an issue or the body corporate as the case may be shall be deemed to be an associate of the other where:
(a) he or it controls directly or indirectly not less than 10 per cent of the voting power of the body corporate or of the registrar to an issue, as the case may be; or,
(b) he or any of his relatives[40] is a director or promoter of the body corporate or of the registrar to an issue, as the case may be.

To maintain proper books of accounts and records, etc. - (1) Every registrar to an issue and share transfer agent being a body corporate shall keep and maintain the following books of accounts and documents in respect of eight preceding financial years, namely: -
(a) in relation to the registrar to an issue and share transfer agent being a body corporate
    (i) a copy of balance sheet and profit and loss account as specified in sections 211 and 212 of the Companies Act, 1956 (1 of 1956);
    (ii) a copy of the auditor's report referred to in section 227 of the Companies Act, 1956;
    (iii) a statement of capital adequacy requirements for each quarter.
(b) in relation to the registrar to an issue and share transfer agent not being a body corporate
    (i) all sums of money received and expended by them and the matters in respect of which the receipt and expenditure take place;

[40] The term 'relative' shall have the same meaning as is assigned to it under section 6 of the Companies Act, 1956.

(ii) their assets and liabilities; and
(iii) a statement of capital adequacy requirements for each quarter.

(2) Every registrar to an issue shall also maintain the following records with respect to: -
(a) all the applications received from investors in respect of an issue;
(b) all applications of investors rejected and reasons therefore;
(c) basis of allotment of securities to the investors as finalised in consultation with the stock exchange;
(d) terms and conditions of purchase of securities;
(e) allotment of securities;
(f) list of names of allottees and non-allottees of the securities;
(g) refund orders dispatched to investors in respect of application monies received from them in response to an issue;
(h) such other records as may be specified by the Board for carrying on the activities as registrars to an issue.

(3) Every share transfer agent shall maintain the following records in respect of a body corporate on whose behalf he is carrying on the activities as share transfer agent namely:
(a) list of holders of securities of such body corporate;
(b) the names of transferor and transferee and the dates of transfer of securities;
(c) such other records as may be specified by the Board for carrying out the activities as share transfer agents.

(4) Every registrar to an issue or share transfer agent shall intimate the Board the place where the books of accounts, records and documents are maintained.

(5) Every registrar to an issue and share transfer agent shall, after the close of each financial year as soon as possible but not later than six months from the close of the said period furnish to SEBI if so required copies of the balance sheet, profit and loss account, statement of capital adequacy requirement and such other documents as may be required by SEBI.

Maintenance of records (Reg 15) - Subject to provisions of any other law, the registrar to an issue or share transfer agent shall preserve the books of accounts and other records and documents maintained under regulation 14 for a minimum period of eight years.

Appointment of a Compliance Officer (Reg 15A) - (1) Every registrar to an issue and share transfer agent shall appoint a compliance officer who shall be responsible for monitoring the compliance of the Act, rules and regulations, notifications, guidelines, instructions etc. issued by the Board or the Central Government and for redressal of investors' grievances.

(2) The compliance officer shall immediately and independently report to the Board any non-compliance observed by him.

17.3 Code of Conduct for Registrars to an Issue and Share Transfer Agents

Schedule III of the regulation specifies the Code of Conduct for Registrars to an Issue and Share Transfer Agent. It states that the RTA agent shall:

1. maintain high standards of integrity in the conduct of its business.
2. fulfil its obligations in a prompt, ethical and professional manner.
3. at all times exercise due diligence, ensure proper care and exercise independent professional judgment.
4. exercise adequate care, caution and due diligence before dematerialisation of securities by confirming and verifying that the securities to be dematerialized have been granted listing permission by the stock exchange/s.
5. always endeavour to ensure that - a) inquiries from investors are adequately dealt with; b) grievances of investors are redressed without any delay; c) transfer of securities held in physical form and confirmation of dematerialisation / rematerialisation requests and distribution of corporate benefits and allotment of securities is done within the time specified under any law.
6. make reasonable efforts to avoid misrepresentation and ensure that the information provided to the investors is not misleading.
7. not reject the dematerialisation / rematerialisation requests on flimsy grounds. Such a request could be rejected only on valid and proper grounds and supported by relevant documents.
8. avoid conflict of interest and make adequate disclosure of its interest.
9. put in place a mechanism to resolve any conflict-of-interest situation that may arise in the conduct of its business or where any conflict of interest arises, shall take reasonable steps to resolve the same in an equitable manner.
10. make appropriate disclosure to the client of its possible source or potential areas of conflict of duties and interest which would impair its ability to render fair, objective and unbiased services.
11. not indulge in any unfair competition, which is likely to harm the interests of other Registrar to the Issue and Share Transfer Agent or investors or is likely to place such other Registrar in a disadvantageous position in relation to the Registrar to Issue and Share Transfer Agent while competing for or executing any assignment.

12. always endeavour to render the best possible advice to the clients having regard to their needs.
13. not divulge to other clients, press or any other person any confidential information about its clients which has come to its knowledge except with the approval / authorisation of the clients or when it is required to disclose the information under any law for the time being in force.
14. not discriminate amongst its clients, save and except on ethical and commercial considerations.
15. ensure that any change in registration status / any penal action taken by the Board or any material change in financials which may adversely affect the interests of clients / investors is promptly informed to the clients.
16. maintain the required level of knowledge and competency and abide by the provisions of the Act, rules, regulations, circulars and directions issued by the Board. The Registrar to an Issue and Share Transfer Agent shall also comply with the award of the Ombudsman passed under SEBI (Ombudsman) Regulations, 2003.
17. co-operate with the Board as and when required.
18. The RTA shall not neglect or fail or refuse to submit to the Board or other agencies with which he is registered, such books, documents, correspondence, and papers or any part thereof as may be demanded / requested from time to time.
19. ensure that the Board is promptly informed about any action, legal proceeding etc. initiated against it in respect of any material breach or non-compliance by it, of any law, rules, regulations, directions of the Board or of any other regulatory body.
20. take adequate and necessary steps to ensure that continuity in data and record-keeping is maintained and that the data or records are not lost or destroyed. Further, it shall ensure that for electronic records and data, up-to-date backup is always available with it.
21. endeavour to resolve all the complaints against it or in respect of the activities carried out by it as quickly as possible.
22. (a) A Registrar to an Issue and Share Transfer Agent or any of its employees shall not render, directly or indirectly any investment advice about any security in the publicly accessible media, whether real-time or non-realtime, unless disclosure of its long or short position in the said security has been made while rendering such advice.

    (b) In case, an employee of a Registrar to an Issue and Share Transfer Agent is rendering such advice, the Registrar to an Issue and Share Transfer Agent shall ensure that it also discloses its own interest, the interests of his dependent family members and that of the employer including their long or short position in the said security while rendering such advice.

23. hand-over all the records/ data and all related documents which are in its possession in its capacity as a Registrar to an Issue and / or Share Transfer Agent to the respective clients, within one month from the date of termination of the agreement with the respective clients or within one month from the date of expiry/cancellation of certificate of registration as Registrar to an Issue and / or Share Transfer Agent, whichever is earlier.
24. not make any exaggerated statement, whether oral or written, to the clients either about its qualifications or capability to render certain services or about its achievements in regard to services rendered to other clients.
25. shall ensure that it has satisfactory internal control procedures in place as well as adequate financial and operational capabilities which can be reasonably expected to take care of any losses arising due to theft, fraud and other dishonest acts, professional misconduct or omissions.
26. provide adequate freedom and powers to its compliance officer for the effective discharge of its duties.
27. develop its own internal code of conduct for governing its internal operations and laying down its standards of appropriate conduct for its employees and officers in carrying out its duties as a Registrar to an Issue and Share Transfer Agent and as a part of the industry. Such a code may extend to the maintenance of professional excellence and standards, integrity, confidentiality, objectivity, avoidance of conflict of interests, disclosure of shareholdings and interests etc.
28. ensure that good corporate policies and corporate governance are in place.
29. ensure that any person it employs or appoints to conduct business is fit and proper and otherwise qualified to act in the capacity so employed or appointed (including having relevant professional training or experience).
30. be responsible for the acts or omissions of its employees and agents in respect of the conduct of its business.
31. not, in respect of any dealings in securities, be a party to or instrumental for - a. creation of false market; b. price rigging or manipulation; c. passing of unpublished price sensitive information in respect of securities which are listed and proposed to be listed in any stock exchange to any person or intermediary.

Case 17.1: SEBI v/s Sharepro Services (I) Pvt Ltd (RTA)

Facts of the case:

a) Basis an anonymous with respect to Sharepro Services (I) Pvt. Ltd. (Sharepro), a SEBI registered registrar to an issue and share transfer agent, alleging inter alia misappropriation of unclaimed dividend which were to be transferred to IPEF, misappropriation of shares belonging to deceased shareholders and tampering of accounts, SEBI conducted an investigation into the matter.

b) While the investigation was in progress, an ex-parte ad-interim order dated March 22, 2016 (Interim Order) was passed against Sharepro and certain others whereby they were inter alia restrained from buying selling or dealing in the securities market or associating themselves with the securities market, either directly or indirectly, in any manner, till further directions.

c) SEBI, vide order dated November 03, 2017 (Confirmatory Order) confirmed the directions issued in the Interim Order

d) Investigation revealed that:

i) Dividends belonging to the rightful shareholders were fraudulently paid to persons belonging to or connected with the management of Sharepro. On 1004 instances (involving Rs.74,95,420/-) Sharepro has misused the authority of instructing the bankers directly by issuing dividend payment instruments to persons who were not shareholders (dividends of those companies which have authorized Sharepro to issue instructions to bankers directly without going through them). Where the companies did not authorize, misled such companies by asking them to issue requisite instructions to bankers to credit the dividend proceeds of rightful investors to entities/persons who were linked to management

ii) Sharepro's management has committed fraud in respect of the transfer, transmission, buyback/ redemption of securities, printing of share certificates and maintenance of records

iii) Securities Misappropriated and the value thereof: The investigation revealed that the total value of securities of various companies so misappropriated, as on October 10, 2016, amounted to Rs. 60,45,74,718.15/

iv) Non-maintenance of proper records and destruction of records

v) Compromise of internal checks and balances in RTA's systems and non -adherence to due procedures- Sharper Services processed requests for issue of duplicate shares without checking the genuineness of such requests

vi) massive falsification and manipulation of records maintained at RTA's end.

vii) Deliberate attempt by Sharepro to mislead SEBI and non-cooperation with SEBI in the course of investigation

(viii)Failing to comply with the summonses issued by the Investigating Authority by submitting false and misleading information or not submitting any information.

e) Fraud committed by Sharepro and its senior management is massive in proportion and has very wide ramifications in the securities market. SEBI registered and regulated intermediaries command and enjoy a solid trust from other market participants, including the common investors. These institutions have a sacrosanct duty to preserve that trust by upholding institutional integrity, fairness and professionalism in the conduct of their business at all times and costs as these values lie at the core of their functioning and are beyond compromise. Any institutional fraud and act of dishonesty committed by such an institution as has been displayed by Sharepro and its management is very likely to undermine the public faith in the entire market mechanism and has the potential to disrupt its smooth functioning and development. Thus, such violations need to be viewed very seriously and dealt with in the strictest manner possible, so as to restore public confidence and preserve market integrity.

Order:

a) SEBI order dated July 8, 2020 stated that Noticee viz., Sharepro, Govind Raj Rao, Indira Karkera, Balram Mukherjee and Prashant Karkera are hereby restrained from accessing the securities market and are further prohibited from buying, selling or otherwise dealing in securities in any manner whatsoever, directly or indirectly, for a period of 10 years from the date of this order.

b) SEBI vide its order dated September 2020 noted that by failing to respond to the post-enquiry SCN, Sharepro has admitted the said charges and hence, the same stand established. Further conduct of the Sharepro, even prior to the period covered by the inspection, lacked integrity and did not befit a registered intermediary upon consideration of the facts and circumstances as above, hereby cancel, with immediate effect, the certificate of registration of the Sharepro as a Registrar to an Issue and Share Transfer Agent.

Review Questions

1. Who is primarily responsible for finalising the list of persons entitled to allotment of securities after an issuance process?

   (a) Registrars to an Issue

   (b) Depository

   (c) Banker to an Issue

   (d) Stockbroker

2. Who are known as Qualified RTA?

   (a) RTA's servicing more than 50 lakh folios

   (b) RTA's servicing more than one crore folios

   (c) RTA's servicing more than two crore folios

   (d) RTA's servicing more than 75 lakh folios

3. An RTA or any of its employees shall not render, directly or indirectly any investment advice about any security in the publicly accessible media, whether real-time or non-realtime, unless a disclosure of its _____ in the said security has been made, while rendering such advice.

   (a) Interest

   (b) Long or Short Position

   (c) Futures Position

   (d) Contracts

4. The Registrar and Share Transfer Agent shall maintain books of accounts and documents for how many years?

   (a) 3 preceding financial years

   (b) 5 preceding financial years

   (c) 7 preceding financial years

   (d) 8 preceding financial years

CHAPTER 18: SEBI (RESEARCH ANALYST) REGULATIONS, 2014

LEARNING OBJECTIVES:

After studying this chapter, you should know about:

- Management of Conflict of Interest and Disclosure requirements
- General Responsibility
- Different Records /Reports to be maintained by Research Analyst

18.1 Introduction

SEBI (Research Analysts) Regulations, 2014 puts in place a framework to register and regulate research analysts. Under these Regulations, a research analyst is defined as under:

"Research analyst" means a person who is primarily responsible for:
i. preparation or publication of the content of the research report; or
ii. providing research report; or
iii. making 'buy/sell/hold' recommendation; or
iv. giving price target; or
v. offering an opinion concerning public offer, with respect to securities that are listed or to be listed in a stock exchange, whether or not any such person has the job title of 'research analyst' and includes any other entities engaged in issuance of a research report or research analysis.
The term also includes any associated person who reports directly or indirectly to such a research analyst in connection with the activities provided above.

Research Analysts are required to be registered with SEBI.

The regulation also defines "Research Report" as any written or electronic communication that includes research analysis or research recommendation or an opinion concerning securities or public offer, providing a basis for investment decision and does not include the following communications: -

(i) comments on general trends in the securities market;
(ii) discussions on the broad-based indices;
(iii) commentaries on economic, political or market conditions;
(iv) periodic reports or other communications prepared for unitholders of a mutual fund or alternative investment fund or clients of portfolio managers and investment advisers;
(v) internal communications that are not given to current or prospective clients;

(vi) communications that constitute offer documents or prospectus that are circulated as per regulations made by SEBI;
(vii) statistical summaries of financial data of the companies;
(viii) technical analysis relating to the demand and supply in a sector or the index;
(ix) any other communication which SEBI may specify from time to time;

18.2 Management of Conflict of Interest and Disclosure requirements

Regulation 15 deals with establishing Internal policies and procedures.
(1) Research analyst or research entity shall have written internal policies and control procedures governing the dealing and trading by any research analyst for:

(i) addressing actual or potential conflict of interest arising from such dealings or trading of securities of the subject company;
(ii) promoting objective and reliable research that reflects the unbiased view of research analyst; and
(iii) preventing the use of research reports or research analysis to manipulate the securities market.

