NISM CERTIFICATION EXAMINATION WORK BOOK

III-C

# Securities Intermediaries Compliance - (Fund)

National Institute of Securities Markets
A Capacity Building Initiative of SEBI

This workbook has been developed to assist candidates in preparing for the National Institute of Securities Markets (NISM) Certification Examination for officers of Intermediaries relating to (Fund Based) activities.

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[1]The updates made in the workbook (version: January 2026) have been highlighted in YELLOW for easy identification. Kindly refer to the workbook (version: January 2026) for appearing in the Series III-C: Certification Examination on or after February 20, 2026.

## 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.

The NISM certification programs aim at enhancing the quality and standards of professionals employed in various segments of the financial sector. NISM develops and conducts certification examinations and Continuing Professional Education (CPE) programs that aim at ensuring that professionals meet the defined minimum common knowledge benchmark for various critical securities market functions.

NISM certification examinations and educational programs serve different securities market 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, wishing to make a professional career in the securities markets.

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, and Bankers to an Issue. This book is a compendium of the important regulations that the Compliance Officers working with various intermediaries in the securities markets refer to.

Sashi Krishnan
Director, NISM

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While the NISM Certification examination will be largely based on material in this workbook, NISM does not guarantee that all questions in the examination will be from material covered herein.

**Acknowledgement**

This workbook has been developed by the Certification team of NISM in coordination with Vatsalya Advisory Services LLP (Designated Partner Mr. B Renganathan), Resource Person, NISM. NISM gratefully acknowledges the contribution of the Examination Committee of NISM-Series-III-C: Securities Complaince Intermediaries (Fund) for officers of Intermediaries relating to (Fund Based) activities, consisting of Industry Experts.

**About NISM Certifications**

NISM is engaged in developing and administering Certification Examination and Continuing Professional Education (CPE) Programmes 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 the 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 a 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.

These certification creates quality market professionals and catalyze greater investor participation in the markets. They also provide structured career paths to students and job aspirants in the securities markets.

**Important**

- Please note that the Test Centre workstations are equipped with either Microsoft Excel or LibreOffice. Therefore, candidates are advised to be well versed with both of these software's for the computation of numerical.
- 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.

**About the Certification for Officers of Intermediaries relating to (Fund Based) activities:**

The examination seeks to create a common minimum knowledge benchmark for persons engaged in compliance functions with any intermediary registered with SEBI as Mutual Funds, Alternative Investment Funds, Real Estate Investment Trusts, and Infrastructure Investment Trusts. 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 that 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 Mutual Funds, Alternative Investment Funds, Real Estate Investment Trusts, and Infrastructure Investment Trusts. 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

***For any feedback and/or queries, please write back at certification@nism.ac.in***

**Weightages to the NISM-Series III-C: Securities Intermediaries Compliance (Fund) Certification Examination**

| ChapterNo. | Chapter Name | Weightages |
|---|---|---|
| **Part A: Understanding the Securities Markets and the Securities Markets regulatory structure in India** | | |
| Chapter 1 | Introduction to the Financial System | 5 |
| Chapter 2 | Regulatory Framework - General View | 6 |
| Chapter 3 | Introduction to Compliance | 4 |
| Chapter 4 | SEBI Act 1992 | 7 |
| Chapter 5 | SCRA 1956 and SCRR, 1957 | 4 |
| Chapter 6 | SEBI Intermediaries Regulations 2008 | 6 |
| Chapter 7 | SEBI (Prohibition of Insider Trading) Regulations, 2019 | 6 |
| Chapter 8 | SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulation, 2003 | 6 |
| Chapter 9 | Prevention of Money Laundering Act, 2002 | 7 |
| Chapter 10 | SEBI (KYC Registration Agency) Regulations, 2011 | 2 |
| Chapter 11 | SEBI (Foreign Portfolio Investors) Regulations, 2019 | 3 |
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| **Part B: Understanding Intermediary Specific Regulations** | | |
| Chapter 14 | SEBI (Mutual Fund) Regulations, 1996 | 11 |
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| Chapter 17 | SEBI (REITs) Regulation, 2014 | 8 |
| | **Total Weightages** | 100 |

# Contents

# 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 Markets Infrastructure Institutions (MIIs)
- 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.

The 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 bankers' acceptances,

Negotiable Certificates of Deposit (NCDs), repos, and Treasury Bills (T-bills), call/notice money market, and 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 the Government (both State and Central), Corporations, and Municipal Bodies. Capital Markets also provide the mechanism for the 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 investors by making initial public offerings 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 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 Markets Infrastructure Institutions (MIIs)

***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 the 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.

***Clearing Corporation*** is an entity that is established to undertake the activity of clearing and settlement of trades in securities or other instruments or products that dealt with or traded on a recognized stock exchange and includes a clearing house and a limited purpose clearing corporation.[2]

***Social Stock Exchange*** is a newly introduced concept by SEBI in India. As per SEBI ICDR Regulations, 2018, Social Stock Exchange is a separate segment of a recognized stock exchange having nationwide trading terminals permitted to register Not for Profit Organizations (NPOs) and/or list the securities issued by Not for Profit Organizations in accordance with provisions of these regulations.

## 1.3 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

[2]The limited purpose clearing corporation details are specified under Chapter IV-A of Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2018.

so that it reflects changes in ownership of shares consequent upon trading and also handle dividend payouts and communications relating to other corporate actions.

***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. According to SEBI Stock Brokers Regulations 1992, a stock broker means a person having trading rights in any recognised stock exchange and includes a trading member.

***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. According to SEBI Custodian regulations, “custodian" means any person who carries on or proposes to carry on the business of providing custodial services.

***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 Trustee Company that holds 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).

**Vault Manager** means any person who carries on or intends to carry on the business of providing vaulting services[3]. Vaulting service in relation to gold means the storage and safekeeping of gold deposited with the Vault Manager, by the depositor, for the purpose of trading in Electronic Gold Receipts (EGRs) and providing services incidental thereto, and includes: —

(i) utilizing the services of assayers empaneled with the Stock Exchanges for testing as per the gold standard, wherever required;
(ii) coordination with depositories for creation, transfer and extinguishment of Electronic Gold Receipt; and
(iii) providing deposit, storage and withdrawal services to the beneficial owners.

## 1.4 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[4];

[3] The Central Government had, in the Union Budget for 2021-22, announced that SEBI would be the regulator for gold exchanges and accordingly finance ministry had notified electronic gold receipts (EGRs), the instrument representing gold, as securities, paving the way for the launch of gold exchanges. The Vault manager are regulated as a SEBI intermediary for providing vaulting services meant for gold deposited to create EGRs. The obligations of the Vault Manager include accepting deposits, storage and safekeeping of gold, creation as well as withdrawal of EGR, grievance redressal and periodic reconciliation of physical gold with the records of depository.

[4] 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.

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 mutual fund scheme or 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;
j) Zero coupon zero principal instruments[5]

**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.

[5] In exercise of the powers conferred by sub-clause (iia) of clause (h) of section 2 of the SCRA, 1956 (42 of 1956), the Central Government declared "zero coupon zero principal instruments" as securities for the purposes of the said Act. "Zero coupon zero principal instrument" means an instrument issued by a Not for Profit Organisation which shall be registered with Social Stock Exchange segment of a recognised Stock Exchange in accordance with the regulations made by SEBI.

**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 diverication 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** A Forward Rate Agreement (FRA) is an over-the-counter forward contract that enables a borrower (or lender) to lock in an interest rate today for a specified borrowing (or lending) period that will begin at a predetermined time in the future. FRAs are commonly used to hedge against adverse movements in short-term interest rates. The contract is based on a notional principal amount, which is used only for calculating the settlement amount and is not exchanged between the parties.

For example, assume a company plans to take a six-month loan starting after three months and expects short-term interest rates to rise. To hedge this risk, the company may enter into a 3×9 FRA at a fixed rate of, say, 7%, using an appropriate market reference rate (such as SOFR or other risk-free benchmark rates, depending on the currency and prevailing market practice). At the start of the underlying loan period (after three months), the agreed fixed rate is compared with the prevailing reference rate for the six-month period. If the reference rate is higher than 7%, the seller of the FRA pays the difference to the company, thereby compensating for the higher borrowing cost. Conversely, if the reference rate is lower than 7%, the company pays the difference to the seller. The settlement is made in cash and is typically based on the present value of the interest differential.

**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 Repository regulated by WDRA 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 explained in section 2.2.

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 (Capital) 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.

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.

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 up to 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. 1st 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 under Special 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, analysing 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:** Analyse 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 Bharatiya Nyaya Sanhita, 2023 (BNS) which contains laws on crimes of various kinds. The BNS has 358 sections divided into 20 Chapters. 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 227 to 268)

b. Offences against property (sections 303 to 334)
c. Offences relating to documents and property marks (sections 335 to 350)
d. Attempts to commit offences

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

Section 228 relates to the fabrication of false evidence. For example: A makes a false entry in his shop-book for the purpose of using it as corroborative evidence in a Court. A has fabricated false evidence.

Section 314 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. Example: A finds a ring lying on the highroad, not in the possession of any person. A, by taking it, commits no theft, though he may commit criminal misappropriation of property.
Section 316 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. Example: A, being executor to the will of a deceased person, dishonestly disobeys the law which directs him to divide the effects according to the will, and appropriates them to his own use. A has committed criminal breach of trust.

Offences relating to property, marks and documents include forgery (sections 336) and making a false document (section 335); 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 334.

## 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.

The regulations also define generally available information which means an information that is accessible to the public on a non-discriminatory basis and does not include unverified event or information reported in print or electronic media. It is intended to define what constitutes generally available information so that it is easier to crystallize and appreciate what constitutes unpublished price sensitive information. Information published on the website of a stock exchange would ordinarily be considered generally available.

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) a 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 relative or banker of the company, has more than ten per cent of the holding or interest; or

(k) a firm or its partner or its employee in which a connected person specified above is also a partner; or

(l) a person sharing household or residence with a connected person specified above.

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. 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 seemingly not 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.

### 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, either by themselves or through mule accounts[6];

(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 affect 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:

[6] A 'mule account' includes a trading account maintained with a stock broker or a dematerialised account or bank account linked with such trading account in the name(s) of a person, where the account is effectively controlled by another person, whether or not the consideration for transactions in the account are paid by such other person.

- the person selling, dealing in or pledging stolen, counterfeit or fraudulently issued securities was a holder in due course; or
- the stolen, counterfeit or fraudulently issued securities were previously traded on the market through a bonafide transaction,
- 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.[7]
The Regulation 29(1) describes disclosure requirements when 5% or more of shares/voting rights are acquired and the Regulation 29(2) concentrates on disclosure requirements pertaining to the transactions resulting in more than 2% change in shareholding/voting rights. Further, Regulation 29(3) states the time limit and intimation to for disclosures required under sub-regulation (1) and sub-regulation (2). These regulations have been covered in detail in Section 13.3.2 of Chapter 13 covering SEBI SAST Regulations, 2011.

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.

[7]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.

### 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.

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 Mismanagement: 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 .

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.

### 2.5.9 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 under the Customs Act, if the total value of such offences is Rs Rs.1 crore or more. Part C deals with offences which have cross-border implications.

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

### 2.5.10 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.

### 2.5.11 Bye-Laws of Stock Exchanges[8]

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 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.

#### 2.5.11.1 Stamp duty[9]

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.

### 2.5.12 Taxes on Securities

#### 2.5.12.1 Income-Tax Act, 1961

[8]Candidates may like to read the different provisions as given under the different bye-laws of the exchanges posted on the Exchange website.
[9] The regulation would come into force w.e.f April 1, 2020.

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 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[10]**

[10]Tax rates are subject to changes. Candidates are advised to refer to latest rates as mentioned in the Finance Act.

| Tax Type | Condition | Tax applicable |
|---|---|---|
| Long-term capital gains tax | On any capital asset (equity, non-equity, real estate etc.) | 12.5% |
| Long-term capital gains tax | On equity shares / units of equity-oriented funds (with STT) | 12.5 % on gains in excess of ₹1,25,000 (i.e. first ₹1,25,000 exempt) |
| Long-term capital gains tax | On real estate / non-equity assets | 12.5 % (option for 20 % with indexation for individuals / HUFs in certain real estate cases) |
| 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 STT is applicable (e.g. equity shares / mutual funds) | 20%. |

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'.

**2.5.12.2 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.

**2.5.12.3 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, stated that 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[11] on 'Compliance

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

function at Market Intermediaries' in which they had defined compliance function as "*A function 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 Compliance Officer (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.

The compliance officer may be appointed under other regulations also, apart from the Securities and Exchange Board of India (Stock Brokers) Regulations, 1992.

### 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 within such time as may be specified, in the notification. However, 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 (this is as per the previous notification, which continues to remain in force).

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.

(4) For the purpose of obtaining a certificate, the board takes the following into consideration:
(a) whether the associated person, as part of his work or operation, deals or interacts with the investors, issuers, or clients of intermediaries;

(b) whether the associated person deals with assets or funds of investor or clients;

(c) whether the associated person handles redressal of investor grievances;

(d) whether the associated person is responsible for internal control or risk management;

(e) whether the associated person is responsible for compliance of any rules or regulations;

(f) whether the associated person is engaged in activities that have a bearing on operational risk of the intermediary.

### 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[12] 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[13], as may be specified by NISM.
(c) Delivering at least four sessions in a specific CPE program, as may be specified by NISM.

[12]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
[13]The CPE Program is as per the new NISM communiqué Ref. No. NISM/Certification/ CPE General/2011/1 dated December 21, 2011.

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 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.

No associated person engaged in any of the activities mentioned in clauses (a) to (f) of sub-regulation (4) of regulation 3 shall continue to be so engaged unless such a person holds a valid certificate as specified by the Board.

### 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[14].

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.

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

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.

**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.

Further, without prejudice to the provisions of section 21 of the Securities Contracts (Regulation) Act, 1956, SEBI may specify the requirements for listing and transfer of securities and other matters incidental thereto.

### 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 various clauses of sub-Sections 15[15], failing to comply with any of these will lead to penalties and adjudication proceedings.

[15] 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.

| 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 information, return, report, books or other documents<br>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<br>c) Maintain books of account or records. | 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 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 | 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 |

| | | | |
|---|---|---|---|
| | 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<br>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<br>d) to despatch unit certificates of any scheme by a person registered with SEBI as a collective investment scheme including mutual funds, in accordance with the regulations governing such despatch<br>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<br>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 | a) to issue contract notes in the form and manner specified by the stock exchange of which the broker is a member.<br>b) To deliver any security or to make payment of the | not be less than one lakh rupees<br><br>not be less than one lakh rupees | one crore rupees<br><br>extend to one lakh rupees for |

| | | | |
|---|---|---|---|
| | amount due to the investor in the manner and within the period specified in the regulations.<br>c) Charging an amount of brokerage in excess of that specified in the regulations. | Not be less than one lakh rupees | each day during which such failure continues maximum of one crore rupees.<br>Extend to five times the amount of brokerage charged in excess of the specified brokerage, whichever is higher. |
| Section 15G: Penalty for insider trading | 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<br>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<br>c) When an insider counsels or procures for any other person to deal in any securities of any corporate body on the basis of unpublished price-sensitive information | 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. |

| | | | |
|---|---|---|---|
| Section 15H: Penalty for non-disclosure of acquisition of shares and takeovers | a) disclose the aggregate of his shareholding in the body corporate before he acquires any shares of that body corporate; or<br>b) make a public announcement to acquire shares at a minimum price; or<br>c) make a public offer by sending a letter of offer to the shareholders of the concerned company; or<br>d) 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, 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 | not be less than one lakh rupees | extend to ten crore rupees or three times the amount of profits made out of such act, whichever is higher. |

| | | | |
|---|---|---|---|
| | influence the investigation, inquiry, audit, inspection or proper administration of any matter within the jurisdiction of the Board.<br><br>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;<br><br>b) without being authorised to do so, access or tries to access, or denies of access or modifies access parameters, to the regulatory data in the database;<br><br>c) without being authorised to do so, downloads, extracts, copies, or reproduces in any form the regulatory data maintained in the system database;<br><br>d) knowingly introduces any computer virus or other | | |

| | | | |
|---|---|---|---|
| | computer contaminant into the system database and brings out a trading halt;<br>e) without authorisation disrupts the functioning of system database;<br>f) knowingly damages, destroys, deletes, alters, diminishes in value or utility, or affects by any means, the regulatory data in the system database; or<br>g) knowingly provides any assistance to or causes any other person to do any of the acts specified above<br>*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. The SAT shall be deemed to be a civil court for all the purposes as mentioned in the SEBI Act.

<u>Section 15T: Appeal to Securities Appellate Tribunal</u>

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, 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 activity 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 a recognised stock exchange or any member thereof to furnish in writing such information or explanation relating to the affairs of the stock exchange or of the member in relation to the stock exchange as SEBI may require; or
- Appoint person(s) to make inquiry into the affairs of the governing body of a stock exchange or the affairs of any of the members of the stock exchange in relation to the stock exchange

and submit a report of the same to SEBI within such time as may be specified in the order or it may direct the governing body of the stock exchange to make the inquiry and submit its report to SEBI in the case of an inquiry in relation to the affairs of any of the members of a stock exchange.

Section 6(4) of SCRA provides that where an inquiry, as mentioned above, has been undertaken, every director, manager, secretary or other officer of such stock exchange; every member of the concerned stock exchange; every partner, manager, secretary or other officer of the firm (if the member of the stock exchange is a firm); and every other person or body of persons who has had dealings in the course of business (directly or indirectly) with any of the persons mentioned earlier, 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[16] or the rules made under section 30; or

[16] 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.

(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 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 recognised 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 or any bye-laws of a recognised stock exchange made thereunder, 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 for every such failure.

Section 23C of SCRA provides that if any stockbroker 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, Naresh Shivlal Rupani and Utam Ravji Gada in the matter of Saianand Commercial Limited (formerly known as Oregon Commercial Limited)**

**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 she/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 her/him or has been proved to be insolvent even though she/he has obtained her/his final discharge;

d. has compounded with her/his creditors unless she/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 she/he undertakes on admission to sever her/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 she/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 her/his name but the name of such other member; or

(c) succeeds to the established business of a deceased or retiring member who is her/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 her/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:**

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.

### 5.2.4 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) Net worth 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
- Fit and Proper Criteria
- ODR Framework introduced by SEBI
- Compliance relating to Cyber Security Framework
- Compliance relating to Artificial Intelligence and Machine Learning

## 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 define Intermediaries as a person mentioned in sub-section 2clauses (b) and (ba) of section 11, sub-section (1) and (1A) of section 12 of the SEBI Act, 1992 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;

- that all disclosures made as prescribed by SEBI.

(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.

**Responsibility for the use of Artificial Intelligence:**

Any person regulated by the Board who uses artificial intelligence and machine learning tools and techniques, either designed by it or procured from third-party technology service providers, irrespective of the scale and scenario of adoption of such tools for conducting its business and servicing its investors, shall be solely responsible –

a)for the privacy, security and integrity of investors' and stakeholders' data including data maintained by it in a fiduciary capacity throughout the processes involved;

b)for the output arising from the usage of such tools and techniques it relies upon or deals with; and

c)or the compliance with applicable laws in force.