(2) Research analysts or research entities shall have in place appropriate mechanisms to ensure the independence of their research activities from their other business activities.

Regulation 16 deals with limitations on trading by research analysts:

(1) Personal trading activities of the individuals employed as research analysts by the research entity shall be monitored, recorded and wherever necessary, shall be subject to formal approval.
(2) Independent research analysts, individuals employed as research analysts by research entities or their associates shall not deal or trade in securities that the research analyst recommends or follows within 30 days before and 5 days after publication of a research report. They cannot shall not deal or trade directly indirectly in securities that he reviews in a manner contrary to his given recommendation.

Regulation 18 deals with limitations on publication of research reports, public appearance and conduct of business etc.
(1) Research analyst or Research entity shall not provide any promise or assurance of favourable review in its research report to a company or industry or sector or group of companies or business group as consideration to commence or influence a business relationship or for the receipt of compensation or other benefits.
(2) Research entity shall ensure that the individuals employed as research analysts are separate from other employees who are performing sales trading, dealing, corporate finance advisory or

any other activity that may affect the independence of its research report. Feedback from sales or trading personnel of brokerage division to ascertain the impact of the research report, however, is allowed.
(3) Research analysts or individuals employed as research analysts by the research entity shall not participate in business activities designed to solicit investment banking or merchant banking or brokerage services business, such as sales pitches and deal roadshows
(4) Research analysts or individuals employed as research analysts by the research entity shall not engage in any communication with a current or prospective client in the presence of personnel from investment banking or merchant banking or brokerage services divisions or company management about an investment banking service transaction.

Regulations 19, 20,21 and 22 deal with Disclosure in research reports, Contents of the research report, recommendations in public media, distribution of research reports respectively. Some key provisions discussed in this are as follows

1) Research analyst or research entity shall disclose the following in research report and public appearance with regard to ownership and material conflict of interest:
a) whether they or its associate or relative has any financial interest in the subject company and nature of such financial interest
b) whether they have actual/beneficial ownership of 1% or more securities of the subject company, at the end of the month immediately preceding date of publication of research report or date of public appearance
c) whether they or its associate or relative has any material conflict of interest at the time of publication of research report or at the time of public appearance
2) Research report shall not be made available selectively to internal trading personnel or a particular client or class of clients in advance of other clients who are entitled to receive the research report.
3) Research analyst or research entity that distributes any third-party research report shall review the third-party research report for any untrue statement of a material fact or any false or misleading information. They also need to disclose any material conflict of interest of such third-party research provider or address that directs the recipient to the relevant disclosure.

18.3 General Responsibility

General responsibilities are specified in Regulation 24 and are stated as below:

(1) Research analyst or research entity shall maintain an arms-length relationship between its research activity and other activities.
(2) Research analysts or research entities shall abide by the Code of Conduct.

(3) In case of change in control of the research analyst or research entity, prior approval from SEBI shall be taken.
(4) Research analysts or research entities shall furnish SEBI information and reports as may be specified by SEBI from time to time.
(5) It shall be the responsibility of the research analyst or research entity to ensure that its employees or partners, as may be applicable, comply with the certification and qualification requirements at all times (*Regulation 7).*

18.4 Maintenance of Records

Research analyst or research entity shall maintain the following records:

(i) research report duly signed and dated;
(ii) research recommendation provided;
(iii) rationale for arriving at research recommendation;
(iv) record of public appearance.

All records shall be maintained either in physical or electronic form and preserved for a minimum period of five years. Further, where records are required to be duly signed and are maintained in electronic form, such records shall be digitally signed.
Research analyst or research entity shall conduct an annual audit in respect of compliance with these regulations from a member of the Institute of Chartered Accountants of India or Institute of Company Secretaries of India.

18.5 Role of Compliance Officer

Regulation 26 discusses the appointment of a compliance officer. Research analyst or research entity which is a body corporate or limited liability partnership firm shall appoint a compliance officer who shall be responsible for monitoring the compliance of the provisions of the Act, these regulations and circulars issued by the Board.

Case 18.1: SEBI v/s Anirudh Sethi

Facts of the case:
a) SEBI has passed an interim order of 2016 against Anirudh Sethi and his extant business "stock market navigator" restraining them from giving investment advice to clients including any recommendations containing company-specific news amounted to a violation of SEBI (PFUTP) Regulations. Further, the order directed notice to cease from acting as a research analyst and remove all material published from the public domain.

Findings of the case:

a) It was observed that Anirudh Sethi was providing subscription-based service providing technical analysis of stock, F&O, Commodities, Currencies etc. Anirudh Sethi was providing services of investment adviser and research analyst through his website.

b) Anirudh Sethi was offering stock-specific tips and recommendations and technical calls which prima-facie falls under the definition of the research analyst of RA regulations.

c) Anirudh Sethi was offering buy/sell recommendations and giving price targets with respect to securities listed on the stock exchange. Anirudh Sethi made a research report to the public which is a violation of RA regulations. Anirudh Sethi did not possess a certificate of registration as a research analyst.

Order:

a) Anirudh Sethi shall refund money received from its clients as fees/profit sharing/compensation in respect of unregistered research analyst services.
b) Anirudh Sethi not to divert any funds raised from investors except for the purpose of refund to clients. Banks and Depositories directed that no debit shall be made without permission of SEBI.
c) Anirudh Sethi directed not to directly or indirectly access the securities market and is prohibited from buying, selling, or otherwise dealing in the securities market, directly or indirectly in whatsoever manner till the expiry of 4 years from the date of the order (March 16, 2018). Anirudh Sethi restrained from associating with any listed public company and any public company or registered intermediary with SEBI till the expiry of 4 years from the date of refund.
d) Anirudh Sethi shall not undertake either directly or indirectly, research analyst services without obtaining a certificate of registration.

Review Questions

1. Who is primarily responsible for making buy/sell recommendations?

   (a) Research Analyst

   (b) Investment Analyst

   (c) Stockbroker

   (d) Registrars to an issue

2. Research Analysts are required to maintain research reports/research recommendations for a minimum period of how many years?

   (a) 5 years

   (b) 2 years

   (c) 7 years

   (d) 3 years

3. Which type of records are to be maintained by the Research Analyst or Research Entity?

   (a) Client's KYC details

   (b) Risk assessment of clients

   (c) Rationale for arriving at research recommendation

   (d) Register of clients which the firm deals with

4. Which of the following statements is TRUE?

   (a) Research Analyst has to do an annual audit in compliance with SEBI Regulations

   (b) Research Analyst has to do a quarterly audit in compliance with SEBI Regulations

   (c) Research Analyst has to do a six-monthly audit in compliance with SEBI Regulations

CHAPTER 19: SEBI (INVESTMENT ADVISERS) REGULATIONS, 2013

LEARNING OBJECTIVES:

After studying this chapter, you should know about:

- General Responsibilities of Investment Advisers
- Identifying Risk Profile of the clients
- Disclosure Requirements of Investment Advisers
- Code of Conduct for Investment Advisers

19.1 Introduction

SEBI (Investment Advisers) Regulations, 2013 regulates the "Investment Advisers". According to the regulations,

- Investment adviser means any person, who for consideration, is engaged in the business of providing investment advice to clients or other persons or group of persons and includes any person who holds out himself as an investment adviser, by whatever name called.
- "Investment advice" means advice relating to investing in, purchasing, selling or otherwise dealing in securities or investment products, and advice on investment portfolio containing securities or investment products, whether written, oral or through any other means of communication for the benefit of the client and shall include financial planning. However, investment advice is given through newspapers, magazines, any electronic or broadcasting or telecommunications medium, which is widely available to the public shall not be considered as investment advice for the purpose of these regulations.
- Asset under advice means the aggregate net value of securities and investment products for which the investment adviser has rendered investment advice irrespective of whether the implementation services are provided by an investment adviser or concluded by the client directly or through other service providers.
- Persons associated with investment advice means any member, partner, officer, director or employee or any sales staff of such investment adviser including any person occupying a similar status or performing similar function irrespective of nature of association with an investment adviser who is engaged in providing investment advisory services to the clients of the investment adviser.

Accordingly, all client-facing such as sales staff, service relationship managers, client relationship managers etc. whatever name called shall be deemed to be persons associated

with investment advice but not include persons who discharge clerical or office administrative functions where there is no client interface

Investment Adviser is required to be registered with the SEBI; however, the regulation provides for exemptions to certain people where registration is not required. According to Section 4 of Regulations, the following persons shall not be required to seek registration:

a) Any person who gives general comments in good faith regarding trends in the financial or securities market or the economic situation where such comments do not specify any particular securities or investment product

b) Any insurance agent or insurance broker who offers investment advice solely in insurance products and is registered with IRDA for such activity

c) Any pension advisor who offers investment advice solely on pension products and is registered with PFRDA

d) Any distributor of mutual funds, who is a member of a self-regulatory organization recognized by the Board or is registered with an association of asset management companies of mutual funds, providing any investment advice to its client incidental to its primary activity

e) Any advocate, solicitor or law firm, who provides investment advice to their client's incidental to legal practice

f) Any member of Institute of Chartered Accountants of India, Institute of Company Secretaries of India, Institute of Cost and Work Accountants of India, Actuarial Society of India or any other professional body as may be specified by SEBI, who provides investment advice to their clients, incidental to his professional service.

g) Any stockbroker, portfolio manager, merchant banker, registered under SEBI under respective regulations, who provides any investment advice to its client's incidental to their primary activity. However, all these intermediaries are required to comply with general obligations and responsibilities specified in Chapter of III of these regulations

h) Any Fund manager by whatever name called of a mutual fund, alternative investment fund or any other intermediary or entity registered with SEBI.

i) Any person who provides investment advice exclusively to clients based out of India:

   Provided that persons providing investment advice to Non-Resident Indian or Person of Indian Origin shall fall within the purview of these regulations;

j) Any principal officer, persons associated with advice and partner of an investment adviser which is registered under these regulations:

   Provided that such principal officer, persons associated with advice and partner shall comply with regulation 7 of these regulations;

k) Any other person as may be specified by the Board.

SEBI vide its circular no. SEBI/HO/IMD-I/DOF1/P/CIR/2021/579 dated June 18, 2021 informed all investment advisors on the framework for administration and supervision of Investment Advisers under SEBI (Investment Advisers) Regulation 2013. As per Regulation 14 of SEBI (Investment Advisers) Regulation 2013, SEBI may inter alia recognize anybody or body corporate for the purpose of regulating Investment Advisers (IA) and delegate administration and supervision of Investment Advisers on such terms and conditions as may be specified. Accordingly, an entity granted recognition under the aforesaid Regulation shall be designated as "Investment Adviser Administration and Supervisory Body (IAASB) and shall be entrusted with administration and supervision of Investment Advisers. The first IAASB recognized by SEBI is BSE Administration & Supervision Ltd, (BASL) wholly-owned subsidiary of BSE Limited.

Accordingly, all existing SEBI registered Investment Advisors and new applicants desirous in obtaining registration as investment advisors are mandatorily required to register with BASL as a member. BASL/SEBI shall from time to time prescribe conditions and requirements to be complied with by a Member for being able to continue to be admitted on BASL which may inter-alia include maintenance of minimum net-worth, deposit, renewal of certification, if any, payment of annual fees, other fees, charges etc. BASL members shall carry out the periodic reporting and submission of such documents as may be called for and be required by BASL from time to time. The admission as a Member of any person who fails to meet these requirements shall be liable to be terminated.

19.2 General Responsibilities

General responsibilities of an investment adviser are specified in Regulation 15 which is given hereunder:

1) An investment adviser shall act in a fiduciary capacity towards its clients and shall disclose all conflicts of interests as and when they arise.
2) An investment adviser shall not receive any consideration by way of remuneration or compensation or in any other form from any person other than the client being advised, in respect of the underlying products or securities for which advice is provided.
3) An investment adviser shall maintain an arms-length relationship between its activities as an investment adviser and other activities.
4) An investment adviser which is also engaged in activities other than investment advisory services shall ensure that its investment advisory services are clearly segregated from all its other activities, in the manner as prescribed hereunder.

5) An investment adviser shall ensure that in case of any conflict of interest of the investment advisory activities with other activities, such conflict of interest shall be disclosed to the client.

6) An investment adviser shall not divulge any confidential information about its client, which has come to its knowledge, without taking prior permission of its clients, except where such disclosures are required to be made in compliance with any law for the time being in force.

7) An investment advisor shall not enter into transactions on its own account which is contrary to its advice given to clients for a period of fifteen days from the day of such advice. However, during the period of such fifteen days, if the investment adviser is of the opinion that the situation has changed, then it may enter into such a transaction on its own account after giving such revised assessment to the client at least 24 hours in advance of entering into such transaction.

8) An investment advisor shall follow Know Your Client (KYC) procedure as specified by SEBI from time to time.

9) An investment adviser shall always abide by the Code of Conduct.

10) An investment adviser shall not act on its own account, knowingly to sell securities or investment products to or purchase securities or an investment product from a client.

11) In case of a change in control of the investment adviser, prior approval from SEBI shall be taken.

12) Investment advisers shall furnish SEBI information and reports as may be specified from time to time.

13) It shall be the responsibility of the Investment Adviser to ensure that its representatives and partners, as applicable, comply with the certification and qualification requirements at all times.

19.3 Risk Profiling and Suitability of Clients

Investment advisers are required to identify the risk profile of their clients. For this purpose, the Investment adviser shall ensure that:

(a) it obtains from the client, such information as is necessary for the purpose of giving investment advice, including the following:

(i) age;

(ii) investment objectives including time for which they wish to stay invested, the purposes of the investment;

(iii) income details;

(iv) existing investments/ assets;

(v) risk appetite/ tolerance;

(vi) liability/borrowing details.

(b) it has a process for assessing the risk a client is willing and able to take, including:

(i) assessing a client's capacity for absorbing loss;

(ii) identifying whether the client is unwilling or unable to accept the risk of loss of capital;

(iii) appropriately interpreting client responses to questions and not attributing inappropriate weight to certain answers.

(c) where tools are used for risk profiling, it should be ensured that the tools are fit for the purpose and any limitations are identified and mitigated;

(d) any questions or descriptions in any questionnaires used to establish the risk a client is willing and able to take are fair, clear and not misleading, and should ensure that:

(i) questionnaire is not vague or use double negatives or in a complex language that the client may not understand;

(ii) questionnaire is not structured in a way that it contains leading questions.

(e) the risk profile of the client is communicated to the client after a risk assessment is done;

(f) information provided by clients and their risk assessment is updated periodically.

Based on the risk profile, suitability of the advice by the investment adviser is required to be ensured as per Regulation 17 which states the Investment adviser shall ensure that:

(a) All investments on which investment advice is provided is appropriate to the risk profile of the client;

(b) It has a documented process for selecting investments based on the client's investment objectives and financial situation;

(c) It understands the nature and risks of products or assets selected for clients;

(d) It has a reasonable basis for believing that a recommendation or transaction entered into:

(i) meets the client's investment objectives;

(ii) is such that the client is able to bear any related investment risks consistent with its investment objectives and risk tolerance;

(iii) is such that the client has the necessary experience and knowledge to understand the risks involved in the transaction.

(e) Whenever a recommendation is given to a client to purchase a particular complex financial product, such recommendation or advice is based upon a reasonable assessment that the structure and risk-reward profile of the financial product are consistent with the client's experience, knowledge, investment objectives, risk appetite and capacity for absorbing the loss.

19.4 Disclosures by Investment Advisers

Investment Advisers are required to make certain disclosures to its clients which are listed below:

1. An investment adviser shall disclose to a prospective client, all material information about itself including its business, disciplinary history, the terms and conditions on which it offers advisory services, affiliations with other intermediaries and such other information as is necessary to make an informed decision on whether or not to avail its services.
2. An investment adviser shall disclose to the client its holding or position, if any, in the financial products or securities which are the subject matter of advice.
3. An investment adviser shall disclose to the client any actual or potential conflicts of interest arising from any connection to or association with any issuer of products/ securities, including any material information or facts that might compromise its objectivity or independence in the carrying on of investment advisory services.
4. An investment adviser shall, while making investment advice, make adequate disclosure to the client of all material facts relating to the key features of the products or securities, particularly, performance track record.
5. An investment adviser shall draw the client's attention to the warnings, disclaimers in documents, advertising materials relating to an investment product which it is recommending to the client.

19.5 Client level segregation of advisory and distribution activities

Regulation 22 provides details of segregation of advisory and distribution activities requirements, which are as follows:

1) An individual investment adviser shall not provide distribution services
2) The family of the individual investment adviser shall not provide distribution services to the client advised by the individual investment adviser and no individual investment adviser shall provide advice to a client who is receiving distribution services from other family members.
3) A non-individual shall have client level segregation at the group level for investment advisory and distribution services

e) Same client cannot be offered both advisory or distribution services within the group of the non-individual entity

f) A client can either be an advisory client where no distribution consideration is received at the group level or distribution services client where no advisory fee is collected from the client at the group level.

g) Group for this purpose shall mean an entity which is holding, subsidiary, associate, subsidiary of holding company to which it is also a subsidiary or investment company or venturer of the company as per Companies Act 2013 for non-individual investment adviser which is a

company under the said Act and in any other case, an entity which has a controlling interest or is subject to the controlling interest of a non-individual investment adviser.

h) Non-individual investment adviser shall maintain arm's length relationship between its activities as investment adviser and distributor by providing advisory services through separate identifiable department or division.

i) Compliance and monitoring process for client level segregation at a group or family level shall be in accordance with guidelines specified by SEBI.

19.6 Implementation of advice or execution

Regulation 22A specifies that Investment advisors may provide implementation services to their advisory clients in the securities market, provided that investment advisers shall ensure that no consideration including commission or referral fees, whether embedded or indirect or otherwise, by whatever name called is received, directly or indirectly, at investment adviser's group or family level for the said service, as the case may be. Investment adviser shall provide implementation services to its advisory clients only through direct schemes/products in the securities market. Investment adviser shall not charge any implementation fees from the client. The client shall not be under any obligation to avail implementation services offered by the investment adviser.

19.7 Maintenance of Records

Regulation 19 specifies the documents and records which need to be maintained by Investment Adviser. An investment adviser shall maintain the following records:

(a) Know Your Client records of the client;

(b) Risk profiling and risk assessment of the client;

(c) Suitability assessment of the advice being provided;

(d) Copies of agreements with clients, incorporating the terms and conditions as may be specified by SEBI

(e) Investment advice provided, whether written or oral;

(f) Rationale for arriving at investment advice, duly signed and dated;

(g) A register or record containing a list of the clients, the date of advice, nature of the advice, the products/securities in which advice was rendered and fee, if any charged for such advice.

All records shall be maintained either in physical or electronic form and preserved for a minimum period of five years, provided that where records are required to be duly signed and are maintained in electronic form, such records shall be digitally signed.

An investment adviser shall conduct a yearly audit in respect of compliance with these regulations from a member of the Institute of Chartered Accountants of India or Institute of Company Secretaries of India and submit a report of the same as may be specified by SEBI.

19.8 Appointment of Compliance Officer

Regulation 20 requires that a compliance officer is required to be appointed. An investment adviser which is a body corporate or a partnership firm shall appoint a compliance officer who shall be responsible for monitoring the compliance by the investment adviser in respect of the requirements of the Act, regulations, notifications, guidelines, instructions issued by SEBI.

19.9 Code of Conduct for Investment Advisers

The code of conduct for investment advisers is given below:

1. **Honesty and fairness**: An investment adviser shall act honestly, fairly and in the best interests of its clients and the integrity of the market.
2. **Diligence**: An investment adviser shall act with due skill, care and diligence in the best interests of its clients and shall ensure that its advice is offered after thorough analysis and taking into account available alternatives.
3. **Capabilities**: An investment adviser shall have and employ effectively appropriate resources and procedures which are needed for the efficient performance of its business activities.
4. **Information about clients**: An investment adviser shall seek from its clients, information about their financial situation, investment experience and investment objectives relevant to the services to be provided and maintain the confidentiality of such information.
5. **Information to its clients**: An investment adviser shall make adequate disclosures of relevant material information while dealing with its clients.
6. **Fair and reasonable charges**: An investment adviser advising a client may charge fees, subject to any ceiling as may be specified by SEBI. The investment adviser shall ensure that the fees charged to the clients are fair and reasonable.
7. **Conflicts of interest**: An investment adviser shall try to avoid conflicts of interest as far as possible and when they cannot be avoided, it shall ensure that appropriate disclosures are made to the clients and that the clients are fairly treated.
8. **Compliance**: An investment adviser including its partners, principal officer and persons associated with investment advice shall comply with all regulatory requirements applicable to the conduct of its business activities so as to promote the best interests of clients and the integrity of the market.
9. **Responsibility of senior management**: The senior management of a body corporate that is registered as an investment adviser shall bear primary responsibility for ensuring the maintenance of appropriate standards of conduct and adherence to proper procedures by the body corporate.

As per SEBI Circular No. SEBI/HO/IMD/DF1/CIR/P/2019/169 dated December 27, 2019, Investment Advisers are required to comply with certain norms in order to strengthen the conduct which is given below:

(i) Restriction on a free trial

As per SEBI (Investment Advisers) Regulations, 2013, investment advice can be given after completing risk profiling of the client and ensuring the suitability of the product. To prevent IAs from advising prospective clients on a free and trial basis, SEBI specifically advised IAs against it. Further, IAs shall not accept part payments (where some part of the fee is paid in advance) for any product/service.

(ii) Proper risk profiling and consent of client on risk profiling

Risk profiling of the client is essential to provide advice on suitable products based on various criteria like income, age, securities market experience etc. RIAs shall provide investment advice only after completing the following steps:

a. Complete the risk profile of the client based on information provided by the client.

b. Obtain the consent of the client on the completed risk profile either through registered email or physical document.

(iii) Receiving fees through banking channel only

To bring transparency in dealing with the clients, IAs shall accept fees strictly by account payee crossed cheques / demand draft or by way of direct credit into their bank account through NEFT/ RTGS/IMPS/UPI. It is clarified that IAs shall not accept cash deposits. This is to ensure a proper audit trail of fees received from clients.

(iv) Display of complaints status on the website

In order to bring more transparency and enable the investors to take an informed decision regarding availing of advisory services, IAs are required to display the specified information as per the table on the homepage (without scrolling) of their website/mobile app. The information should be displayed properly using a font size of 12 or above and made available on monthly basis (within 7 days from the end of the previous month).

SEBI vide it's circular dated September 23, 2020 issue guidelines to Investment Advisor (IA). It includes the following:

a) Client level segregation of advisory and distribution activities

i. Existing clients, who wish to take advisory services, will not be eligible for availing distribution services within the group/family of IA. Similarly, Existing clients who wish to take distribution services will not be eligible for availing advisory services within the group/family of IA.

ii. A new client will be eligible to avail of either advisory or distribution services within the group/family of IA. However, the option to avail either advisory services or distribution services shall be made available to such clients at the time of onboarding.

b) Agreement between IA and client – IA shall ensure that neither any investment advice is rendered nor any fee is charged until the client has signed the aforesaid agreement and provided a copy of the signed agreement to the client

c) Fees – Two modes are prescribed viz., i) Assets under Advice (AUA)mode - The maximum fees that may be charged under this mode shall not exceed 2.5 per cent of AUA per annum per client across all services offered by IA. ii) Fixed fee mode -The maximum fees that may be charged under this mode shall not exceed INR 1,25,000 per annum per client across all services offered by IA.

d) Qualification and Certification requirement - Regulation 7 of the amended IA Regulations specifies the minimum qualification and certification requirements for IAs. Further, in terms of the second proviso of regulation 7 (1) existing individual IAs above fifty years of age (as on September 30, 2020) shall not be required to comply with the qualification and experience requirements specified under Regulation 7(1) (a) and 7(1)(b) of the amended IA Regulations. However, such IAs shall hold NISM accredited certifications and comply with other conditions specified.

e) Registration as a non-individual investment advisor – An individual IA shall apply for registration as non-individual IA on or before reaching 150 clients. Once the number reaches 150 till the grant of registration as non-individual IA, individual IA shall not be on board with fresh clients.

f) Maintenance of records – IA shall be required to maintain records viz telephone recording, email from registered email id, physical records, a record of SMS messages, any other legally verifiable record for a period of 5 years

g) Audit – IA shall ensure the annual audit is completed within 6 months from the end of the financial year

h) Risk profiling and suitability for non-individual clients – IA shall use the investment policy as approved by the board/management team of such non-individual clients for risk profiling and suitability analysis.

i) Display of details on the website and in other communication channels - IAs shall display the following information prominently on its website, mobile app, printed or electronic materials, know your client forms, client agreements and other correspondences with the clients viz., Complete name of IA as registered with SEBI, Type of Registration -Individual, Non-Individual, Registration number, the validity of the registration, complete address with telephone numbers, Contact details of the Principal Officer -contact no, email id etc., Corresponding SEBI regional/local office address.

19.10 Operating guidelines of IAs in IFSC

SEBI vide its circular [41] has specified the Operating Guidelines for Investment Advisers in International Financial Services Centre. Relevant extracts are given below:

Eligibility Conditions:

The following persons shall be eligible to apply for an Investment Adviser Registration in IFSC.

- Any entity, being a company or a limited liability partnership (LLP), which has the minimum prescribed net worth as specified by SEBI at the time of application can act as an Investment Adviser (IA) in the IFSC, in the following forms-
    a. Any recognised entity or entities desirous of operating in IFSC as an IA may form a company or LLP or any other similar structure recognised under the laws of its parent jurisdiction, desirous of operating in IFSC as an investment adviser, may form a company or LLP to provide investment advisory services.
    b. The formation of a separate company or LLP shall not be applicable in case the applicant is already a company or LLP in IFSC.
- Persons seeking registration under the Investment Adviser Regulations read with these Guidelines shall provide investment advisory services only to those persons referred in Clause 9 (3) of the IFSC Guidelines. Further, the investment advisor shall ensure to comply with the applicable guidelines issued by the relevant overseas regulator/ authority, while dealing with persons resident outside India and non-resident Indians seeking investment advisory services to them.

Compliance Requirements, Conditions and Restrictions

Qualification and Experience Requirement:[42] Partners and representatives of applicants offering investment advice shall have:

a. at all times, professional qualification or post-graduate degree or postgraduate diploma (minimum two years' tenure) in finance, accountancy, business management, commerce, economics, capital market, banking, insurance or actuarial science from a university or an institution recognized by the central government or any state government or a recognised foreign university or institution or association; and
b. an experience of at least five years in activities relating to advice in financial products or securities, or fund/ asset/ portfolio management, or investment advisory services.

[41] SEBI/HO/IMD/DF1/CIR/P/2020/04 dated January 09, 2020 and SEBI/HO/IMD/DF1/CIR/P/2020/185 dated Sep 28, 2020
[42] Corresponding Regulation in Investment Adviser Regulations- 7(1)

Certification Requirement: [43] Partners and representatives of the applicants offering investment advice shall have, at all times, a certification on investment advisory services:

a. in respect of partners and representative's resident in India-

   i. from National Institute of Securities Markets (NISM); or

   ii. from any other organization or institution including Financial Planning Standards Board India (FPSB) or any recognized stock exchange in India provided that such certification is accredited by NISM

b. in respect of partners and representatives' resident outside India, from any other organization or institution or association or stock exchange which is recognized/ accredited by a Financial Market regulator in that foreign jurisdiction.

However, certification from NISM shall be mandatory for partners and representatives of applicants who offer investment advice in relation to Indian securities markets.

Net Worth Requirement: In case of applicants, the net worth requirement shall be as under:

a. An applicant shall have a net worth of not less than USD 1.5 million.

b. In case the IA is set up as a subsidiary, the net worth requirement is to be met by the subsidiary itself. However, if the subsidiary does not meet the criteria, the net worth of the parent can be considered.

c. The IAs/parent entity shall fulfil the aforesaid net worth requirement, separately and independently for each activity undertaken by it under the relevant regulations.

Annual Audit: An IA shall ensure to conduct an annual audit in respect of compliance with Investment Adviser Regulations and these guidelines from a chartered accountant or a company secretary.

[43] Corresponding Regulation in Investment Adviser Regulations- 7(2)

Case 19.1: Capvision Investment Advisor v/s SEBI

Facts of the case:

a) Appellant is an investment advisor registered with SEBI. In 2015, SEBI received a complaint on SCORES from one Mr Devashish Vimal alleging that the appellant misappropriated some money from the complainant paid towards commodity trading.

b) Employee/representative of appellant persuaded the complainant to trade in commodities and to transfer money for the said purpose to open a trading account. All these was done through messaging system of the employee/representative of the appellant rather than through the company's own general messaging system.

c) Appellant induced complainant through a fake trading account in the guise of an MCX account and sent false trading messages to complainant.

d) Adjudication Officer of SEBI vide order dated November 2017 imposed a penalty of Rs 16 lakhs (Rs 8 lakh each for violation of Code of Conduct and non-redressal of client grievance) under section 15HB of the SEBI Act, 1992.

e) Appeal was filed aggrieved by the said order.

Findings of the case:

a) Learned Counsel for the appellant submitted that company did commit any violations because it was an action/mistake made by an employee without knowledge of the company. When the company came to know of this, the action was taken against the employee dismissing him and the amount of Rs 3,37,000/- deposited by the complainant to open a trading account, Rs 2,50,000/- has been repaid to the complainant deducting the balance amount against the services provided for investment advice.

b) Learned Counsel for SEBI stated that the appellant was carrying commodity broking in the guise of providing investment advice. The account no. 'MCX 4661'were clearly creations of such unauthorised transactions and was not even registered with MCX. Rs 2.50 lakhs paid to the complainant was not fully paid initially as two cheques worth Rs 1 lakh had bounced and only after substantial follow up and long-time the said amount was paid. In the light of this, an investment adviser who was expected to provide honest and sincere advice to its clients itself was misguiding its client as well as misusing clients' funds.

c) The records confirmed that the appellant violated provisions of Investment Advisor Regulations and conducted its business without proper care and diligence thereby resulting in losses to its clients. It was found that the complaint lodged in SCORES on January 2015 was even partially settled only by March 2016.

Order:

a) Given the fact that the appellant is small investment adviser and the amount involved in the matter is only Rs 3.37 lakhs penalty of 16 lakhs imposed under Section 15HB of the SEBI Act where the maximum penalty is Rs 1 crore appears disproportionate. The penalty need not be reduced substantially because this is not the first time the appellant has committed the offence.

b) Consolidated penalty of 16 lakhs is reduced to Rs 8 lakhs.