(2) The Board may, in case of violation of the provisions of sub-regulation (1), take such action as it may deem fit including action under Chapter V of these regulations. Explanation: For the purpose of this regulation,-

a)the expression "artificial intelligence and machine learning tools and techniques" may include any application or software program or executable system or a combination thereof, offered by the person regulated by the Board to investors/stakeholders or used

internally by it to facilitate investing and trading or to disseminate investment strategies and advice or to carry out its activities including compliance requirements and the same are portrayed as part of the products offered to the public or under usage for compliance or management or other business purposes;

b)the expression "person regulated by the Board" shall have the same meaning as provided under Explanation 1 to regulation 16A.[17]

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

[17] [17] https://www.sebi.gov.in/legal/regulations/dec-2025/securities-and-exchange-board-of-india-intermediaries-regulations-2008-last-amended-on-december-5-2025-_98642.html

3. Without prejudice to the provisions the Act, the inspecting authority shall, in the course of inspection, be entitled to examine or record statements of any principal officer, director, trustee, partner, proprietor or employee of such intermediary.
4. It is the duty of every director, proprietor, trustee, partner, officer and employee of such intermediary to give to the inspecting authority all assistance which the inspecting authority may reasonably require in connection with the inspection.

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

1. 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, in terms of Regulation 24(2), the Executive Director shall appoint an officer not below the rank of a Division Chief, as a designated authority. The Executive Director may, at his discretion, appoint a bench of 3 officers each of whom will not be below the rank of Division Chief 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.
2. The designated authority shall issue a 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.
3. The 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.
4. Every notice shall specify the contravention alleged to have been committed by notice by indicating the provisions of the securities laws or the direction or the order of the SEBI which are alleged to have been contravened.
5. Moreover, 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.
6. The designated authority may grant a request for inspection of documents.
7. The designated authority shall grant an opportunity of personal hearing and issue or cause to issue a notice scheduling a date for hearing.
8. If the noticee does not reply to the 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 days 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, in writing, 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)**

(1) Notwithstanding anything contained in these regulations, the procedure as provided under this regulation shall be applied to -

(a) the stock broker or a clearing member, in respect of which intimation has been received by SEBI from all the stock exchange(s) or the clearing corporation(s), as the case may be, of which it was a member, that such stock broker or clearing member has been expelled as its member;

(b) a depository participant, in respect of which intimation has been received by SEBI from all the depository(ies) where the participant was admitted, that the depository participant agreement has been terminated by the depository(ies);

(c) a person found to have made claim(s) of return or performance in respect of or related to a security or securities, unless otherwise permitted by SEBI to make such claim(s);

(d) a person which fails to pay the fees, to SEBI or to such body as may be specified, in terms of provisions of the relevant regulations governing such a person;

(e) a person not traceable at its physical address and email address available in the records of SEBI;

(f) a person which has failed to submit periodic reports to the Board for three consecutive periods or such other period(s) as may be specified in the relevant regulations or circulars issued thereunder which govern such a person; (g) a person which has admitted to have violated any of the provisions of the securities laws or directions, instructions or circulars issued by the Board.

(2) The competent authority shall issue a notice to the person referred to in sub-regulation (1) communicating the grounds for initiation of the proceedings under this regulation and the violation(s) alleged to have been committed by such person.

(3) The notice issued under sub-regulation (2) shall require the noticee to make submission(s), if any, within twenty-one calendar days from the date of receipt of the notice, only through a written response, along with documentary evidence, if any, as to why the certificate of

registration granted under the Act and the regulations made thereunder shall not be cancelled or suspended:

Provided that the competent authority may, for the reasons to be recorded, permit the noticee to submit a written response within a further period not exceeding fifteen calendar days.

(4) No further opportunity beyond the timelines specified in sub-regulation (3) shall be allowed.

(5) After considering the facts and circumstances of the case, material on record and the written submissions, if any, the competent authority shall endeavor to pass an order within twenty-one calendar days from—

(i) the date of receipt of the written submissions of the noticee; or

(ii) the date of expiry of the time period granted by the competent authority to file the written submissions under sub-regulation (3), in case no written submissions are filed within the specified period.

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

(7) The competent authority shall pass an appropriate order of cancellation or suspension of the certificate of registration of the noticee or any other order, as deemed fit.

(8) The competent authority may, while passing the order, impose such conditions upon the noticee as it deems fit to protect the interest of the investors or the clients of the noticee or the securities market.

(9) While passing the order, the competent authority shall, wherever considered necessary, require the noticee to satisfy the Board on the following—

(a) arrangements made for maintenance and preservation of records and other documents as required under the relevant regulations;

(b) redressal of investor grievances;

(c) transfer of records, funds or securities of its clients;

(d) arrangements made for ensuring continuity of service to the clients;

(e) defaults or pending action, if any;

(f) such other conditions in the interest of investors or the client(s) of the noticee or the securities market.

(10) On and from the date of cancellation of the certificate of registration, the noticee shall forthwith –

(a) return to the Board the certificate of registration so cancelled, if the same has been issued in the physical form and shall not represent itself to be a holder of the certificate for any purpose;

(b) cease to carry on any activity in relation to which the certificate had been granted;

(c) transfer its activities to another person holding a valid certificate of registration to carry on such activity or 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 any liability incurred or assumed by it;

(e) take such other action including action relating to any record(s) or document(s) and securities or money of the investors that may be in the custody or control of such person, within the time and in the manner, as may be required under the relevant regulations or as may be directed by the competent authority while passing the order under this regulation.

(11) A copy of the order passed under this regulation shall be–

(a) sent to the noticee;

(b) sent to the stock exchange(s) or the clearing corporation(s) or the depository(ies) or the body or body corporate recognized by SEBI for administration and supervision of the intermediary, as the case may be, and shall be uploaded on their respective websites; and

(c) uploaded on the website of SEBI.

**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.

**6.4.7 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.

**Fit and Proper Criteria:** The applicant or intermediary shall meet the 'fit and proper 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.

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 fulfil the 'fit and proper person' criteria.

   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.

For the purpose of determining as to whether any person is a 'fit and proper person', SEBI may consider 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.

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.

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.

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.

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.

Chapter III B

Usage of Artificial Intelligence

Responsibility for the use of artificial intelligence.

16C.(1) Any person regulated by SEBI who uses artificial intelligence and machine learning tools and techniques, either designed by it or procured from third-party technology service providers, irrespective of the scale and scenario of adoption of such tools for conducting its business and servicing its investors, shall be solely responsible –

a) for the privacy, security and integrity of investors' and stakeholders' data including data maintained by it in a fiduciary capacity throughout the processes involved;

b) for the output arising from the usage of such tools and techniques it relies upon or deals with; and

c) or the compliance with applicable laws in force.

(2) SEBI may, in case of violation of the provisions of sub-regulation (1), take such action as it may deem fit including action under Chapter V of these regulations.

Explanation: For the purpose of this regulation,-

a) the expression "artificial intelligence and machine learning tools and techniques" may include any application or software program or executable system or a combination thereof, offered by the person regulated by the Board to investors/stakeholders or used internally by it to facilitate investing and trading or to disseminate investment strategies and advice or to carry out its activities including compliance requirements and the same are portrayed as part of the products offered to the public or under usage for compliance or management or other business purposes;

b) the expression "person regulated by SEBI" shall have the same meaning as provided under Explanation 1 to regulation 16A.

CHAPTER IIIC

VERIFICATION OF PAST RISK AND RETURN METRICS

Applicability

16D. The provisions of this chapter shall be applicable only to Investment Advisers, Research Analysts, Algo Providers empaneled with a recognised stock exchange, and intermediaries

permitted by SEBI to provide the services of Investment Advisers, Research Analysts and Algorithmic Trading.

Explanation – For the purposes of this Chapter, an algo provider shall mean a person empaneled with a recognised stock exchange for providing the facility of algorithmic trading services, in the manner specified by the recognised stock exchange.

Verification of risk-return metrics

16E (1). The persons referred to in Regulation 16D shall be permitted to make claim of returns or performance in the form of risk and return metrics, which have been verified by a credit rating agency recognized by SEBI to carry out the activity of a Past Risk and Return Verification Agency.

(2) Any claim in the form of verified risk or return metrics as referred to in sub-regulation (1) shall be made in the manner specified by the SEBI.

Action for Violation

16F. SEBI may, in case of violation of sub-regulations (1) or (2) of Regulation 16E, take such action as it may deem fit including action under Chapter V of these regulations.]

**6.6 Online Resolution of Disputes, Cyber Security & Resilience Framework in the Indian Securities Market**

According to the current system of complaint resolution, any investor having a complaint can first approach the stock exchange for resolution of the complaint and if not satisfied, lodge a complaint with the SCORES. After exhausting these avenues, any complainant who is not satisfied, may opt for the arbitration mechanism of the exchanges. Stock exchanges and depositories, together known as 'Market Infrastructure Institutions' (MIIs), have a robust and time-bound grievance redressal process. The current mechanism caters to disputes between stock brokers and their clients.

SEBI has strengthened the existing mediation/conciliation and arbitration mechanism administered by the MIIs and extended the mechanism to the resolution of complaints against all intermediaries in the Indian securities market. With this view, SEBI has directed the MIIs to establish a common Online Dispute Resolution (ODR) portal. The ODR portal harnesses online conciliation and online arbitration for resolution of disputes arising in the securities markets.