Review Questions

1. As per the SEBI (IA) Regulations, an 'Investment Adviser' shall not enter into transactions on its own account which is contrary to its advice given to clients for a period of _____from the day of such advice.

   (a) Five

   (b) Ten

   (c) Fifteen

   (d) Thirty

2. As per SEBI (Investment Advisers) Regulations, 2013, when can investment advice be given to a client?

   (a) After Risk Profiling of Client is done

   (b) After Ensuring Suitability of the product

   (c) After confirming the net worth of the client

   (d) Both A & B above

3. Risk-profiling of a client is based on which of the following criteria?

   (a) Income

   (b) Age

   (c) Liability/Borrowing Details

   (d) All of the above options

4. Which of the following statements are true?

   (a) Investment Advisers can accept fees by banking channel only

   (b) Investment Advisers can accept fees by way of cash

   (c) Investment Advisers can accept fees by both cash and banking channels only

CHAPTER 20: SEBI (DEBENTURE TRUSTEES) REGULATIONS, 1993

LEARNING OBJECTIVES:

After studying this chapter, you should know about:

- Prerequisites for registering as a debenture trustee
- Capital adequacy requirements for debenture trustee
- Responsibilities and obligations of debenture trustee
- Code of conduct for debenture trustees
- Dissemination of information by debenture trustees

20.1 Registration as Debenture Trustee

Debenture trustee means a trustee appointed in respect of any issue of debentures of a body corporate. An application by a debenture trustee for a grant of certificate of registration shall be made to SEBI as per the prescribed format. No person shall be entitled to act as a debenture trustee unless he is either –

a) a scheduled bank carrying on commercial activity; or
b) a public financial institution within the meaning of section 2(72) of the Companies Act, 2013; or
c) an insurance company; or
d) body corporate as defined under sub-section (11) of section 2 of the Companies Act, 2013.

SEBI shall take into account the following while considering the application of grant of registration to Debenture Trustees. The debenture trustee should-

- have the necessary infrastructure like adequate office space, equipment's and manpower to effectively discharge his activities;
- have any experience as a debenture trustee or has in his employment a minimum of two persons who had the experience in matters which are relevant to a debenture trustee;
- not have any person who is directly or indirectly is connected with the applicant who has not been granted registration by SEBI;
- have in his employment at least one person who possesses the professional qualification in law from an institution recognised by the Government;
- not have any of its director or principal officer convicted for any offence involving moral turpitude or have been found guilty of any economic offence;
- be a fit and proper person as defined in the SEBI (Intermediaries) Regulations, 2008;
- fulfil the capital adequacy requirements.

The certificate of registration granted under sub-regulation (1) shall be valid unless it is suspended or cancelled by the Board.

Every debenture trustee shall pay fees of twenty lakh rupees at the time of grant of certificate of registration. The fee shall be paid by the debenture trustees within fifteen days from the date of receipt of intimation from SEBI. A debenture trustee who has been granted a certificate of registration, to keep its registration in force, shall pay a fee of nine lakh rupees every three years from the sixth year, from the date of grant of certificate of registration or from the date of grant of certificate of initial registration granted prior to the commencement of the SEBI (Change in Conditions of Registration of Certain Intermediaries) (Amendment) Regulations, 2016, as the case may be. The fee shall be paid by the Debenture Trustee three months before the expiry of the block for which the fee has been paid.

The non-refundable fee payable along with an application for registration shall be a sum of fifty thousand rupees.

20.2 Capital Adequacy Requirements

The capital adequacy requirement shall not be less than the net worth of ten crore rupees,

20.3 Responsibilities and Obligations of Debenture Trustees

20.3.1 Obligations before appointment as Debenture Trustees

No debenture trustee shall act as such in respect of each issue of debenture unless –

a. he enters into a written agreement with the body corporate before the opening of the subscription list for the issue of debentures;

b. the agreement shall contain (i) an undertaking by the body corporate to comply with all regulations / provisions of Companies Act, 2013, guidelines of other regulatory authorities in respect of allotment of debentures till redemption; (ii) the time limit within which the security for the debentures shall be created or the agreement shall be executed in accordance with the Companies Act, 2013 or provisions as prescribed by any regulatory authority as applicable.

20.3.2 Debenture Trustee not to act for an associate

A person shall not be appointed as a debenture trustee, in case-

1. The debenture trustee –

(a) is an associate of the body corporate

(b) beneficially holds shares in the company;

(c) is a promoter, director, or key managerial personnel or any other officer or an employee of the company or its holding, subsidiary or associate company;
(d) is beneficially entitled to moneys which are to be paid by the company otherwise than as remuneration payable to the debenture trustee;
(e) is indebted to the company, or its subsidiary or its holding or associate company or a subsidiary of such holding company;
(f) has furnished any guarantee in respect of the principal debts secured by the debentures or interest thereon;
(g) has any pecuniary relationship with the company amounting to 2% or more of its gross turnover or total income or ₹50 lakh or such higher amount as may be prescribed, whichever is lower, during the two immediately preceding financial years or during the current financial year;
(h) is relative of any promoter or any person who is in the employment of the company as a director or key managerial personnel;
(i) is likely to have a conflict of interest in any other manner.

Provided that this requirement shall not be applicable in respect of debentures issued: (i) wherever there is a guarantee by the state / central government for the debentures issued.

2. It has lent and the loan is not yet fully repaid or is proposing to lend money to the body corporate ***provided*** that this requirement shall not be applicable in respect of debentures issued prior to the commencement of the Companies (Amendment) Act, 2000, where—
(i) recovery proceedings in respect of the assets charged against security have been initiated, or
(ii) the body corporate has been referred to Board for Industrial and Financial Reconstruction under the Sick Industrial Companies (Special Provisions) Act, 1985, prior to commencement of SEBI (Debenture Trustees) Regulations, 2003.

20.3.3 Obligation of the Debenture Trustees towards the content of the trust deed

Every debenture trustee shall amongst other matters, accept the trust deeds which shall contain the matters as specified in section 71 of Companies Act, 2013 and Form No. SH.12 specified under the Companies (Share Capital and Debentures) Rules, 2014. Such trust deed shall consist of two parts: a. Part A containing statutory/standard information pertaining to the debt issue; b. Part B containing details specific to the particular debt issue. It shall be the duty of every debenture trustee to -
(a) satisfy itself that the prospectus or letter of offer does not contain any matter which is inconsistent with the terms of the issue of debentures or with the trust deed;

(b) satisfy itself that the covenants in the trust deed are not prejudicial to the interest of the debenture holders;

(c) call for periodical status/ performance reports from the issuer company within 7 days of the relevant board meeting or within 45 days of the respective quarter whichever is earlier;

(d) communicate promptly to the debenture holders' defaults, if any, with regard to payment of interest or redemption of debentures and action taken by the trustee, therefore;

(e) appoint a nominee director on the Board of the company in the event of:

(i) two consecutive defaults in payment of interest to the debenture holders; or

(ii) default in the creation of security for debentures; or

(iii) default in the redemption of debentures.

(f) ensure that the company does not commit any breach of the terms of issue of debentures or covenants of the trust deed by monitoring the same in the manner specified by the Board and take such reasonable steps as may be necessary to remedy any such breach;

(g) inform the debenture holders immediately of any breach of the terms of issue of debentures or covenants of the trust deed;

(h) ensure the implementation of the conditions regarding creation of security for the debentures, if any , debenture redemption reserve and recovery expense fund;

(i) ensure that the assets of the company issuing debentures and of the guarantors, if any, are sufficient to discharge the interest and principal amount at all times and that such assets are free from any other encumbrances except those which are specifically agreed to by the debenture holders;

(j) do such acts as are necessary in the event the security becomes enforceable;

(k) call for reports on the utilization of funds raised by the issue of debentures;

(l) take steps to convene a meeting of the holders of debentures as and when such meeting is required to be held;

(m) ensure that the debentures have been converted or redeemed in accordance with the terms of the issue of debentures;

(n) perform such acts as are necessary for the protection of the interest of the debenture holders and do all other acts as are necessary in order to resolve the grievances of the debenture holders;

(o) take possession of trust property in accordance with the provisions of the trust deed;

(p) to take appropriate measures for protecting the interest of the debenture holders as soon as any breach of the trust deed or law comes to his notice;

(q) ascertain and satisfy itself that-

(i) in case where the allotment letter has been issued and debenture certificate is to be issued after registration of charge, the debenture certificates have been dispatched by the body

corporate to the debenture holders within 30 days of the registration of the charge with the Registrar of Companies;

(ii) debenture certificates have been dispatched to the debenture holders or debentures have been credited in the Demat accounts of the debenture holders in accordance with the provisions of the SEBI (Debenture Trustee) Regulations 1993, SEBI (Issue and Listing of Debt Securities) Regulations 2008, SEBI (Listing Obligations and Disclosure Requirements) Regulations 2015 and any other regulations issued by SEBI;

(iii) interest warrants for interest due on the debentures have been dispatched to the debenture holders on or before the due dates;

(iv) debenture holders have been paid the monies due to them on the date of redemption of the debentures;

(r) inform SEBI immediately of any breach of trust deed or provision of any law, which comes to the knowledge of the trustee.

The communication to the debenture holders by the debenture trustee as mentioned in these regulations may be made by electronic media, press-release and placing notice on its website;

(s) exercise due diligence to ensure compliance by the body corporate, with the provisions of the Companies Act, Securities and Exchange Board of India (Listing Obligations and Disclosure Requirement), Regulations, 2015, the listing agreement of the stock exchange or the trust deed or any other regulations issued by SEBI pertaining to debt issue;

(t) in case where listed debt securities are secured , it shall

(i) On a Quarterly basis- (a) carry out the necessary due diligence and monitor the security cover in the manner as may be specified by the Board from time to time

(ii) On a Half-Yearly basis- (a) obtain a Certificate from the statutory auditor of the issuer regarding security cover including compliance with the covenants of the Offer document/information memorandum in the manner as may be specified by SEBI from time to time.

The debenture trustee shall:

(a) obtain reports from the lead bank regarding the progress of the project;
(b) monitor utilisation of funds raised in the issue;
(c) obtain a certificate from the issuer's Statutory Auditor:
(i) in respect of utilisation of funds during the implementation period of the project; and (ii) in the case of debentures issued for financing working capital, at the end of each accounting year.

A debenture trustee shall call or cause to be called by the body corporate a meeting of all the debenture holders on-

(a) a requisition in writing signed by at least one-tenth of the debenture holders in value for the time being outstanding;

(b) the happening of any event, which constitutes a default or breach of covenants (as specified in the Offer Document/Information Memorandum and/or debenture trust deed) or which in the opinion of the debenture trustees affects the interest of the debenture holders.

However, a debenture trustee may seek the consent of debenture holders through e-voting, wherever applicable. It is further stated that the requirement to convene a meeting of all debenture holders in case of a default in payment obligation by the issuer, shall not be applicable in case of debentures issued by way of public issue.

No debenture trustee shall relinquish its assignments as debenture trustee in respect of the debenture issue of any body corporate, unless and until another debenture trustee is appointed in its place by the body corporate.

A debenture trustee shall maintain the net worth requirements as specified in the regulations continuously and shall inform SEBI immediately in respect of any shortfall in the net worth and such a case it shall not be entitled to undertake new assignments until it restores the net worth to the level of specified requirement within the time specified by SEBI.

A debenture trustee may inspect books of account, records, registers of the body corporate and the trust property to the extent necessary for discharging its obligations.

Before creating a charge on the security for the debentures, the debenture trustee shall exercise independent due diligence to ensure that such security is free from any encumbrance or that it has obtained the necessary consent from other charge-holders if the security has an existing charge, in the manner as may be specified by the SEBI from time to time.

Subject to the approval of the debenture holders and the conditions as may be specified by the Board from time to time, the debenture trustee, on behalf of the debenture holders, may enter into inter-creditor agreements provided under the framework specified by the Reserve Bank of India.

20.3.4 Maintenance of books of account, records, documents etc.

1) Subject to the provisions of any law every debenture trustee shall keep and maintain proper books of account, records and documents, relating to the trusteeship functions for a period of not less than five financial years from the date of redemption of debentures.
(2) Every debenture trustee shall intimate to SEBI, the place where the books of account, records and documents are maintained.

20.4 Code of Conduct for the Debenture Trustees

Regulation 16 of the SEBI (Debenture Trustees) Regulations, 1993 read along with Schedule III details the code of conduct for the debenture trustees. A debenture trustee shall:

1. Make all efforts to protect the interest of debenture holders.
2. Maintain high standards of integrity, dignity and fairness in the conduct of its business.
3. Fulfil its obligations in a prompt, ethical and professional manner.
4. At all times exercise due diligence, ensure proper care and exercise independent professional judgment.
5. Take all reasonable steps to establish the true and full identity of each of its clients, and each client's financial situation and maintain a record of the same.
6. Ensure that any change in registration status/any penal action taken by SEBI or any material change in a financial position that may adversely affect the interests of clients/debenture holders are promptly informed to the clients and any business remaining outstanding is transferred to another registered intermediary in accordance with any instructions of the affected clients.
7. Avoid conflict of interest and make adequate disclosure of its interest.
8. Not divulge to anybody either orally or in writing, directly or indirectly, any confidential information about its clients which has come to its knowledge, without taking prior permission of its clients, except where such disclosures are required to be made in compliance with any law for the time being in force.
9. Put in place a mechanism to resolve any conflict-of-interest situation that may arise in the conduct of its business or where any conflict of interest arises, shall take reasonable steps to resolve the same in an equitable manner.
10. Make appropriate disclosure to the client of its possible source or potential areas of conflict of duties and interest while acting as debenture trustee which would impair its ability to render fair, objective and unbiased services.
11. Not indulge in any unfair competition, which is likely to harm the interests of other trustees or debenture holders or is likely to place such other debenture trustees in a disadvantageous position while competing for or executing any assignment nor shall it wean away from the clients of another trustee on assurance of lower fees.
12. Not discriminate among its clients, except and save on ethical and commercial considerations.
13. Share information available with-it regarding client companies, with registered credit rating agencies.
14. Provide clients and debenture holders with adequate and appropriate information about its business, including contact details, services available to clients, and the identity and status of employees and others acting on its behalf with whom the client may have to contact.