Disputes between Investors/Clients (including institutional/corporate clients) and listed companies (including their registrar and share transfer agents) or any of the specified intermediaries/regulated entities in securities market may be resolved through the ODR portal. Listed companies / specified intermediaries / regulated entities OR their clients/investors (or holders on account of nominations or transmission being given effect to) may also refer any

unresolved issue of any service requests / service-related complaints for due resolution through the ODR portal.

SEBI has also strengthened the existing cyber security and cyber resilience framework of MIIs with the new guidelines. They are:

- Malls will have to maintain offline, encrypted backups of data and regularly test these backups at least on a quarterly basis in order to ensure confidentiality, integrity and availability; MIIs should explore the possibility of retaining spare hardware in an isolated environment in order to rebuild systems in the event starting their operations from both the Primary Data Centre (PDC) and Disaster Recovery Site (DRS) is not feasible;
- MIIs should regularly conduct business continuity drills in a bid to check the readiness of the organization and the effectiveness of the existing security controls at the ground level to deal with ransomware attacks;
- MIIs are also required to conduct regular vulnerability scanning to identify and address vulnerabilities, especially those on internet-facing devices in order to limit the attack surface. They should also implement a cybersecurity user awareness and training programme which includes guidance on how to identify and report suspicious activity;
- As MIIs are systematically important institutions since they provide the infrastructure necessary for the smooth functioning of the securities market, SEBI directed them to Multi Factor Authentication (MFA) for all services.

**6.7 Compliance relating to Artificial Intelligence and Machine Learning (AI & ML):**

SEBI has also directed the market Intermediaries to meet prescribed reporting and disclosure requirements regarding the Artificial Intelligence and Machine Learning (AI & ML) applications and systems offered and used by them.

**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 Ja tin 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 been, during the six months prior to the concerned act, associated with a company, in any capacity, directly or indirectly, 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, whether temporary or permanent, with the company, that allows such a 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) a 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 relative or banker of the company, has more than ten per cent of the holding or interest; or
(k) a firm or its partner or its employee in which a connected person specified in sub-clause (i) of clause (d) is also a partner; or
(l) a person sharing household or residence with a connected person specified in sub-clause (i) of clause (d);

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. 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 seemingly not 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 and shall not include unverified event or information reported in print or electronic media. It is intended to define what constitutes generally available information so that it is easier to crystallize and appreciate what constitutes unpublished price sensitive information. 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 as an "insider" regardless of the manner in which one came into possession of or had access to such information. Various circumstances are provided to enable 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 leveling 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, award or termination of order/contracts not in the normal course of business and such other transactions;
(v) changes in key managerial personnel, other than due to superannuation or end of term, and resignation of a Statutory Auditor or Secretarial Auditor;
(vi) change in rating(s), other than ESG rating(s);
(vii) fund raising proposed to be undertaken;
(viii) agreements, by whatever name called, which may impact the management or control of the company;
(ix) fraud or defaults by the company, its promoter, director, key managerial personnel, or subsidiary or arrest of key managerial personnel, promoter or director of the company, whether occurred within India or abroad;
(x) resolution plan/ restructuring or one-time settlement in relation to loans/borrowings from banks/financial institutions;
(xi) admission of winding-up petition filed by any party /creditors and admission of application by the Tribunal filed by the corporate applicant or financial creditors for initiation of corporate insolvency resolution process against the company as a corporate debtor, approval of resolution plan or rejection thereof under the Insolvency and Bankruptcy Code, 2016;
(xii) initiation of forensic audit, by whatever name called, by the company or any other entity for detecting mis-statement in financials, misappropriation/ siphoning or diversion of funds and receipt of final forensic audit report;
(xiii) action(s) initiated or orders passed within India or abroad, by any regulatory, statutory, enforcement authority or judicial body against the company or its directors, key managerial personnel, promoter or subsidiary, in relation to the company;
(xiv) outcome of any litigation(s) or dispute(s) which may have an impact on the company;
(xv) giving of guarantees or indemnity or becoming a surety, by whatever named called, for any third party, by the company not in the normal course of business;
(xvi) granting, withdrawal, surrender, cancellation or suspension of key licenses or regulatory approvals.[18]

***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-

[18]https://www.sebi.gov.in/legal/regulations/mar-2025/securities-and-exchange-board-of-india-prohibition-of-insider-trading-regulations-2015-last-amended-on-march-12-2025-_92672.html

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.

Provided that entry of information, not emanating from within the organisation, in structured digital database may be done not later than 2 calendar days from the receipt of such information.

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 one hundred and twenty calendar days from the public disclosure of the plan;

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

iii. set out following parameters for each trade to be executed;

(i) either the value of trade to be effected or the number of securities to be traded;

(ii) nature of the trade;

(iii) either specific date or time period not exceeding five consecutive trading days;

(iv) price limit, that is an upper price limit for a buy trade and a lower price limit for a sell trade, subject to the range as specified below:

a. for a buy trade: the upper price limit shall be between the closing price on the day before submission of the trading plan and upto twenty per cent higher than such closing price;

b. for a sell trade: the lower price limit shall be between the closing price on the day before submission of the trading plan and upto twenty per cent lower than such closing price.

iv. 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 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 execute any trade in the securities outside the scope of the trading plan or to deviate from it except due to permanent incapacity or bankruptcy or operation of law.

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.
Further, if the insider has set a price limit for a trade as specified in the regulations, the insider shall execute the trade only if the execution price of the security is within such limit. If price of the security is outside the price limit set by the insider, the trade shall not be executed

(5) The compliance officer shall approve or reject the trading plan within two trading days of receipt of the trading plan and notify the approved plan to the stock exchanges on which the securities are listed, on the day of approval.

***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:

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

(iv) 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

(v) 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.

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.

Schedule A of the regulations 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 the 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 UPSI. Such closure shall be imposed in relation to such securities to which such UPSI 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.

11A. 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.

In order to keep pace with the evolving market dynamics, SEBI (Prohibition of Insider Trading) Regulations, 2015 (hereinafter "SEBI PIT Regulations" or "PIT Regulations") was amended from time to time.

With an objective to provide greater clarity on several concepts related to the SEBI (PIT) Regulations, 2015, as also to shed more light on the nuances of various requirements of the regulations, SEBI had issued comprehensive Frequently Asked Questions (FAQs) on April 29, 2021, which consolidated all the FAQs and guidance notes issued earlier. In the light of the queries and suggestions received, and consultations with market participants, the FAQs have now been revised and updated on March 31, 2023, more particularly, with regard to structured digital database and contra-trade.

With a view to provide more clarity and ease of reference, these FAQs are categorized subject-wise under various headings, namely -

1. Trading Related
2. Structured Digital Database
3. Pledge
4. Trading Plan
5. Disclosures including system Driven Disclosures
6. Pre-clearance
7. Trading Window Closure
8. Contra Trade
9. Designated Person and Immediate Relatives
10. General

Source - https://www.sebi.gov.in/sebi_data/faqfiles/apr-2023/1680758865899.pdf

**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 |
| UPS<br>I 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.

**Case 7.4: SEBI fined the Compliance Officer of Listed Company**

**Facts of the case:** SEBI received a few complaints from Nyaya Manch alleging manipulation in the scrip of Kwality from March to April 2018. Subsequently, SEBI received a letter from the directorate of enforcement (ED) forwarding complaints from one Kashyap Mansukhlal Vyas alleging price manipulation from July 2017 to May 2018. According to complaints, SEBI investigated Kwality. SEBI forwarded complaints received from Nyaya Manch and the letter from ED to BSE and National Stock Exchange (NSE).

Based upon the complaints, BSE submitted the reports stating that Kwality's promoters and directors, Sanjay Dhingra and Siddhant Gupta traded in the scrip for which they did not file necessary disclosures under SEBI (PIT) Regulations with the exchange. Further, BSE said Mr Gupta traded from 18 Dec 2017 to 18 Apr 2018 and had taken an opposite position or executed contra trade, which appears to be in violation of the provisions of para 10 of Schedule B, read with the Reg. 9(1) and 9(2) of SEBI (PIT) Regulations. However, no adverse inference was drawn with respect to price or volume manipulation by BSE, it added.

In its report, NSE submitted that it identified three price-sensitive corporate announcements made by the Company on 7 Apr 2018, 28 May 2018, and 3 Jul 2018. Based on the analysis of these announcements, NSE shortlisted four clients, Mr Dhingra, promoter and MD, Mr Gupta (non-executive director), Abbot Gouri and Suri Ankan, whose trading pattern pointed towards trading based on UPSI. However, no adverse inference was drawn for price or volume manipulation by NSE.

**Findings nd Reasoning:**

SEBI's investigation revealed that Sidhaant & Sons (Hindu undivided family-HUF), where Mr Gupta was the karta and traded in Kwality scrip while possessing UPSI, unlawfully avoided a loss of Rs.96,300. Mr Dhingra, promoter and MD of the Company has executed contra trades within six months and a profit of Rs2.12 crore and did not remit it to SEBI for credit to the investor protection and education fund (IEPF). Further, Mr Dhingra also traded during the trading window closure period.

Mr Gupta, non-executive director of the Company, executed contra trades within six months, thus, he has not complied with Clause 10 of Schedule B read with Regulation 9(1) of the PIT Regulations. He also failed to make disclosures in terms of PIT Regulations regarding the disposal of shares, SEBI says.

SEBI noted that following designated persons of the Company executed contra trades within six months and failed to remit the profit to the credit to Investor Education and Protection Fund (IEPF)

1. Lokesh Kumar Varshneya - Profit earned - Rs14,063.75. Also traded during the trading window closure period.
2. Sudesh Kumar - Profit earned - Rs.57,900.
3. Manjit Dahiya (a director of the Company) executed contra trades within six months.

4. Satish Kumar Gupta, Inderjit Singh, Acharya Ramanuj, Jayanta Karmakar and Ashutosh Kapil - executed contra trades within six months and traded during the trading window closure period.

As per clause 1.5 of the Company's Code of Conduct and Regulation 9(3) and Regulation 2(1)(c) of the PIT Regulations, it is the duty and responsibility of a compliance officer to administer the code of conduct and other requirements including monitoring the trades of all designated persons. Mr Dhingra, in his reply on 29 Nov 2022, submitted that Mr Srivastava was the compliance officer of Kwality during the investigation period (IP).

During the investigation, Beetal Financial & Computer Services, Registrar and Share Transfer Agent (RTA) of Kwality, informed SEBI that it used to send specific information as and when sought by the Company through e-mail to Mr Srivastava.

SEBI then issued a show cause notice to Mr Srivastava. In his response, Mr Srivastava accepted that he received information from RTA every week, and he and his team have analysed the same regarding any change in shareholding of promoters and trading by the employees of the Kwality. However, the SEBI AO noted that Mr Srivastava did not take any action on various violations of the code of conduct by the promoter, directors and designated persons of the Company.

As a compliance officer of Kwality, Mr Srivastava failed to monitor the trades of all designated persons, comply with the Company's code of conduct and administer the PIT Regulations effectively in the Company during the IP.

During a personal hearing, Mr Srivastava submitted that due to wilful concealment of facts and non-cooperation of the alleged concerned violators, the compliance officer could not be held liable for acts of wilful violators who intentionally failed to comply with relevant provisions of applicable laws and intimating the compliance officer of the Company.

As a law-abiding professional, Mr Srivastava said that he promptly reported all transactions and violations to Mr Dhingra, the then MD of the Company, as required by his role and responsibilities. He also submitted that the enquiry by SEBI was conducted in his absence as, by then, he had left the employment of Kwality.

The AO of SEBI, however, observed that as a compliance officer, Mr Srivastava was required to undertake all necessary steps to ensure that legal and regulatory compliances are adhered to, including the disclosures to the stock exchange on behalf of the Company. "Further, when the promoter and managing director, to whom he was reporting, non-executive director and designated persons of the Company were themselves non-compliant, prudently and ethically, Mr Srivastava could have brought the non-compliances observed by him to the attention of the Company board or independent director or committee of independent directors or stock exchange or SEBI. However, it is noted that Mr Srivastava did not take any such measures."

**Order –**

The Adjudicating officer (AO) of SEBI noted that from 1 March 2017 to 31 July 2018, Mr Srivastava failed to report non-compliances by 11 erring entities who indulged in either trading by insiders while having unpublished price sensitive information (UPSI), or in trading by designated persons when the trading window was closed or in contra trade by designated persons, or failed to make disclosure under SEBI (Prohibition of Insider Trading) Regulations being director of the Company, all of which were in contravention of code of conduct of the Company and PIT regulations. Mr Srivastava failed to fulfil his responsibilities, which were crucial for safeguarding the interest of investors.

While imposing a penalty of Rs2 lakh on Mr Srivastava, the then compliance officer of Kwality, the SEBI AO said that - "To protect the interest of all the investors and considering the past actions against Mr Srivastava, I feel appropriate to levy a penalty, which is commensurate with the nature of the violation and which acts as a deterrent factor for him and others in protecting the interest of the investors in the securities market."

**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.

q) 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) Require the person concerned to call upon any of its officers, other employees or representatives to refrain from dealing in securities in any particular manner,
(g) Prohibit the person concerned from disposing of any of the securities acquired in contravention of these regulations,
(h) Direct the person concerned to dispose of any such securities acquired in contravention of these regulations, in such manner as the Board may deem fit, for restoring the status quo ante.

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 lakhs were 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 lakhs to Rs. 25 lakhs. 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 lakhs 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.***"

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."*

The Act clarifies that:

i. 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;

ii. 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 Paragraph 2 of 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, in such manner as may be prescribed.

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 as mentioned in the Introduction part of this chapter.:

(1) Provisions of the PMLA stipulate that every banking company, financial institution and intermediary shall maintain a record.
As per Section 12 of the Act, 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.

(5) The Central Government may, by notification, exempt any reporting entity or class of reporting entities from any obligation under this Chapter.

**Section 12 AA of PMLA** stipulates enhanced due diligence by reporting entities. The details are given below:

(1) 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 fulfil 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[19].

*Explanation*. —For the purposes of this section, "specified transaction" means—

*(a)* any withdrawal or deposit in cash, exceeding specified amount;

*(b)* any transaction in foreign exchange, exceeding specified 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.

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:

(5) 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;

(6) 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;

(7) 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,

[19] For maintenance of records of transactions (nature and value) read PMLR at https://fiuindia.gov.in/files/AML_Legislation/notification.html . For example: Every reporting entity shall maintain the record of all transactions including the record of all cash transactions of the value of more **than ten lakhs** rupees or its equivalent in foreign currency.

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.

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:

(a) issue a warning in writing or
(b) direct such reporting entity or its designated director on the Board or any of its employees to comply with specific instructions or
(c) 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
(d) 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 proceedings.
   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 Master Circular on Guidelines on AML and CFT[20]

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 and the requirements as laid down in the PMLA and guidelines issued by the Government of India from time to time.

In case there is a variance in Client Due Diligence (CDD) / Anti Money Laundering (AML) standards specified by SEBI and the regulators of the host country, branches/overseas subsidiaries of registered intermediaries are required to adopt the more stringent requirements of the two.

If the host country does not permit the proper implementation of AML/CFT measures consistent with the home country requirements, financial groups shall be required to apply appropriate additional measures to manage the ML/TF risks, and inform SEBI.

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

[20] https://www.sebi.gov.in/legal/master-circulars/jun-2024/guidelines-on-anti-money-laundering-aml-standards-and-combating-the-financing-of-terrorism-cft-obligations-of-securities-market-intermediaries-under-the-prevention-of-money-laundering-act-2002-a-_83942.html

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[21]:

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 is 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 of policies and procedures, 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:

[21] https://www.sebi.gov.in/legal/master-circulars/jun-2024/guidelines-on-anti-money-laundering-aml-standards-and-combating-the-financing-of-terrorism-cft-obligations-of-securities-market-intermediaries-under-the-prevention-of-money-laundering-act-2002-a-_83942.html

- Communication of group policies relating to the prevention of money laundering and terrorist financing to all management and relevant staff that handle account information, securities transactions, money and client records etc. whether in branches, departments or subsidiaries;
- 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) Risk Management
(d) Monitoring of Transactions

**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 person on whose behalf a transaction is being conducted. It also

incorporates those persons who exercise ultimate effective control over a legal person or arrangement.

(b) Identify the clients, verify their identity using reliable and independent sources of identification, obtain information on the purpose and intended nature of the business relationship, where applicable;

(c) Verify the client's identity using reliable, independent source documents, data or information. Where the client purports to act on behalf of juridical person or individual or trust, the registered intermediary should verify that any person purporting to act on behalf of such client is so authorized and verify the identity of that person;

Provided that in case of a Trust, the reporting entity should ensure that trustees disclose their status at the time of commencement of an account-based relationship.

(d) 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. The beneficial owner shall be determined as prescribed by SEBI;

(e) 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);

(f) Understand the ownership and control structure of the client; and

(g) 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;

(h) Registered intermediaries should review the due diligence measures including verifying again the identity of the client and obtaining information on the purpose and intended nature of the business relationship, as the case may be, when there are suspicions of money laundering or financing of the activities relating to terrorism or where there are doubts about the adequacy or veracity of previously obtained client identification data.

(i) Registered intermediaries should periodically update all documents, data or information of all clients and beneficial owners collected under the CDD process such that the information or data collected under client due diligence is kept up-to-date and relevant, particularly for high risk clients.

(j) Every registered intermediary should register the details of a client, in case of client being a non-profit organisation, on the DARPAN Portal of NITI Aayog, if not already registered, and maintain such registration records for a period of five years after the business

relationship between a client and the registered intermediary has ended or the account has been closed, whichever is later.

(k) Where registered intermediary is suspicious that transactions relate to money laundering or terrorist financing, and reasonably believes that performing the CDD process will tip-off the client, the registered intermediary should not pursue the CDD process, and instead file a STR with FIU-IND.

(l) No transaction or account-based relationship should be undertaken without following the CDD procedure.

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 anonymous or in a fictitious name or on behalf of other persons whose identity has not been disclosed or cannot be verified;

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.

iii. The registered intermediaries shall undertake enhanced due diligence measures as applicable for Clients of Special Category (CSC). CSC[22] 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;
    f. Clients in high risk countries;
    g. Non-face to face clients;
    h. Clients with dubious reputation as per public information available etc.

[22]As defined in the 'Guidelines on Anti-Money Laundering (AML) Standards and Combating the Financing of Terrorism (CFT) /Obligations of Securities Market Intermediaries under the Prevention of Money Laundering Act, 2002 and Rules framed there under'.

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;

iv. 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.

v. It should be ensured that an account is not opened where the intermediary is unable to apply appropriate CDD measures. This should apply in cases where it is not possible to ascertain the identity of the client, or the information provided to the intermediary is suspected to be non - genuine, or there is perceived non - co-operation of the client in providing full and complete information. The registered 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 registered intermediary should be cautious to ensure that it does not return securities or money that may be from suspicious trades. However, the registered intermediary should consult the relevant authorities in determining what action it should take when it suspects suspicious trading.

vi. 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.

vii. 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.

viii. The CDD process should 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 (CIP) 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). Such procedures shall include seeking relevant information from the client, referring to publicly available information or accessing the commercial electronic databases of PEPs.