15. Ensure that adequate disclosures are made to the debenture holders, in a comprehensible and timely manner so as to enable them to make a balanced and informed decision.
16. Endeavour to ensure that (a) inquiries from debenture holders are adequately dealt with; (b) grievances of debenture holders are redressed in a timely and appropriate manner; (c) where a complaint is not redressed promptly, the debenture holder is advised of any further steps which may be available to the debenture holder under the regulatory system.
17. Make reasonable efforts to avoid misrepresentation and ensure that the information provided to the debenture holders is not misleading.
18. Maintain the required level of knowledge and competency and abide by the provisions of the Act, regulations and circulars and guidelines. The debenture trustee shall also comply with the award of the Ombudsman passed under the Securities and Exchange Board of India (Ombudsman) Regulations, 2003.
19. Not make an untrue statement or suppress any material fact in any documents, reports, papers or information furnished to SEBI.
20. A Debenture Trustee or any of its directors, partners or manager having the management of the whole or substantially the whole of affairs of the business, shall not either through its account or their respective accounts or through their associates or family members, relatives or friends indulge in any insider trading.
21. Ensure that SEBI is promptly informed about any action, legal proceeding, etc., initiated against it in respect of any material breach or non-compliance by it, of any law, rules, regulations, directions of SEBI or any other regulatory body.
22. Not render, directly or indirectly, any investment advice about any security in the publicly accessible media, whether real-time or non-real-time unless disclosure of his interest including long or short position in the said security has been made while rendering such advice; (b) In case, an employee of the Debenture Trustee is rendering such advice, the debenture trustee shall ensure that he discloses his interest, the interest of his dependent family members and that of the employer, including their long or short position in the said security, while rendering such advice.
23. Ensure that any person it employs or appoints to conduct business is fit and proper and otherwise qualified to act in the capacity so employed or appointed (including having relevant professional training or experience.
24. Ensure that it has adequate resources to supervise diligently and does supervise diligently persons employed or appointed by it to conduct business on its behalf.
25. Have internal control procedures and financial and operational capabilities which can be reasonably expected to protect its operations, its clients, debenture holders and other

registered entities from financial loss arising from theft, fraud, and other dishonest acts, professional misconduct or omissions.

26. Be responsible for the acts or omissions of its employees and agents in respect to the conduct of its business.
27. Provide adequate freedom and powers to its compliance officer for the effective discharge of its duties.
28. Ensure that the senior management, particularly decision-makers have access to all relevant information about the business on a timely basis.
29. Ensure that good corporate policies and corporate governance is in place.
30. Develop its own internal code of conduct for governing its internal operations and laying down its standards of appropriate conduct for its employees and officers in the carrying out of their duties. Such a code may extend to the maintenance of professional excellence and standards, integrity, confidentiality, objectivity, avoidance of conflict of interests, disclosure of shareholdings and interests, etc.
31. Not be a party to (i) creation of false market; (ii) price rigging or manipulation; (iii) passing of unpublished price sensitive information in respect of securities which are listed and proposed to be listed in any stock exchange to any person or intermediary.

20.5 Monitoring and Disclosure Requirement

SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 and SEBI (Debenture Trustees) Regulations, 1993 ("DT Regulations") mandates issuers to submit information/ documents to Debenture Trustee(s). In order to enable debenture trustee(s) to discharge its obligations in respect of listed debt securities, the debenture trustee(s) shall undertake an independent periodical assessment of the compliance with covenants or terms of the issue of listed debt securities including for 'security created'.

Debenture trustee shall carry out periodical monitoring in the following manner:
1. Debenture trustee shall incorporate the terms and conditions of periodical monitoring in the debenture trust deed wherein listed entity shall be liable to provide relevant documents/ information, as applicable, to enable the debenture trustee(s) to submit the following reports/ certification to Stock Exchange(s) within the timelines mentioned below:

Reports/Certificate	**Periodicity**
Security cover or higher security cover certificate	
Statement of the value of pledged securities	

Statement of value for Debt Service Reserve account or any other form of security offered.	Quarterly basis within 75 days from the end of the quarter except last quarter of financial year Last quarter within 90 days from the end of the financial year
Net worth certificates of guarantor (secured by way of personal guarantee).	Half-yearly basis within 60 days from the end of each half-year
Financials/value of guarantor prepared on basis of audited financial statement etc. of the guarantor (secured by way of corporate guarantee).	Annual basis within 75 days from the end of each financial year
Valuation report and title search report for the immovable/movable assets	Once in three years within 75 days from the end of the financial year

For existing debt securities, listed entities and debenture trustee(s) shall enter into supplemental/amended debenture trust deed within 120 days from the date of this circular incorporating the changes in the debenture trust deed

In case, a listed entity has more than one debenture trustee for its listed debt securities, then debenture trustees may choose a common agency for the preparation of asset cover certificate.

The debenture trustee(s) shall make the following disclosures on their websites as specified below

Disclosure	**Periodicity**
Revision in Credit ratings.	Continuous basis within T+1 day from receipt of the information.
Status of payment of interest/ principal by the listed entity.	
Monitoring of Security cover or higher security cover certificate and Quarterly compliance report of the listed entity.	Quarterly basis within 75 days of the end of each quarter. For last quarter within 90 days from the end of the financial year
Details of Debenture issues handled by debenture trustee and their status.	Half-yearly basis within 60 days of the end of each half-year.
Status of information regarding breach of covenants/terms of the issue, if any action taken by debenture trustee.	
Complaints received by debenture trustee(s) including default cases.	

Status regarding maintenance of accounts maintained under the supervision of debenture trustee.	Annual basis within 75 days of the end of the financial year
Status of information regarding any default by the listed entity and action taken by debenture trustee	
Monitoring of Utilization Certificate	

20.6 Appointment of Compliance Officer

Regulation 17A deals with the appointment of compliance officer by Debenture Trustees. It states that:

(1) Every debenture trustee shall appoint a compliance officer who shall be responsible for monitoring the compliance of the Act, rules and regulations, notifications, guidelines, instructions, etc., issued by the Board or the Central Government and for redressal of investors' grievances.

(2) The compliance officer shall immediately and independently report to the SEBI any non-compliance observed by him.

(3) The compliance officer shall report any non-compliance, with the requirements specified in the listing agreement with respect to debenture issues and debenture holders, by the body corporate to the SEBI.

(4) The Compliance Officer so appointed shall obtain certification in terms of the SEBI CAPSM Regulations, 2007 or as may be specified by the SEBI.

Case 20.1: SEBI Settlement order in the matter of Axis Trustee Services Ltd

Facts of the case:

a) SEBI initiated adjudication proceedings in respect of Axis Trustee Services Ltd (ATSL) for alleged violation of Regulation 15(1)(g)(iii) &(iv)of SEBI Debenture Trustee Regulations 1993 (now 15(1)(q)(iii) &(iv) of SEBI Denture Trustee Amendment Regulations, 2017, SEBI circular of Auguste 6, 2007 and March 15, 2013, Clause 19 of Code of Conduct read with regulation 16 of SEBI Debenture Trustee Regulations.

b) Details of non-compliance are summarized:

Nature of violation	**Details of provisions violated**
Reliance Communications Ltd had defaulted in repayment of the principal as well as	ATSL has not monitored payment of interest/principal made by the issuer

interest due on NCD issued by it. CARE and ICRA downgraded ratings assigned to NCDs issued by RCL to default (D) as the company delayed in payment of interest as well as principal on its NCDs ATSL was acting as Debenture Trustees for the aforementioned NCDs issued by the issuer company	company to debenture holders so as to ascertain and satisfy itself that the debenture holders have been paid the dues in a timely manner. ATSL did not carry due verification to ascertain the status of payment of NCDs Non-co-operation by the issuer company was not shared by the ATSL with credit rating agencies (violation of SEBI circular of March 15, 2013) ATSL in its half-yearly report submitted for the half-year ended 2017 did not mention RCL in the list of companies that have defaulted in payment of interest/principal on their NCD. (violation of clause 19 of Code of Conduct and Regulation 16 of SEBI Debenture Trustee Regulations) ATSL neither issued a press release nor informed SEBI regarding default by RCL in payment of interest/principal to debenture holders on the due date (violation of SEBI circular of August 6, 2007)

c) SEBI appointed adjudicating Officer against the applicant for the aforesaid alleged violation and show cause notice was issued on September 06, 2018. During the personal hearing, the authorized representative of ATSL submitted that ATSL would like to file an application for settlement and request to keep adjudication in abeyance

Order:

a) Applicant paid a sum of Rs 15,93,750/- towards settlement charges

Review Questions

1. As per SEBI (Debenture Trustees) Regulations, which of the following can apply for registration as a Debenture Trustee?

   (a) Scheduled Bank

   (b) Public Finance Institution

   (c) Insurance Company

   (d) All of the above

2. As per the SEBI (Debenture Trustee) Regulations, the certificate of registration as Debenture Trustee is valid ____.

   (a) For 1 year

   (b) For 3 years

   (c) Permanently until suspended

   (d) For 4 years

3. As per the SEBI (Debenture Trustees) Regulations, the debenture trustee shall communicate to the debenture holders on _____ basis regarding compliance, defaults, etc. and the action taken by it.

   (a) Monthly

   (b) Quarterly

   (c) Half-yearly

   (d) Annually

4. The debenture trustee shall comply with the award of Ombudsman passed under the Securities and Exchange Board of India (Ombudsman) Regulations, 2003. State whether True or False.

   (a) True

   (b) False

CHAPTER 21: SEBI (CREDIT RATING AGENCIES) REGULATIONS, 1999

LEARNING OBJECTIVES:

After studying this chapter, you should know about the:

- Conditions for getting registered as a credit rating agency
- Restrictions on rating of securities issued by promoters
- Code of conduct for credit rating agencies
- Guidelines for credit rating agencies

21.1 Registration as a Credit Rating Agency

Credit rating agencies are body corporate that is engaged in, or proposes to be engaged in, the business of rating of securities that are listed or proposed to be listed on a stock exchange recognized by the Board.

Rating means an opinion regarding securities, expressed in the form of standard symbols or any standardised manner, assigned by a credit rating agency and used by the issuer of such securities, to comply with the requirement specified by these regulations.

Any person wanting to commence business as a credit rating agency should make an application to SEBI in the format prescribed by SEBI.

Promoter of Credit Rating Agency

SEBI shall not consider the application for grant of certificate of registration of Credit Rating Agency, unless the applicant is promoted by a person belonging to any one of the following categories, namely:

(a) a public financial institution, as defined in section 2(72) of the Companies Act, 2013;
(b) a scheduled commercial bank included for the time being in the second schedule to the Reserve Bank of India Act, 1934;
(c) a foreign bank operating in India with the approval of the Reserve Bank of India;
(d) a foreign credit rating agency incorporated in a Financial Action Task Force (FATF) member jurisdiction and recognised under their law, having a minimum of five years' experience in rating securities;
(e) any company or a body corporate, having a continuous net worth of minimum Rs. One hundred crores as per its audited annual accounts for the previous five years prior to the filing of the application with SEBI for the grant of certificate under these regulations.

21.1.1 Eligibility Criteria

Further, the applicant shall also satisfy the following conditions, for SEBI to consider the application for grant of certificate:

a) the applicant is set up and registered as a company under the Companies Act, 2013;
b) the applicant has, in its Memorandum of Association, specified rating activity as one of its main objects;
c) the applicant has a minimum net worth of rupees twenty-five crore;
d) the applicant has adequate infrastructure, to enable it to provide rating services in accordance with the provisions of the Act and these regulations;
e) the applicant and the promoters of the applicant have professional competence, financial soundness and general reputation of fairness and integrity in business transactions, to the satisfaction of SEBI;
f) neither the applicant, nor its promoter, nor any director of the applicant or its promoter, is involved in any legal proceeding connected with the securities market, which may have an adverse impact on the interests of the investors;
g) neither the applicant, nor its promoters, nor any director, of its promoter, has at any time in the past been convicted of any offence involving moral turpitude or any economic offence;
h) the applicant has, in its employment, persons having adequate professional and other relevant experience to the satisfaction of SEBI;
i) neither the applicant nor any person directly or indirectly connected with the applicant has in the past been (i) refused by SEBI a certificate under these regulations or (ii) subjected to any proceedings for a contravention of the Act or any rules or regulations made under the Act.
j) the applicant, in all other respects, is a fit and proper person for the grant of a certificate;
k) grant of certificate to the applicant is in the interest of investors and the securities market.
l) the promoter of the credit rating agency has a minimum shareholding of 26% in the credit rating agency.

21.1.2 Certificate Renewal and Validity

SEBI, on being satisfied that the applicant is eligible, shall grant a certificate of registration in Form B and shall send an intimation to the applicant. The certificate of registration granted under the regulation shall be valid unless it is suspended or cancelled by SEBI. The grant of a certificate of registration shall be subject to payment of the registration fees as specified under Part A of Second Schedule, in the manner prescribed in Part B thereof. Application fee for grant of registration is Rs. 50,000 and the registration fee is Rs. 26,66,700. Recurring registration fee for every three years is Rs.15,00,000.

A credit rating agency that has been granted a certificate of registration under regulation 8(1), shall pay registration fees within fifteen days from the date of receipt of intimation from SEBI.

A credit rating agency who has been granted a certificate of registration, to keep its registration in force, shall pay recurring registration fees, for every three years from the sixth year of the date of grant of certificate of registration or of the date of grant of certificate of initial registration granted prior to the commencement of the Securities and Exchange Board of India (Change in Conditions of Registration of Certain Intermediaries) (Amendment) Regulations, 2016, as the case may be. The credit rating agency shall at all times maintain a net worth of Rs 25 crores

21.2 General Obligations of Credit Rating Agencies

21.2.1 Agreement with client

Every credit rating agency shall enter into a written agreement with each client whose securities it proposes to rate, and every such agreement shall include the following provisions, namely:

a) Rights and liabilities of each party in respect of the rating of securities;
b) Fees which shall be charged by the credit rating agency;
c) the client shall co-operate with the credit rating agency in order to enable the latter to carry out periodic review of the rating during the tenure of the rated instrument ;
d) That the client shall co-operate with the credit rating agency in order to enable the latter to arrive at, and maintain, a true and accurate rating of the client's securities and shall, in particular, provide to the latter, true, adequate and timely information for the purpose;
e) The credit rating agency shall disclose to the client the rating assigned to the securities of the latter through regular methods of dissemination, irrespective of whether the rating is or is not accepted by the client;
f) The client shall disclose, in the offer document (i) the rating assigned to the client's listed securities by any credit rating agency during the last three years; and(ii) any rating is given in respect of the client's securities by any other credit rating agency, which has not been accepted by the client;
g) The client shall obtain a rating for any issue of debt securities in accordance with the relevant regulations.
h) The client shall provide explicit consent to the credit rating agency to obtain the details related to their existing and/or future borrowing of any nature, its repayment and delay or default if any, and of nature, in servicing of the borrowing, either from the lender or any other statutory/non-statutory organisation maintain such information to enable credit rating agency to have timely information on the same and to consider the impact of such information on the rating assigned by the credit rating agency.

21.2.2 Monitoring of Ratings

Every credit rating agency shall, during the lifetime of securities rated by it continuously monitor the rating of such securities unless the rating is withdrawn, subject to provisions of the SEBI (Credit Rating Agencies) Regulations. The credit rating agencies shall also disseminate information regarding newly assigned ratings, and changes in earlier ratings promptly through press releases and websites. In the case of securities issued by listed companies, such information shall also be provided simultaneously to the concerned regional stock exchange and to all the stock exchanges where the said securities are listed.

21.2.3 Procedure for review of Rating

Every credit rating agency shall carry out periodic reviews of all published ratings during the lifetime of the securities unless the rating is withdrawn, subject to the provisions of the SEBI (Credit Rating Agencies) Regulation.

If the client does not co-operate with the credit rating agency so as to enable the credit rating agency to comply with its obligations, the credit rating agency shall carry out the review on the basis of the best available information or in the manner as specified by SEBI from time to time.

Provided that if owing to such lack of co-operation, a rating has been based on the best available information, the credit rating agency shall disclose to the investors the fact that the rating is so based.