(b) All registered intermediaries are required to obtain senior management approval for establishing business relationships with Politically Exposed Persons (PEPs). Where a client has been accepted and the client or beneficial owner is subsequently found to be, or subsequently becomes a PEP, registered intermediaries shall obtain senior management approval to continue the business relationship.

(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. Considering 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 conduct ongoing due diligence where it notices inconsistencies in the information provided. The underlying objective should be to follow the requirements enshrined in the PMLA, SEBI Act and Regulations, directives and circulars issued thereunder so that the intermediary is aware of the clients on whose behalf it is dealing.

Every intermediary shall formulate and implement a CIP which shall incorporate the requirements of the PML Rules Notification No. 9/2005 dated July 01, 2005 (as amended from time to time), which notifies rules for maintenance of records of the nature and value of transactions, the procedure and manner of maintaining and time for furnishing of information and verification of records of the identity of the clients of the banking companies, financial

institutions and intermediaries of securities market and such other additional requirements that it considers appropriate to enable it to determine the true identity of its clients.

It may be noted that irrespective of the amount of investment made by clients, no minimum threshold or exemption is available to registered intermediaries (brokers, depository participants, AMCs etc.) from obtaining the minimum information/documents from clients as stipulated in the PML Rules/ SEBI Circulars (as amended from time to time) regarding the verification of the records of the identity of clients. Further no exemption from carrying out CDD exists in respect of any category of clients. In other words, there shall be no minimum investment threshold/ category-wise exemption available for carrying out CDD measures by registered intermediaries. This shall be strictly implemented by all registered intermediaries and non-compliance shall attract appropriate sanctions.

**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.

In cases where there is any suspected 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.

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.

Furthermore, all the registered intermediaries shall put in place a system of maintaining proper record of the nature and value of transactions as prescribed under AML/CFT Guidelines and PML Rules.

### 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 mentioned in Rule 3 of PML Rules need to be maintained and preserved for a period of five years from the date of transactions between the client and intermediary.

The registered intermediaries are required to formulate and implement the CIP containing the requirements as laid down in the PML Rules and such other additional requirements that it considers appropriate. 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.

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.

Furthermore, the registered intermediaries should apply client due diligence measures also to existing clients on the basis of materiality and risk, and conduct due diligence on such existing relationships appropriately. The extent of monitoring shall be aligned with the risk category of the client.

The intermediary should also ensure a record of the transactions is preserved and maintained as prescribed in the PMLA. Suspicious transactions shall also be regularly reported to the higher authorities within the intermediary.

The compliance cell of the intermediary shall randomly examine a selection of transactions undertaken by clients to comment on their nature i.e. whether they are in the nature of suspicious transactions or not.

**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 Designated/Principal 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 Designated/Principal 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) should 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)

Designation of officers for ensuring compliance with provisions of PMLA.

a) **Appointment of a Principal Officer:** The Principal Officer is an officer designated by a registered intermediary who should be an officer at the management level. The Principal Officer would act as a central reference point in facilitating onward reporting of suspicious transactions.

b) **Appointment of a Designated Director:** In addition to the existing requirement of designation of a Principal Officer, the registered intermediaries shall also designate a person as a 'Designated Director'. Designated director is a person designated by the reporting entity to ensure overall compliance with the obligations imposed under chapter IV of the PMLA Act and the Rules.

**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 wilful", 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 lakhs

   (c) Rs. 25 lakhs

   (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), have 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[23] 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.

The Hon'ble Supreme Court in its judgement dated April 30, 2025, emphasized the need for equal and accessible inclusion of persons with disabilities for availing financial services and directed to ensure that the process of digital KYC is accessible to persons with disabilities.

SEBI is committed to the cause of enabling equal access of services of its registered intermediaries to persons with disabilities, including persons with visual impairments and in order to make the digital KYC process inclusive and accessible.[24]

## 10.2 Registration as a KRA

[23]SEBI Circular Ref. No. MIRSD/Cir- 26 /2011 December 23, 2011.

[24]https://www.sebi.gov.in/legal/circulars/sep-2025/compliance-guidelines-for-digital-accessibility-circular-rights-of-persons-with-disabilities-act-2016-and-rules-made-thereunder-mandatory-compliance-by-all-regulated-entities-dated-july-31-2025-_96862.html

SEBI shall consider the application for the grant of a certificate of registration as a KRA from an applicant who is a fit and proper person[25] 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;
(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 net worth of at least Rs. 25 crores 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;

[25]As per the SEBI Intermediaries 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[26] 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.

[26]Inter-operability means the ability of the KRA to determine whether the KYC documents of the client are in the custody of another KRA.

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) 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.

i) Ensure that the integrity of the automatic data processing systems for electronic records is maintained at all times.

j) 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.

k) Have adequate mechanisms for the purposes of reviewing, monitoring and evaluating its controls, systems, procedures and safeguards.

l) 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.

m) 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.

n) Have checks built in its system so that an intermediary can access the information only for the clients who approach him.

o) 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.

p) Send a letter to each client after receipt of the KYC documents from the intermediary, confirming the client's details thereof.

q) 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.

r) KRA shall maintain an audit trail of any upload/ modification /download regarding the KYC records of each client.

s) The KRA shall ensure compliance with the Investor Charter specified by the Board from time to time.

t) All the registered KRAs shall take necessary steps to bring the Investor Charter,by way of:

a) disseminating the Investor Charter on their websites / through e-mail;

b) displaying the Investor charter at prominent places in offices etc. [27]

### 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

[27] https://www.sebi.gov.in/legal/circulars/may-2025/publishing-investor-charter-for-kyc-know-your-client-registration-agencies-kras-on-their-websites-_93811.html

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 and shall 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 who have 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.[28]

***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

[28] 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

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

# 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 2019, 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 subject to following conditions:

(i) the contribution of a single non-resident Indian (NRI) or overseas citizen of India (OCIs) or resident Indian (RI) individual should be below 25 percent of the total contribution in the corpus of the applicant.

(ii) the aggregate contribution of NRIs, OCIs and RI individuals in the corpus of the applicant shall be below 50 percent of the total contribution in the corpus of the applicant;

This provision should not be applicable to an applicant, regulated by the International Financial Services Centres Authority and based in the International Financial Services Centres in India and subject to conditions as may be specified by SEBI[29].

[29] https://www.sebi.gov.in/legal/circulars/jun-2024/participation-by-non-resident-indians-nris-overseas-citizens-of-india-ocis-and-resident-indian-ri-individuals-in-sebi-registered-fpis-based-in-international-financial-services-centres-in-india_84449.html

(iii) the contribution of RI individuals should be made through the Liberalised Remittance Scheme notified by the Reserve Bank of India and should be in global funds whose Indian exposure is less than 50 percent.

(iv) the NRIs, OCI and RI individuals should not be in control (right to appoint majority of directors, management decisions etc.) of the applicant.

(v) any other conditions as may be specified by SEBI from time to time.

The provisions of sub-clauses (i), (ii) and (iv) of clause (c) shall not be applicable to foreign portfolio investor who invests only in Government Securities, in accordance with the conditions as may be specified by SEBI from time to time.

Provided further that a mutual fund registered under the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996 may also be constituent of the applicant, subject to such conditions as may be specified by the Board from time to time[30]

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 Indians, other than individuals, may also be constituents of the applicant, subject to the following conditions, namely –

(i) the applicant is an Alternative Investment Fund or a Retail Scheme set up in the International Financial Services Centres and regulated by the International Financial Services Centres Authority;

(ii) such resident Indian, other than individuals, is a fund management entity or its associate of the applicant; and

(iii) the contribution of such resident Indian, other than individuals, shall be up to

(a) 10% of the corpus of the applicant in case the applicant is an Alternative Investment Fund; or

[30] https://www.sebi.gov.in/legal/regulations/dec-2025/securities-and-exchange-board-of-india-foreign-portfolio-investors-regulations-2019-last-amended-on-december-3-2025-_98240.html

(b) 10% of the Assets under Management in case the applicant is a Retail scheme;.

Explanation –'fund management entity' and 'associate' shall have the meaning as provided under International Financial Services Centres Authority (Fund Management) Regulations, 2025 as amended from time to time

Provided further that the provisions of sub-clause (ii) of clause (c) shall not be applicable to an applicant, regulated by the International Financial Services Centres Authority and based in the International Financial Services Centres in India and subject to conditions as may be specified by the Board: Provided further that the provisions of sub-clause (ii) of clause (c) shall not be applicable to a SWAGAT-FI.

Single Window Automatic and Generalised Access for Trusted Foreign Investor" or "SWAGAT-FI" shall, subject to conditions as may be specified by the Board from time to time, include the following:(i) Government and Government related investors as provided under sub-clause (i) of clause (a) of regulation 5 of these regulations; (ii) Public retail funds as defined in the Explanation clause under sub-regulation (4) of regulation 22 of these regulations;

The applicant is a resident of a country whose securities market regulator is a signatory to the International Organisation of Securities Commission's Multilateral Memorandum of Understanding or a signatory to a bilateral MoU with SEBI. Provided that an applicant being a 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.

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 the Bank for International Settlements;

The applicant or its underlying investors contributing more than the threshold prescribed under the Prevention of Money-laundering (Maintenance of Records) Rules, 2005] 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;

The applicant is a fit and proper person based on the criteria specified in Schedule II of the SEBI (Intermediaries) Regulations, 2008, and

Any other criteria specified by SEBI from time to time.

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(s)<br>(ii) Pension funds and university funds;<br>(iii) Regulated entities such as insurance or reinsurance entities, banks, asset management companies, investment managers, investment advisors, portfolio managers, broker-dealers and swap dealers;<br>(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<br>(v) An entity:<br>(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<br>(b) which is at least seventy-five per cent owned, directly or indirectly by another entity, eligible under sub-clause (points) (ii), (iii) and (iv) of this category under the 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;<br>ii) Endowments and foundations;<br>iii) Charitable organisations;<br>iv) Corporate bodies;<br>v) Family offices;<br>vi) Individuals; |

| | |
|---|---|
| | vii) Regulated entities investing on behalf of their client, as per conditions specified by SEBI from time to time<br>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 Application 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 an 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 recognised 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 recognised 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.

(3) 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) Subject to the compliance with the provisions of the Act, 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.

4) While accepting surrender applications, depository participants may impose such conditions as may be specified by SEBI.

Pertaining to surrender of registration, the designated depository participants must 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

SEBI vide master circular dated May 30, 2024 had issued following guidelines pertaining to the issuance of Offshore Derivative Instruments (ODIs) by Foreign Portfolio Investors (FPIs):

1. FPIs shall not be allowed to issue ODIs referencing derivatives. Further, no FPI shall be allowed to hedge their ODIs with derivative positions on stock exchanges in India.
2. As an exception to above clause, the following is permitted through a separate FPI registration of an ODI issuing FPI under Category I:
   a. Derivative positions that are taken on stock exchanges by the FPI for 'hedging of equity shares' held by it in India, on a one to one basis; and/or
   b. An ODI issuing FPI may hedge the ODIs referencing equity shares with derivative positions in Indian stock exchanges, subject to a position limit of 5% of market wide position limits for single stock derivatives. The permissible position limit for stock index derivatives is higher of INR 100 crores or 5% open interest; and/or
   c. An ODI issuing FPI, which hedges its ODI only by investing in securities (other than derivatives) held by it in India, cannot undertake proprietary derivative positions through the same FPI registration. Such FPI must segregate its ODI and proprietary derivative investments through separate FPI registrations in the manner prescribed by SEBI.
3. No fresh derivative position which are not in compliance with above requirements shall be allowed henceforth.
4. In determining whether a derivative instrument issued is an ODI or not, the threshold for trades with non-proprietary indices (e.g. MSCI World or MSCI EM Asia) as underlying shall be taken as 20%, i.e. those trades for which the materiality of Indian underlying is less than 20% of the index would not be regarded as ODIs, even if such exposure is hedged onshore in India. However, trades with custom baskets as underlying if hedged onshore would always be regarded as ODIs regardless of percentage of Indian component that is hedged onshore in India.

5. Synthetic short activities, where ODI are issued which has the effect of short sale in the Indian securities, continue to be prohibited for FPIs.
6. ODI issuer shall ensure that it has collected documents/ information enough to satisfy itself with regard to the relationship between the ODI subscriber and its Investment Manager from a FATF member country as allowed in explanation under Regulations 21 (1) (b) of the Regulations.

Investment restrictions as specified under the Regulation 20(7) of SEBI (Foreign Portfolio Investor) Regulations, 2019 shall apply to ODI subscribers also.

## 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;

a) price rigging or manipulation of prices of securities listed or proposed to be listed in any stock exchange in India;

b) passing of price-sensitive information to any person or intermediary in the securities market

Irrefutably, the FPIs are also required to refer to various operational guidelines through issued by SEBI from time to time.

**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.

## Case 11.2: SEBI fined Stock Holding Corporation of India (SHCIL) as a DDP

**Facts of the case:**

SEBI inspected documents and other records of SHCIL to verify the possible violations of the provisions of SEBI FPI regulations. During the inspection, SEBI observed non-maintenance of records and documents, registration of ineligible FPIs, discrepancies in the DDP manual, non-compliance with KYC and demat forms, non-compliance with fit and proper check, and failure to segregate activities and to maintain necessary infrastructure by SHCIL.

SEBI then issued a show cause notice (SCN) to the DDP. After perusing the response and documents submitted by SHCIL, the SEBI AO observed that the material available on record does not quantify any disproportionate gains or unfair advantage, if any, made by the DDP and the losses, if any, suffered by the investors due to such violations on its part.

From the document available on record, the SEBI AO noted that it was not ascertainable whether the acts of SHCIL are repetitive in nature. However, the role of a DDP is crucial as it is primarily responsible for the registration and on boarding of FPIs. Registration is with the objective of protecting the interests of the investors, as it casts accountability and responsibility upon the DDP to comply with all regulatory requirements applicable to the conduct of its business activity so as to promote the best interests of clients and the integrity of the market.

**Findings of the case:**

The adjudicating officer (AO) of SEBI said in the order that the irregularities on the part of SHCIL regarding non-maintenance of records and documents, registration of ineligible foreign portfolio investors (FPIs), discrepancies in the DDP manual, non-compliance with know-your-customer (KYC) form and demat form and fit and proper check, failure on its part to segregate activities and maintain necessary infrastructure and delay in forwarding audit report on internal controls does not absolve it from penalty. The irregularities on the part of SHCIL clearly shows that it has failed in its fiduciary duties owed to its clients.

**Order:**

SEBI imposed a fine of Rs.16 lakh on Stock Holding Corp of India Ltd (SHCIL), a designated depository participant (DDP), for non-compliance with rules and regulations, thus failing in fiduciary duties.

**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.

**(a) True**

(b) False

## CHAPTER 12: FOREIGN EXCHANGE MANAGEMENT ACT

**LEARNING OBJECTIVES:**

After studying this chapter, you should know about:

- FEMA and its relation with Securities Markets in India
- Foreign Direct Investment and different entry routes
- Foreign Investments under different PIS Schemes
- FEMA (Non Debt) Rules
- Different RBI Reporting Requirements

### 12.1 Introduction

The Foreign Exchange Management Act (FEMA) is an act of the Parliament of India that was enacted in 1999 to replace the Foreign Exchange Regulation Act (FERA) of 1973. FEMA aims to consolidate and amend the law relating to foreign exchange with the objective of facilitating external trade and payments and promoting the orderly development and maintenance of foreign exchange market in India.

Under FEMA, Reserve Bank of India (RBI ) is empowered to regulate and supervise all transactions involving foreign exchange, whether they are current account transactions or capital account transactions. Current account transactions are those that relate to the normal business activities of an individual or an entity, such as import and export of goods and services, travel, remittances,

etc. Capital account transactions are those that alter the assets or liabilities of an individual or an entity, such as foreign direct investment, portfolio investment, external commercial borrowing, etc.

RBI issues various rules, regulations, notifications, circulars and guidelines to implement the provisions of FEMA and to ensure compliance by the authorized dealers, banks, financial institutions, and other entities involved in foreign exchange transactions. RBI also monitors the inflow and outflow of foreign exchange and intervenes in the market to maintain the stability of the exchange rate and the balance of payments.

## 12.2 Relation Between FEMA and Securities Market In India

FEMA and the securities market in India are interrelated in various ways, as FEMA regulates and supervises the transactions involving foreign exchange in the securities market. FEMA plays a crucial role in facilitating the growth and development of the Indian economy by enabling the free flow of foreign exchange and fostering a conducive environment for foreign trade and investment. It also seeks to prevent the misuse of foreign exchange and to safeguard the national interest and security of the country.

## 12.3 Foreign Direct Investment in India

Foreign Direct Investment (FDI) in India is undertaken in accordance with the FDI Policy of the Government of India and governed by the provisions of the Foreign Exchange Management Act (FEMA), 1999. FEMA Regulations which prescribe amongst other things the mode of investments i.e. issue or acquisition of shares / convertible debentures and preference shares, manner of receipt of funds, pricing guidelines and reporting of the investments to the Reserve Bank.

### 12.3.1 Entry routes for investments in India

Under the Foreign Direct Investments (FDI) Scheme, investments can be made in shares, mandatorily and fully convertible debentures and mandatorily and fully convertible preference shares of an Indian company by non-residents through two routes:

- **Automatic Route:** Under the Automatic Route, the foreign investor or the Indian company does not require any approval from the Reserve Bank or Government of India for the investment.
- **Government Route:** Under the Government Route, the foreign investor or the Indian company should obtain prior approval of the Government of India (Foreign Investment Promotion Board (FIPB), Department of Economic Affairs (DEA), Ministry of Finance or Department of Industrial Policy & Promotion, as the case may be) for the investment.

### 12.3.2 Type of instruments

Indian companies can issue

i. equity shares,

ii. fully and mandatorily convertible debentures,

iii. fully and mandatorily convertible preference shares and

iv. warrants

v. subject to the pricing guidelines / valuation norms and reporting requirements amongst other requirements as prescribed under FEMA Regulations.

**12.3.3 Issue of shares**

**Pricing guidelines**

- **Fresh issue of shares:**

For listed companies:

Price of fresh shares issued to persons resident outside India under the FDI Scheme, shall be based on SEBI guidelines in case of **listed companies;**

For Unlisted companies:, the price shall not be less than fair value of shares determined by a SEBI registered Merchant Banker or a Chartered Accountant as per any internationally accepted pricing methodology on arm's length basis.

- **Partly paid shares:**

For listed companies:

The pricing of the partly paid equity shares shall be determined upfront and 25% of the total consideration amount (including share premium, if any), shall also be received upfront;

The balance consideration towards fully paid equity shares shall be received within a period of 12 months, if the issue size is Rs 500 crores or less.