A credit rating agency shall not withdraw a rating so long as the obligations under the security rated by it are outstanding, except where the company whose security is rated is wound up or merged or amalgamated with another company, or as may be specified by SEBI from time to time.

21.2.4 Internal procedures to be framed

Every credit rating agency shall frame appropriate procedures and systems for monitoring the trading of securities by its employees in the securities of its clients, in order to prevent contravention of;

(a) The SEBI (Insider Trading) Regulations, 2015;

(b) The SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to the Securities Market) Regulations, 1995; and

(c) Other laws relevant to trading of securities.

21.2.5 Disclosure of Rating Definitions and Rationale

Every credit rating agency shall:

a) make public the definitions of the concerned rating, along with the symbol
b) state that the ratings do not constitute recommendations to buy, hold or sell any securities..

c) They shall also make available to the general public information relating to the rationale of the ratings, which shall cover an analysis of the various factors justifying a favourable assessment, as well as factors constituting a risk.

21.2.6 Submission of information to SEBI

Every credit rating agency shall comply with such guidelines, directives, circulars and instructions as may be issued by SEBI from time to time, on the subject of credit rating. The credit rating agency shall furnish information as sought by SEBI–

(a) within a period specified by SEBI or
(b) if no such period is specified, then within a reasonable time.

Every credit rating agency shall, at the close of each accounting period, furnish to SEBI copies of its balance sheet and profit and loss account.

21.2.7 Maintenance of Books of Accounts, records, etc.

Regulation 21 of the SEBI (Credit Rating Agencies) Regulations, 1999 provides that every credit rating agency shall keep and maintain, for a minimum period of five years, the following books of accounts, records and documents, namely:

- copy of its balance sheet, as on the end of each accounting period;
- copy of its profit and loss account for each accounting period;
- copy of the auditor's report on its accounts for each accounting period.
- copy of the agreement entered into, with each client;
- information supplied by each of the clients;
- correspondence with each client;
- ratings assigned to various securities including up-gradation and down-gradation (if any) of the ratings so assigned.
- rating notes considered by the rating committee;
- record of decisions of the rating committee;
- letter assigning rating;
- particulars of fees charged for rating and such other records as SEBI may specify from time to time.

The credit rating agency shall also intimate to SEBI the place where the books of account, records and documents as required under the regulations are kept.

21.3 Appointment of Compliance Officer

Every credit rating agency shall appoint a compliance officer who shall be responsible for monitoring the compliance of the Act, rules and regulations, notifications, guidelines, instructions etc. issued by the Board or the Central Government. The compliance officer shall immediately and independently report to SEBI any non-compliance observed by him.

21.4 Steps on auditor's report

Every credit rating agency shall, within two months from the date of the auditor's report, take steps to rectify the deficiencies if any, made out in the auditor's report.

21.5 Confidentiality

Every credit rating agency shall treat, as confidential, information supplied to it by the client and no credit rating agency shall disclose the same to any other person, except where such disclosure is required or permitted by under or any law for the time being in force.

21.6 Rating process

1. Every credit rating agency shall -

(h) specify the rating process and

(i) file a copy of the same and any modifications or additions made therein from time to time with SEBI for the record.

2. The credit rating agency shall, in all cases, follow a proper rating process.
3. They should have professional rating committees, comprising members who are adequately qualified and knowledgeable to assign a rating.
4. All rating decisions, including the decisions regarding changes in rating, shall be taken by the rating committee.
5. Every credit rating agency shall have qualified analysts to carry out a rating assignment.
6. Every credit rating agency shall inform SEBI about new rating instruments or symbols introduced by it.
7. Every credit rating agency, shall, while rating security, exercise due diligence in order to ensure that the rating given by the credit rating agency is fair and appropriate.
8. A credit rating agency shall not rate securities issued by it.

SEBI in its circular dated November 4, 2019 has specified that MD/CEO of the Credit Rating Agency (CRA) shall not be a member of the rating committee of the CRAs[44].This aims to ensure enhanced governance and accountability of CRAs. It also specifies that the 'Rating committees' of a CRA shall report to a Chief Ratings Officer (CRO). One-third of the board of a CRA shall comprise of independent directors if the board is chaired by a non-executive director. In case the board of the CRA is chaired by an executive director, half of the board shall comprise of independent directors.

During the rating process, CRAs shall record minutes of the meeting with issuer management and incorporate them in the rating committee note. Further, CRAs shall meet the audit committee of the rated entity, at least once a year, to discuss issues including related party transactions, internal financial control and other material disclosures made by the management, which have a bearing on the rating of the listed NCDs.

9. Rating definition, as well as the structure for a particular rating product, shall not be changed by a credit rating agency, without prior information to SEBI.

10. A credit rating agency shall disclose to the concerned stock exchange through press releases and websites for general investors, the rating assigned to the securities of a client, after periodic review, including changes in rating, if any.

21.6.1 Shareholding in a credit rating agency

Regulation 24A states as under (1) A credit rating agency shall not:

(a) directly or indirectly, hold 10 per cent or more shareholding and/ or voting rights in any other credit rating agency, or

(b) have representation on the Board of any other credit rating agency.

Provided that a credit rating agency may, with the prior approval of SEBI, acquire shares and/ or voting rights exceeding 10 per cent in any other credit rating agency only if such acquisition results in a change in control in the credit rating agency whose shares are being acquired.

On the basis of the prior approval sought by the acquirer, SEBI may approve the acquisition in the interest of investors, market integrity and stability. A shareholder holding 10 per cent or more shares and/ or voting rights in a credit rating agency shall not hold 10 per cent or more shares and/ or voting rights, directly or indirectly, in any other credit rating agency.

Provided that the said restriction shall not apply to holdings by Pension Funds, Insurance Schemes and Mutual Fund Schemes. For the purpose of this regulation, a "credit rating agency" means a credit rating agency registered with SEBI.

[44] SEBI Circular Ref. No. SEBI/HO/MIRSD/CRADT/CIR/P/2019/121 Dated November 4, 2019.

21.7 Restrictions on Rating of Securities issued by Promoters

Securities Issued by Promoter

No credit rating agency shall rate a security issued by its promoters. Where the promoter is a lending institution, its Chairman, director or employee shall not be a Chairman, director or employee of the credit rating agency or its rating committee.

Securities Issued by certain entities, connected with a Promoter etc.

The credit rating agency shall not rate a security issued by an entity, which is (a) a borrower of its promoter, or (b) a subsidiary of its promoter, or (c) an associate of its promoter if (i) there are common Chairman, Directors between the credit rating agency and these entities, (ii) there are common employees, (iii) there are common Chairman, Directors, Employees on the rating committee.

No credit rating agency shall rate a security issued by its associate or subsidiary if the credit rating agency or its rating committee has a Chairman, Director or employee who is also a Chairman, Director or employee of any such entity.

Provided that the Credit Rating Agency may, subject to the provisions of sub-regulation (1), rate security issued by its associate having a common independent director with it or rating committee if, -

i. such an independent director does not participate in the discussion on rating decisions, and
ii. the Credit Rating Agency makes a disclosure in the rating announcement of such associate (about the existence of common independent director[45]) on its Board or of its rating committee, and that the common independent director did not participate in the rating process or the meeting of its Board of Directors or in the meeting of the rating committee when the securities rating of such associate was discussed.

21.8 Code of conduct of the Credit Rating Agencies

Regulation 13 of the SEBI (Credit Rating Agencies) Regulations details out the code of conduct to be followed by the Credit Rating Agencies. A credit rating agency shall:

1. Make all efforts to protect the interests of investors.

[45] the expression 'independent director' means a director who, apart from receiving remuneration as a director, does not have any other material pecuniary relationship or transactions with the company, its promoters, its management or its subsidiaries, which in the judgment of the board of the company, may affect the independence of the judgment of such director.

2. In the conduct of its business, shall observe high standards of integrity, dignity and fairness in the conduct of its business.
3. Fulfil its obligations in a prompt, ethical and professional manner.
4. At all times exercise due diligence, ensure proper care and exercise independent professional judgment in order to achieve and maintain objectivity and independence in the rating process.
5. A credit rating agency shall have a reasonable and adequate basis for performing rating evaluations, with the support of appropriate and in-depth rating researches. It shall also maintain records to support its decisions.
6. Have in place a rating process that reflects consistent and international rating standards.
7. Not indulge in any unfair competition nor shall it wean away from the clients of any other rating agency on assurance of higher rating.
8. Keep track of all important changes relating to the client companies and shall develop efficient and responsive systems to yield timely and accurate ratings. Further, a credit rating agency shall also monitor closely all relevant factors that might affect the creditworthiness of the issuers.
9. Disclose its rating methodology to clients, users and the public.
10. Disclose to the clients, possible sources of conflict of duties and interests, which could impair its ability to make fair, objective and unbiased ratings. Further, it shall ensure that no conflict of interest exists between any member of its rating committee participating in the rating analysis and that of its client.
11. Not make any exaggerated statement, whether oral or written, to the client either about its qualification or its capability to render certain services or its achievements with regard to the services rendered to other clients.
12. Not make any untrue statement, suppress any material fact or make any misrepresentation in any documents, reports, papers or information furnished to SEBI, stock exchange or the public at large.
13. Ensure that SEBI is promptly informed about any action, legal proceedings etc., initiated against it alleging any material breach or non-compliance by it, of any law, rules, regulations and directions of SEBI or any other regulatory body.
14. Maintain an appropriate level of knowledge and competence and abide by the provisions of the Act, regulations and circulars, which may be applicable and relevant to the activities carried on by the credit rating agency. The credit rating agency shall also comply with the award of the Ombudsman passed under the Securities and Exchange Board of India (Ombudsman) Regulations, 2003.

15. Ensure that there is no misuse of any privileged information including prior knowledge of rating decisions or changes.

16. Not render, directly or indirectly any investment advice about any security in the publicly accessible media. They shall not offer fee-based services to the rated entities, beyond credit ratings and research.

17. Ensure that any change in registration status/any penal action taken by SEBI or any material change in financials which may adversely affect the interests of clients/investors is promptly informed to the clients and any business remaining outstanding is transferred to another registered person in accordance with any instructions of the affected clients/investors.

18. Maintain an arm's length relationship between its credit rating activity and any other activity.

19. Develop its own internal code of conduct for governing its internal operations and laying down its standards of appropriate conduct for its employees and officers in the carrying out of their duties within the credit rating agency and as a part of the industry. Such a code may extend to the maintenance of professional excellence and standards, integrity, confidentiality, objectivity, avoidance of conflict of interests, disclosure of shareholdings and interests, etc. Such a code shall also provide for procedures and guidelines in relation to the establishment and conduct of rating committees and the duties of the officers and employees serving on such committees.

20. Provide adequate freedom and powers to its compliance officer for the effective discharge of his duties.

21. Ensure that the senior management, particularly decision-makers have access to all relevant information about the business on a timely basis.

22. Ensure that good corporate policies and corporate governance are in place.

23. Not generally and particularly in respect of the issue of securities rated by it, be a party to or instrumental for —

    (a) creation of false market;

    (b) price rigging or manipulation; or

    (c) dissemination of any unpublished price sensitive information in respect of securities which are listed and proposed to be listed in any stock exchange, unless required, as part of the rationale for the rating accorded.

Case 21.1: SEBI order against 3 rating agencies in the matter of IL&FS

Facts of the case:

a) The crisis at diversified IL&FS, whose board was superseded by the government, came to light in September 2018 and since then, the company as well as related entities have come under the regulatory lens.

b) SEBI in December 2019, imposed a fine of Rs 25 lakh each ICRA, CARE Ratings and India Ratings and Research Pvt Ltd in the matter saying the default by IL&FS occurred due to "lethargic indifference and needless procrastination and laxity" of these rating agencies.

c) While the regulator came down heavily on the rating agencies with sharp observations but it was felt that the same was not reflected in a penalty, according to several experts.

d) SEBI examined the order passed by Adjudicating Officer (AO) and observed that the penalty levied by AO appeared to be erroneous and not commensurate with the overall impact these violations had on the market.

e) In view of the same, the competent authority granted approval to review the AO order and accordingly SEBI issued show-cause notices to rating agencies, "calling upon the reasons why the penalty amount should not be enhanced".

f) The case relates to the default by IL&FS and its subsidiary IL&FS Financial Services on their obligations in respect of commercial paper (CP), inter-corporate deposits (ICDs) as well as on interest payments related to non-convertible debentures (NCDs).

Findings of the case:

a) Sebi said IL&FS is a "systemically important" Non-Deposit Accepting Core Investment Company registered with RBI and lends and invests in IL&FS Group Companies and IL&FS operated through more than 250 subsidiaries which in turn operated in a wide range of sectors including engineering and construction, financial services, transportation, energy etc.

b) While there are other companies also engaged in engineering and construction, the scale, diversity of operations and business model of the IL&FS group makes it a kind of a unique company with no real comparable peers in India, it added.

c) IL&FS was a big conglomerate with significant borrowings and as observed from the balance sheet of IL&FS for the year ended March 31, 2018, it had a consolidated borrowing of over Rs 91,000 crore.

d) According to SEBI NCDs, which were given the highest rating by the rating agencies and which continued till August 2018, were abruptly downgraded to default grade in September 2018.

e) SEBI said the default by IL&FS and its steep downgrade by the rating agencies in a matter of 25-40 days has completely changed the risk perception of the corporate bond market.

f) As on the date of downgrading the ratings of NCDs and CPs of IL&FS and IFIN to 'D' on September 17, 2018, the outstanding amount of securities so rated by ICRA, India Ratings and CARE amounted to Rs 11,725 crore, Rs 16,270 crore and Rs 20,942 crore, respectively, Sebi noted

g) SEBI in three separate orders stated that the lapses on the side of ICRA, CARE and India Ratings while rating the securities of IL&FS and its subsidiary IL&FS Financial Services (IFIN) have resulted in real and severe financial loss to investors.

h) SEBI further stated that it has shaken the investors' faith in the reliability of credit ratings in the context of the corporate debt market.

"Had the rating agencies downgraded the ratings at the appropriate time and thereby forewarned the investors, the impact of the default on investors who invested in AAA-rated instruments, could not have been this severe," SEBI noted.

i) Justifying the reasons for enhancing the amount of penalty, SEBI said the role of a CRA (credit rating agency) is that of a financial 'gatekeeper' and any inaccuracy in the rating processes adopted by the CRA has a significant negative impact on the securities market.

It, further, said the impact of the violations committed by the rating agencies is not limited to the monetary loss caused to the investors of NCDs issued by IL&FS but has had wider and larger ramifications on the investor confidence, the financial sector and the securities markets as a whole.

i) According to SEBI, AO has failed to give due weightage to the magnitude of the loss caused to the investors, despite the same being a specified parameter under the SEBI Act.

Imposition of lighter penalties on these rating agencies, tends to create a disadvantage for the other CRAs who may have complied with the law.

"The Board needs to safeguard market integrity, and when scams of this size occur, which questions and challenges the regulatory and supervisory framework put in place with respect to CRAs, it is but imperative, to subject the conduct of CRAs to tight scrutiny and restore investor confidence by enhancing the penalty," Sebi said.

While assigning a credit rating to the NCDs of IL&FS, the three entities failed to exercise proper skill, care, and due diligence while discharging its responsibilities as a credit rating agency and violated the provisions of the code of conduct of the CRAs, SEBI noted.

Order:

Sebi vide orders dated September 22, 2020 enhanced the penalty amount to Rs 1 crore each on three rating agencies, ICRA, CARE and India Ratings, in connection with lapses on their parts while assigning a credit rating to the non-convertible debentures of IL&FS

Review Questions

1. For SEBI to consider the application of registration as a credit rating agency of an entity promoted by a company, the promoter shall have a continuous net worth of minimum _____ for the previous five years.

   (a) Rs. 1 crore

   (b) Rs. 10 crore

   (c) Rs. 100 crore

   (d) Rs. 1000 crore

2. As per the SEBI (Credit Rating Agencies) Regulations, the certificate of registration as a credit rating agency is valid _____.

   (a) For 1 year

   (b) For 2 years

   (c) Permanently until suspended

   (d) For 4 years

3. What is the renewal fee to keep the registration in force as a credit rating agency?

   (a) Rs. 15 lakh

   (b) Rs. 50 lakh

   (c) Rs. 20 lakh

   (d) Rs. 25 lakh

4. A credit rating agency encouraged its client-facing employees to assure a higher rating to the clients than the competitors. Is it a violation as per the SEBI code of conduct for credit rating agencies?

   (a) Yes

   (b) No

CHAPTER 22: SEBI (CUSTODIAN) REGULATIONS, 1996

LEARNING OBJECTIVES:

After studying this chapter, you should know about:

- Functions of a custodian and the services offered by them
- Registration of a custodian with SEBI
- Obligations and responsibilities of custodians
- Code of conduct for custodians

22.1 Custodian and Custodial Services

A "Custodian " is any person who carries on or proposes to carry on the business of providing custodial services. Custodial services in relation to securities or goods of a client or gold or gold-related instruments or silver or silver related instruments held by a mutual fund or title deeds of real estate assets held by a real estate mutual fund scheme in accordance with the SEBI (Mutual Funds) Regulations, 1996 means, the safekeeping of such securities or goods or gold or gold-related instruments or silver or silver related instruments or title deeds of real estate assets and providing services incidental thereto, and includes—

i. maintaining accounts of securities or goods or gold or gold-related instruments or silver or silver related instruments or title deeds of real estate assets of a client;

ii. undertaking activities as a Domestic Depository in terms of the Companies (Issue of Indian Depository Receipts) Rules, 2004;

iii. collecting the benefits or rights accruing to the client in respect of securities or goods or gold or gold-related instruments or silver or silver related instruments or title deeds of real estate assets;

iv. keeping the client informed of the actions taken or to be taken by the issuer of securities, having a bearing on the benefits or rights accruing to the client;

v. keeping the client informed of the actions taken or to be taken with respect to the goods held on its behalf and

vi. maintaining and reconciling records of the services as have been referred to in the above points (i) to (iv). As per SEBI Circular No. SEBI/HO/MRD/DOP1/CIR/P/2019/106 dated October 10, 2019, only a company incorporated in India and listed on a Recognized Stock Exchange in India' ('Listed Company') may issue Permissible Securities or their holders may transfer Permissible Securities, for the purpose of issue of Depository Receipts ('DRs'), subject to compliance of the requirements stated therein.

It is important to note the following:

- Indian Depositories, in consultation with each other, shall develop a system to ensure that aggregate holding of DR holders along with their holding, if any, through offshore derivative instruments and holding as a Foreign Portfolio Investor belonging to the same investor group shall not exceed the limit on foreign holding under the FEMA and applicable SEBI Regulations. For this purpose, Indian Depositories shall have the necessary arrangement with the Domestic Custodian and / or Foreign Depository.
- Domestic Custodian shall maintain records in respect of, and report to, Indian depositories all transactions in the nature of issue and cancellation of depository receipts, for the purpose of monitoring limits.
- Indian Depositories shall coordinate among themselves and with Domestic Custodian to disseminate:

  (a) the outstanding Permissible Securities against which the DRs are outstanding; and,

  (b) the limit up to which Permissible Securities can be converted to DRs.
- The Foreign Depository shall not issue or pre-release the DRs unless the Domestic Custodian has confirmed the receipt of underlying Permissible Securities.

22.2 Registration and Eligibility

Any person proposing to act as a custodian needs to get himself registered with SEBI. As stated in Regulation 6 of the SEBI (Custodian of Securities) Regulations, 1996, SEBI will consider the application for grant of certificate after looking into the following:

a. the applicant should fulfil the capital requirement in accordance with regulation;
b. the applicant should have the necessary infrastructure, including adequate office space, vaults for safe custody of securities and computer systems capability, required to effectively discharge his activities as custodian;
c. the applicant should have the requisite approvals under any law for the time being in force, in connection with providing custodial services in respect of goods of a client or gold or gold-related instruments or silver or silver related instruments of a mutual fund or the title deeds of a real estate assets held by a real estate mutual funds scheme, where applicable;
d. the applicant should have employed adequate and competent persons who have the experience, capacity and ability to manage the business of the custodian;
e. the applicant should have prepared a complete manual, setting out the systems and procedures to be followed by him for the effective and efficient discharge of his functions and the arms-length relationships to be maintained with the other businesses, if any, of the applicant;

f. whether the applicant is a person who has been refused a certificate by SEBI or whose certificate has been cancelled by SEBI;
g. whether the applicant, his director, his principal officer or any of his employees is involved in any litigation connected with the securities market;
h. the applicant, his director, his principal officer or any of his employees has at any time been convicted of any offence involving moral turpitude or of any economic offence
i. the grant of the certificate should be in the interest of investors;
j. the applicant should be a fit and proper person as defined in the SEBI (Intermediaries) Regulations, 2008.
k. SEBI shall not consider an application under these Regulations unless the applicant is a body corporate.

Capital Adequacy Requirements

An applicant for the Custodian of Securities should have a networth[46] of a minimum of Rs. 50 crores.

Period of Validity of Certificate

Every certificate granted to the applicant as a Custodian shall be valid unless it is suspended or cancelled by SEBI.

On being granted the certificate of registration, the Custodian of securities needs to pay the application fee of Rs.5 lakh, a registration fee of Rs. 50 lakh to SEBI, and an annual fee of Rs. 10 lakh or 0.0005 per cent of the 'assets under custody' of the custodian, whichever is higher.[47] The annual fee shall be payable with reference to each financial year, within one month of completion of the financial year.

22.3 General Obligations and Responsibilities of Custodians

22.3.1 Segregation of Activities

In cases where the custodian is carrying on any activity besides that of acting as a custodian, then, he should ensure that the activities relating to his business as custodian is separate and segregated from all other activities. Further, the officers and employees engaged in providing custodial services shall not be engaged in any other activity carried on by him.

22.3.2 Monitoring, Review evaluating and inspecting systems and controls

[46] For the purposes of this regulation, the expression "net worth" means the paid-up capital and the free reserves as on the date of the application.
[47] The expression "assets under custody" means the value of the assets held by the custodian of securities as disclosed by him.

Every custodian shall have in place adequate mechanisms for the purposes of reviewing, monitoring and evaluating the custodian's controls, systems, procedures and safeguards. The custodian shall have the mechanisms inspected annually by an expert and shall forward the inspection report to SEBI within three months from the date of inspection.

22.3.3 Prohibition of assignment

Custodian shall not assign or delegate its functions as a custodian to any other person unless such person is a custodian ***provided*** that a custodian may engage the services of a person not being a custodian, for the purpose of physical safekeeping of goods or gold or silver belonging to its client including a mutual fund having a gold exchange-traded fund scheme or a silver exchange traded fund scheme. However, this would be subject to the following conditions—

- the custodian shall remain responsible in all respects to its client for safekeeping of the goods or gold or silver kept with such other person, including any associated risks;
- all books, documents and other records relating to the goods or gold or silver so kept with the other person shall be maintained in the premises of the custodian or if they are not so maintained, they shall be made available therein, if so, required by SEBI;
- the custodian shall continue to fulfil all duties to the clients relating to the goods or gold or silver so kept with the other person, except for its physical safekeeping.

22.3.4 Separate custody account

Every custodian shall open a separate custody account for each client, in the name of the client whose securities are in its custody and the assets of one client shall not be mixed with those of another client.

22.3.5 Agreement with the client

Every custodian shall enter into an agreement with each client on whose behalf it is acting as custodian of securities and every such agreement shall provide for the following matters:

- the circumstances under which the custodian will accept or release securities, goods, assets or documents from the custody account;
- the circumstances under which the custodian will accept or release monies from the custody account;
- the circumstances under which the custodian will receive rights or entitlements on the securities or goods of the client;
- the circumstances and the manner of registration of securities in respect of each client; and
- details of the insurance, if any, to be provided for by the custodian.

22.3.6 Internal controls

Every custodian shall have adequate internal controls to prevent any manipulation of records and documents including audits for securities, goods and rights or entitlements arising from the

securities and goods held by it on behalf of its client. Every custodian shall have appropriate safekeeping measures to ensure that such securities, goods, assets or documents are protected from theft and natural hazard.

22.3.7 Maintenance of records and documents and furnishing of information

Without prejudice to the provisions of any other law for the time being in force every custodian shall maintain the following records and documents for a minimum period of five years:

a. records containing details of securities, goods, assets or documents received and released on behalf of each client;
b. records containing details of monies received and released on behalf of each client;
c. records containing details of rights or entitlements of each client arising from the securities held on behalf of the client;
d. records containing details of registration of securities in respect of each client;
e. ledger for each client;
f. records containing details of instructions received from and sent to clients; and
g. records of all reports submitted to SEBI.

Further, the custodian shall also inform SEBI of the place where the records and documents as mentioned above are maintained. Such records and documents are required to be maintained for a minimum period of five years.

22.4 Appointment of Compliance Officer

Every custodian shall appoint a compliance officer who shall be responsible for monitoring the compliance of the Act, rules and regulations, notifications, guidelines, instructions, etc., issued by the Board or the Central Government and for redressal of investors' grievances. The compliance officer shall immediately and independently report to the Board any non-compliance observed by him.

22.5 Code of Conduct

SEBI (Custodian) Regulations, 1996 prescribes the Code of Conduct for the Custodian which is discussed below. The Custodian shall:

1. Maintain the highest standard of integrity, fairness and professionalism in the discharge of his duties.
2. Be prompt in distributing dividends, interest or any such accruals of income received or collected by him on behalf of his clients on the securities held in custody.

3. Be continuously accountable for the movement of securities or goods in and out of the custody account, deposit, and withdrawal of cash from the client's account and shall provide a complete audit trail, whenever called for by the client or SEBI.
4. Establish and maintain an adequate infrastructural facility to be able to discharge custodial services to the satisfaction of clients, and the operating procedures and systems of the custodian shall be well documented and backed by operations manuals.
5. Maintain client confidentiality in respect of the client's affairs. Where custodian records are kept electronically, the custodian has to take necessary precautions to ensure that continuity in record-keeping is not lost or destroyed and that sufficient backup of records is available.
6. Create and maintain the records of securities held in custody in such a manner that the tracing of securities or obtaining duplicate title documents is facilitated, in the event of loss of original records for any reason.
7. Extend to other custodial entities, depositories and clearing organizations all such co-operation that is necessary for the conduct of business in the areas of inter custodial settlements, transfer of securities and transfer of funds.
8. Ensure that an arms-length relationship is maintained, both in terms of staff and systems, from his other businesses.
9. Exercise due diligence in safe-keeping and administration of the assets of his clients in his custody for which he is acting as custodian of securities.
10. Not render, directly or indirectly any investment advice about any security in the publicly accessible media, whether real-time or non-real-time, unless a disclosure of his interest including a long or short position in the said security has been made while rendering such advice. In case an employee of the custodian is rendering such advice, he shall also disclose the interest of his dependent family members and employer including their long or short position in the said security while rendering such advice.

Review Questions

1. A person who carries on or proposed to carry on the business of providing custodial services is called _____.

   (a) Depository

   (b) Custodian

   (c) Debenture trustee

   (d) Underwriter

2. The certificate of registration as custodian is valid for a period of _____as per the SEBI (Custodian) Regulations.

   (a) 1 year

   (b) 2 years

   (c) 3 years

   (d) till suspended

3. The custodian should segregate his custodial activities from his other activities. State whether True or False?

   (a) True

   (b) False

4. As per the SEBI (Custodian) Regulations, every custodian shall maintain the records and documents for a minimum period of how many years?

   (a) 3

   (b) 5

   (c) 7

   (d) 10

CHAPTER 23: PROXY ADVISORS

Learning Objective

After studying this chapter, you should know about

- Definition and Role of Proxy Advisors
- Conflict of Interest and Disclosure Requirement for Proxy Advisers

23.1 Introduction

Regulation 2 (p) of Research Analyst Regulations, 2014 defines Proxy Advisers as "Proxy Adviser" means any person who provides advice, through any means, to institutional investors or shareholders of a company, in relation to exercise of their rights in the company including recommendations on public offer or voting recommendation on agenda items.

Proxy advisory firms are independent research outfits that evaluate the pros and cons of corporate matters such as mergers, acquisitions, top appointments and CEO pay, which shareholders are expected to vote on in AGMs, EGMs or court-convened meetings. These firms engage in heavy-duty analysis of the major actions that are put to vote and produce detailed reports advising shareholders on how they should swing to safeguard their interests. Proxy advisory firms charge fees to institutional investors and provide regular, independent voting recommendations on the companies that the latter own. Internationally, proxy advisers have become quite persuasive and large institutional investors have become reliant on their research.

Since the implementation of the Companies Act 2013 (the 'Act') and enhanced corporate governance standards under the Securities and Exchange Board of India (SEBI) (Listing Obligations and Disclosure Requirements) Regulations 2015, the role of proxy advisers has become more prominent. Their recommendations have been responsible for shaping increased disclosures, transparency and compliance with the best corporate governance practices by many listed companies in India.

23.2 Impact of Proxy Advisors on Corporate governance

Proxy Advisers assists in creating a positive impact on corporate governance and compliance culture. Benefits foreseen are as follows :

i) Benefits to Institutional Investor – Institutional investor's managers have a fiduciary responsibility to vote in a manner that is in the best interests of their beneficiaries. It is an important and monumental task that happens during a very compressed timeframe, as shareholder meetings happen based on the calendar set by corporate law. Thus, proxy advisors help investors vote intelligently, especially when there is a time crunch to read and analyse a lot of data.

ii) Benefits to global investors – It is not always easy for global investors to have a complete understanding of all local market practices, across what may be highly diversified global investment portfolios. Proxy advisors prepare research reports that help global investors receive informed analyses and recommendations, taking into account local as well as global good practice principles.

iii) Efficiencies of scale and non-duplication of effort – Instead of thousands of institutional investors doing the same primary research, there are efficiencies of scale if a handful of proxy advisors conduct the same and pass on the benefit of costs and specialisation to the investors. As proxy advisors review hundreds of companies across sectors, they are also able to provide a bird's eye view and deeper dive into the companies being researched.

iv) Benefits to small investors – Many investors do not have the necessary resources or time to follow and closely analyse all shareholder meeting announcements and have access to all published materials on shareholder meetings, often published in local languages and/or at short notice. Proxy advisors serve as 'information gatherers for them, providing full access to all relevant company meeting materials and disclosed information, as well as voting recommendations. Many proxy advisors do not share detailed rationale which is reserved for their paid institutional investors while providing free recommendations to all investors without charge.

v) Better public disclosure by companies – Broadly, proxy advisors keep clients up to date with corporate governance developments, offering specialist insights. Proxy advisors have increased shareholder activism and pushed companies to adopt a high level of disclosures. It has led to higher rates of compliance with corporate governance codes and standards. Additionally, they encourage companies to improve the transfer of relevant information, increase issuer and market awareness of local and global best practices and contribute to improvements in corporate governance in specific and governance in general.

vi) Easier translation and understanding of legal language – Proxy advisors collect and translate key materials, translating legal and accounting jargon into plain English and provide a consistent structure of relevant information across all companies in all markets. This allows shareholders to have a better understanding of the companies in which they invest, resulting in a positive impact on the relationship the company has with its shareholders. Earlier companies considered obtaining shareholder's approval a mere procedural formality, however, they are now wary of the fact that entities are scrutinising their resolutions, particularly with the interest of minority shareholders in mind. Companies now take additional care in drafting their resolutions. Consequent to the reports of proxy advisors, the companies had to withdraw/amend resolutions put forth to the shareholders for approvals due to concerns raised by proxy advisors.

Currently, Proxy Advisors registered with SEBI are as follows

i) Institutional Investor Advisory Services India Ltd (IiAS)

ii) Stakeholder Empowerment Services (SES)

iii) Institutional Shareholder Services India Pvt Ltd (ISSIPL)

iv) Ingovern Research Services Pvt Ltd (IRSP)

23.3 Internal Controls and Disclosures under Research Analyst Regulations, 2014

SEBI regulates the activity of proxy advisers in India under SEBI Research Analyst Regulations, 2014. Under these Regulations, such entities are required to register with SEBI and comply with the provisions pertaining to formation of internal policies and procedures, disclosures in reports etc., code of conduct, maintaining a record of voting recommendations. Key aspects are listed below.

1)All provisions of Chapters II, III, IV, V and VI shall mutatis mutandis apply to proxy advisors. These include

Chapter II Registration of Research Analyst

Chapter III Management of conflicts of interest and disclosure requirement

Chapter IV Inspection

Chapter V Procedure for action in case of default and power to relax strict enforcement of the Regulations

Chapter VI Miscellaneous.

For a detailed reading of these chapters, please refer to the SEBI Research Regulations, 2014.

2)The employees of proxy advisors engaged in providing proxy advisory services shall be required to have a minimum qualification of being a graduate in any discipline: Provided further that certification requirements for employees of proxy advisors engaged in providing proxy advisory services shall be as specified by SEBI.

3) The proxy adviser shall additionally disclose the following:
(i) the extent of research involved in a particular recommendation and the extent and/or effectiveness of its controls and procedures in ensuring the accuracy of issuer data;

(ii)policies and procedures for interacting with issuers, informing issuers about the recommendation and review of recommendations;

4) Proxy adviser shall maintain the record of his voting recommendations and furnish the same to the Board on request.

5) In case of any inconsistency or difficulty in respect of applicability of provisions of these regulations to proxy advisers, SEBI may issue such clarifications or exemptions as may be deemed appropriate

6) Proxy advisor shall abide by Code of conduct prescribed under Third Schedule of SEBI Research Regulations, 2014.

23.4 Procedural guidelines prescribed for Proxy Advisors

There are broad three key areas of conflict for Proxy advisors viz.,

1) shareholding in the proxy advisor by a listed company or a group which has listed companies

2)consulting assignments provided to companies who may, in turn, be scrutinised in the next shareholding meeting

3)any other source of revenue or relationship (for instance inter-locking board positions) which poses a real or apparent conflict of interest

Regulation 24(2) read with 23(1) of SEBI (Research Analyst) Regulations, 2014 mandates proxy advisors to abide by the Code of Conduct specified therein. SEBI circular of August 3, 2020, August 27, 2020 and December 31, 2020 prescribes compliance of following procedural guidelines by SEBI

a) Proxy Advisors shall formulate the voting recommendation policies and disclose the updated voting recommendation policies to its clients. Proxy Advisors shall ensure that the policies should be reviewed at least once annually. The voting recommendation policies shall also disclose the circumstances when not providing a voting recommendation.

b) Proxy Advisors shall disclose the methodologies and processes followed in the development of their research and corresponding recommendations to its clients.

c) Proxy Advisors shall alert clients within 24 hours of receipt of information, about any factual errors or material revisions to the report. Further, any such material revisions to their reports shall be communicated to the clients within 72 hours of receipt of the information, while ensuring that adequate time is available for clients to make an informed decision.

d)Proxy Advisors shall have a stated process to communicate with its clients and the company

e) Proxy Advisors shall share their reports with their clients and the company at the same time. This sharing policy should be disclosed by proxy advisors on their websites. Timeline to receive comments from the company may be defined by proxy advisors and all comments/clarifications received from the company, within the timeline, shall be included as an addendum to the report.

If the company has a different viewpoint on the recommendations stated in the report of the proxy advisors, then proxy advisors, after taking into account the said viewpoint, may either revise the recommendation in the addendum report or issue an addendum to the report with its remarks, as considered appropriate

f) Proxy Advisors shall clearly disclose in their recommendations the legal requirement vis-a-vis the higher standard they are suggesting if any, and the rationale behind the recommendation of higher standards.

g) Proxy Advisors shall disclose conflict of interest on every specific document where they are giving their advice. Further, the disclosures should especially address possible areas of potential conflict and the safeguards that have been put in place to mitigate possible conflicts of interest.

h) Proxy Advisors shall establish clear procedures to disclose, manage and/or mitigate any potential conflicts of interest resulting from other business activities including consulting services, if any, undertaken by them and disclose the same to clients.

23.5 Grievance redressal between listed entities and proxy advisers

Regulation 4(2)(a) of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 ('LODR') casts certain obligations on listed entities to protect and facilitate the exercise of the rights of shareholders, including:

a.right to participate in, and to be sufficiently informed of, decisions concerning fundamental corporate changes,

b.opportunity to participate effectively and vote in general shareholder meetings,

c.effective shareholder participation in key corporate governance decisions, such as the nomination and election of members of the board of directors and

d.exercise of ownership rights by all shareholders, including institutional investors.

Proxy advisors, over the past few years, have played a key role in enabling shareholders to effectively participate in corporate governance decisions and thus, furthering the achievement of the above objectives. Proxy advisors provide advice to institutional investors /shareholders of a listed entity, in relation to the exercise of their rights in the company including voting recommendations on agenda items. However, due to the inherent nature of the work, it is probable that proxy advisors and listed entities may have different views on any agenda item of the listed entity leading to grievances.

SEBI vide it's circular dated August 4, 2020 stated that in order to facilitate resolution of such grievances of listed entities against SEBI registered proxy advisors, the listed entities may approach SEBI. SEBI will examine the matter for non-compliance by proxy advisors with the provisions of the Code of Conduct under regulation 24 (2) read with regulation 23(1) of the SEBI (Research Analyst) Regulations, 2014 and the procedural guidelines for proxy advisors issued vide SEBI circular dated August 03, 2020.

Review Questions

1. A person who provides advice to an institutional investor in relation to exercise of their rights in the company including recommendations on public offer or voting recommendation on agenda items is called _____.

(a) Custodian
(b) Proxy Advisors
(c) Investment advisor
(d) Merchant Banker

2. In case of grievance of the listed entity against SEBI registered proxy advisor, the listed entity may approach _____

(a) SAT
(b) ROC
(c) SEBI
(d) RBI

3. Proxy Advisors shall not disclose conflict of interest on every specific document where they are giving their advice. Is it True or False

(a) True
(b) False

4. Which of the following corporate events are evaluated by proxy advisors?

(a) Mergers and Acquisitions
(b) Senior Management Appointments
(c) CEO compensation
(d) **All of these**

ANNEXURE 1: LIST OF SEBI MANDATED NISM CERTIFICATIONS UNDER SEBI (CAPSM) REGULATIONS, 2007

MANDATED EXAMINATIONS		
Sr. No.	**Name of the examination**	**Mandated for whom**
1	NISM Series I: Currency Derivatives Certification Examination	Approved users and sales personnel of trading members of currency derivatives segments of recognized stock exchanges.
2	NISM Series II-A: Registrars and Transfer Agents (Corporate) Certification Examination AND NISM Series II-B: Registrars and Transfer Agents (Mutual Fund) Certification Examination	Associated persons employed or engaged or to be employed or engaged by Registrars to an Issue and Share Transfer Agents for performing any of the following functions for listed companies: (a) dealing or interacting with the investors or issuers; (b) dealing, collecting or processing applications from the applicants; (c) dealing with matters relating to corporate actions, refunds or redemptions, repurchase of securities, etc; (d) handling redressal of investors' grievances; (e) responsible for internal control and risk management; # responsible for any compliance of securities laws; (f) responsible for any other activity performed under the Securities and Exchange Board of India (Registrars to an Issue and Share Transfer Agents) Regulations, 1993.
3	NISM Series-III-A: Securities Intermediaries Compliance (Non-Fund) Certification Examination	The compliance officer/s and other person/s engaged in compliance function with any intermediary registered as Stockbrokers, Sub-brokers, Depository Participants, Merchant Bankers, Underwriters, Bankers to the Issue, Debenture Trustees and Credit Rating Agencies.
4	NISM Series IV: Interest Rates Derivatives Certification Examination	Approved users and sales personnel of the 'Trading Members' who are registered as such in the Currency Derivatives Segment of a recognized stock exchange and trading in Interest Rate Derivatives.

5	NISM Series V-A: Mutual Fund Distributors Certification Examination	Associated persons including distributors, agents, brokers, sub-brokers or called by any other name, employed or engaged or to be employed or engaged in the sale and/or distribution of mutual fund products.
6	NISM Series V-B: Mutual Fund Foundation Certification Examination	New cadre of distributors including, postal agents, retired government and semi-government officials (class III and above or equivalent) with a service of at least 10 years, retired teachers with a service of at least 10 years, retired bank officers with a service of at least 10 years, and other similar persons (such as Bank correspondents) as may be notified by AMFI/AMC from time to time, allowed to sell units of simple and performing mutual fund schemes".
7	NISM Series VI: Depository Operations Certification Examination	Associated persons engaged or employed by a registered depository participant in: (a) dealing or interacting with clients; (b) dealing with securities of clients; (c) handling redressal of investor grievances; (d) internal control or risk management; (e) activities having a bearing on operational risk; or (f) maintenance of books and records pertaining to the above activities
8	NISM Series VII: Securities Operations and Risk Management Certification Examination	Associated persons of a registered stock-broker / trading member / clearing member in recognized stock exchanges, involved in (a) assets or funds of investor or clients, (b) redressal of investor grievances, (c) internal control or risk management, and (d) activities having a bearing on operational risk.
9	NISM Series VIII: Equity Derivatives Certification Examination	Associated persons functioning as approved users and sales personnel of the trading member of equity derivatives exchange or equity derivative segment of a recognized stock exchange.
10	NISM Series IX: Merchant Banking Certification Examination	Associated persons designated as Key Management Personnel, who,-

		a. perform SEBI regulated activities such as initial public offer, further public offer, Open Offer, Buy-back, Delisting; b. deal with the issuers in connection with activities mentioned in (a) above; c. deal with intermediaries associated with activities mentioned in (a) above; d. act as designated Compliance Officer dealing with the activities mentioned in (a) above; e. submit Due Diligence Certificates to SEBI in connection with the activities mentioned in (a) above;
11	NISM-Series X-A: Investment Adviser (Level 1) Certification Examination AND NISM Series X-B: Investment Adviser (Level 2) Certification Examination	Associated persons registered as investment advisors and partners and representatives of investment advisers under SEBI (Investment Advisers) Regulations, 2013 and offering investment advisory services.
12	NISM Series-XIII: Common Derivatives Certification Examination	(1) NISM-Series-I: Currency Derivatives Certification Examination as the requisite standard for the approved users and sales personnel of trading members of currency derivatives segments of recognized stock exchanges. (2) NISM-Series-IV: Interest Rate Derivatives Certification Examination as the requisite standard for the approved users and sales personnel of trading members who are registered as such in the currency derivatives segment of a recognized stock exchange and trading in interest rate derivatives. (3) NISM-Series-VIII: Equity Derivatives Certification Examination as the requisite standard for associated persons functioning as approved users and sales personnel of the trading member of an equity derivatives exchange or

		equity derivative segment of a recognized stock exchange.
13	NISM Series-XV: Research Analyst Certification Examination	Associated persons registered as research analysts under SEBI (Research Analyst) Regulations, 2014, individuals employed as a research analyst and partners of a research analyst, engaged in preparation and/or publication of research report or research analysis.
14	NISM Series XVI: Commodity Derivatives Certification Examination	Approved users and sales personnel of the trading members in the commodity derivatives segments of recognized stock exchanges.
15	NISM Series XXI-A: Portolio Management Services (PMS) Distributors Certification Examination	The associated persons, engaged by a Portfolio Manager as a distributor of the Portfolio Management Services
16	NISM Series XXI-B: Portolio Managers Certification Examination	The associated persons functioning as principal officer of a Portfolio Manager or employee(s) of the Portfolio Manager having decision making authority related to fund management.

About NISM

National Institute of Securities Markets (NISM) is an educational institution established by the Securities and Exchange Board of India (SEBI), the securities market regulator, in 2006. The Institute was established in pursuant to the Union Finance Minister's proposal, in his 2005-06 Budget Speech, to set up an institution 'for teaching and training intermediaries in the securities markets and promoting research'.

NISM is committed to its vision 'to lead, catalyze and deliver educational initiatives to enhance the quality of securities markets'. The Institute conducts a wide range of capacity building programmes in securities markets - from basic financial literacy to full-time post-graduation programmes. The Institute's six Schools of Excellence, viz., School for Certification of Intermediaries, School for Securities Education, School for Investor Education and Financial Literacy, School for Regulatory Studies and Supervision, School for Corporate Governance and School for Securities Information and Research upholds NISM's vision and works in synergy towards professionalizing the markets.

NISM is mandated by SEBI (Certification of Associated Persons in the Securities Markets) Regulations, 2007 to conduct certification examinations and continuing professional education programs for associated persons engaged by an intermediary. NISM also conducts certification examinations for other regulators like IBBI and PFRDA. NISM's certifications establish a single market-wide knowledge benchmark for different functions in the Indian securities market and enable the associated persons to advance their knowledge and skills.

About the Workbook

This workbook has been developed to assist candidates in preparing for the National Institute of Securities Markets (NISM) Certification Examination Securities Intermediaries Compliance (Non Fund). NISM Series-III-A: Securities Intermediaries Compliance-(Non Fund) Certification Examination seeks to create a common minimum knowledge benchmark for persons engaged in compliance function with any intermediary registered with SEBI as Stock Brokers, Depository Participants, Merchant Bankers, Underwriters, Bankers to the Issue, Debenture Trustees and Credit Rating Agencies.

The book covers financial and regulatory structure in India, the different regulations which the intermediaries should be aware of, specific rules and regulations governing the Stock Brokers, Depository Participants, Merchant Bankers, Underwriters, Bankers to the Issue, Debenture Trustees and Credit Rating Agencies. It also focuses on the importance of compliance activity and the scope and role of the compliance officer in the Indian securities market.

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