For unlisted Indian companies:

The pricing of the partly paid equity shares shall be determined upfront and 25% of the total consideration amount (including share premium, if any), shall also be received upfront;

The balance consideration amount can be received after 12 months where the issue size exceeds Rs. 500 crores, subject to the appointment of a Monitoring Agency

**Warrants:**

Listed companies:

The pricing of the warrants and price/ conversion formula shall be determined upfront and 25% of the consideration amount shall also be received upfront.

The balance consideration towards fully paid up equity shares shall be received within a period of 18 months;

Unlisted companies:

The pricing of the warrants and price/ conversion formula shall be determined upfront and 25% of the consideration amount shall also be received upfront.

The price at the time of conversion should not in any case be lower than the fair value worked out, at the time of issuance of such warrants.

**Additional conditions for issue of partly paid shares and warrants**

(a) Prior approval of the Government will be required if the activity or sector requires permission for investments.

(b) The forfeiture of the amount paid upfront on non-payment of call money shall be in accordance with the provisions of the Companies Act, 2013 and Income tax provisions, as applicable;

(c) sectoral caps are not breached even after the shares get fully paid-up or warrants get converted into fully paid equity shares.

**Issue of shares by SEZs against import of capital goods:** In this case, the share valuation has to be done by a Committee consisting of Development Commissioner and the appropriate Customs officials.

**Right Shares:** The price of shares offered on rights basis by the Indian company to non-resident shareholders shall be:

i. In the case of shares of a company **listed** on a recognised stock exchange in India, at a price as determined by the company.

ii. In the case of shares of a company **not listed** on a recognised stock exchange in India, at a price which is not less than the price at which the offer on right basis is made to the resident shareholders.

**12.3.4 Mode of Payment**

An Indian company issuing shares /convertible debentures under FDI Scheme to a person resident outside India shall receive the amount of consideration required to be paid for such shares /convertible debentures by:

(i) inward remittance through normal banking channels.

(ii) debit to NRE / FCNR account of a person concerned maintained with an AD category I bank.

(iii) debit to non-interest bearing Escrow account in Indian Rupees in India which is opened with the approval from AD Category – I bank and is maintained with the AD Category I bank on behalf of residents and non-residents towards payment of share purchase consideration.

**Refund of consideration**: If the shares or convertible debentures are not issued within 180 days from the date of receipt of the inward remittance or date of debit to NRE / FCNR(B) / Escrow account, the amount of consideration shall be refunded.

### 12.3.5 Acquisition / transfer of existing shares (private arrangement)

A) Transfer of existing shares **from Resident to Non-resident**

**Listed companies:** ***Negotiated price, which is not less than*** the price arrived for preferential allotment of shares under the SEBI guidelines.

**Unlisted companies:**

The price shall not be less than the fair value worked out as per any internationally accepted pricing methodology for valuation of shares on arm's length basis, duly certified by a Chartered Accountant or a SEBI registered Merchant Banker.

**B)** Transfer of existing shares **by Non-resident to a Resident**

***Negotiated price which shall not be more than*** the minimum price at which the transfer of shares can be made from a resident to a non-resident ***as given above***.

The pricing of shares / convertible debentures / preference shares should be decided / determined upfront at the time of issue of the instruments or based on a conversion formula which has to be determined / fixed upfront, in accordance with the extant FEMA regulations. This is subject to the price at the time of conversion which should not be less than the fair value worked out, at the time of issuance of these instruments.

**C) Transfer of shares by a Person resident outside India**

**Non Resident to Non-Resident (Sale / Gift):**

A person resident outside India (other than NRI) may transfer by way of sale or gift, shares or convertible debentures to any person resident outside India (including NRIs).

**NRI to NRI (Sale / Gift):** NRIs may transfer by way of sale or gift the shares or convertible debentures held by them to another NRI.

**D) Non Resident to Resident (Sale / Gift)**

(i) **Gift:** A person resident outside India can transfer any security to a person resident in India by way of gift.

(ii) **Sale under private arrangement**

General permission is also available for transfer of shares / convertible debentures, by way of sale under private arrangement by a person resident outside India to a person resident in India subject to the following

a. The original and resultant investment comply with the extant FDI policy/ FEMA regulations;

b. The pricing complies with the relevant SEBI regulations (such as IPO, Book building, block deals, delisting, exit, open offer/ substantial acquisition / SEBI (SAST) and buy back); and

c. CA certificate to the effect that compliance with relevant SEBI regulations as indicated above is attached to the Form FC-TRS to be filed with the AD bank.

E) **Prior approval of the Government**:

Transfer of shares from a Non Resident to Resident other than under SEBI regulations and where the FEMA pricing guidelines are not met would require the prior approval of the Reserve Bank of India.

F) **Sale of shares/ convertible debentures on the Stock Exchange by person resident outside India:**

A person resident outside India can sell the shares and convertible debentures of an Indian company on a recognized Stock Exchange in India through a stock broker registered with stock exchange or a merchant banker registered with SEBI.

**G) Transfer of shares/convertible debentures from Resident to Person Resident outside India**

A person resident in India can transfer by way of sale, shares / convertible debentures (including transfer of subscriber's shares), of an Indian company under private arrangement to a person resident outside India, subject to compliance with SEBI Regulations & FEMA.

a) where the transfer of shares requires the prior approval of the FIPB as per extant FDI policy provided and the requisite FIPB approval has been obtained; and the transfer of share adheres with the pricing guidelines and documentation requirements as specified by the Reserve Bank of India from time to time.

b) **For listed companies**: where SEBI (SAST) guidelines are attracted, subject to adherence with the pricing guidelines and documentation requirements as specified by the Reserve Bank of India from time to time.

In case the pricing guidelines under FEMA are not met:

i) the resultant FDI shall be in compliance with the extant FDI policy and FEMA regulations in terms of sectoral caps, conditionalities (such as minimum capitalization, etc.), reporting requirements, documentation, etc.;

i) the pricing for the transaction shall be compliant with specific/explicit, extant and relevant SEBI regulations (such as IPO, book building, block deals, delisting, open/ exit offer, substantial acquisition/SEBI(SAST); and

iii) CA Certificate to the effect that compliance with relevant SEBI regulations as indicated above has been met shall be attached to the Form FC-TRS to be filed with the AD bank.

iv) The FDI policy and FEMA Regulations in terms of sectoral caps, conditionalities (such as minimum capitalization, etc.), reporting requirements, documentation etc., shall be complied with.

**H) Transfer of Shares by Resident which requires Government approval**

The following instances of transfer of shares from residents to non-residents by way of sale or otherwise requires Government approval:

(i) Transfer of shares of companies engaged in sector falling under the Government Route.

(ii) Transfer of shares resulting in foreign investments in the Indian company, breaching the sectoral cap applicable.

**Prior permission of the Reserve Bank in certain cases for acquisition / transfer of security**

(i) Transfer of shares or convertible debentures from residents to non-residents by way of sale requires prior approval of Reserve Bank in case ***where the non-resident acquirer proposes deferment of payment of the amount of consideration.***

(ii) A person resident in India, who intends to transfer any security, **by way of gift** to a person resident outside India, has to obtain prior approval from the Reserve Bank and

a) The gift does not exceed 5 per cent of the paid-up capital of the Indian company / each series of debentures / each mutual fund scheme.

b) The applicable sectoral cap limit in the Indian company is not breached.

c) The transferor (donor) and the proposed transferee (donee) are close relatives as defined in Section 6 of the Companies Act, 2013, as amended from time to time.

**(iii) Transfer of shares from NRI to NR requires the prior approval of the Reserve Bank of India.**

**Acquisition of shares under the FDI scheme by a non-resident on a recognized Stock Exchange**

A non resident including a Non Resident Indian may acquire shares of a listed Indian company on the stock exchange through a registered broker under FDI scheme provided that:

i. The non-resident investor has already acquired and continues to hold the control in accordance with SEBI (Substantial Acquisition of Shares and Takeover) Regulations;

II. The original and resultant investments are in line with the extant FDI policy and FEMA regulations in respect of sectoral cap, entry route, reporting requirement, documentation, etc;

Issue of shares through certain modes:

**A) Issue of Rights / Bonus shares**

An Indian company may issue Rights / Bonus shares to existing non-resident shareholders, subject to adherence to sectoral cap, reporting requirements, etc. and compliance with the

provisions of the Companies Act, 2013, SEBI (Issue of Capital and Disclosure Requirements), Regulations 2009, etc.

- **Additional allocation of rights share by residents to non-residents:** Existing non-resident shareholders are allowed to apply for issue of additional shares / convertible debentures / preference shares over and above their rights share entitlements. The investee company can allot the additional rights shares out of unsubscribed portion, subject to the condition that the overall issue of shares to non-residents in the total paid-up capital of the company does not exceed the sectoral cap.

**B) Issue of shares under Employees Stock Option Scheme (ESOPs)**

An Indian company may issue "employees' stock option" and/or "sweat equity shares" to its employees/directors or employees/directors of its holding company or joint venture or wholly owned overseas subsidiary/subsidiaries who are resident outside India, provided that :

a. The scheme has been drawn either in terms of regulations issued under the SEBI Act, 1992 and/or the Companies Act, 2013.

b. The Issue is in compliance with the sectoral cap applicable to the said company.

**C) Acquisition of shares under Scheme of Merger / Amalgamation**

In case of Mergers and amalgamations of companies in India ---the transferee company is allowed to issue shares to the shareholders of the transferor company resident outside India, subject to

- percentage of shareholding of persons resident outside India in the transferee or new company does not exceed the sectoral cap, and
- the transferor company or the transferee or the new company is not engaged in activities which are prohibited under the FDI policy.

**D) Issue of Non-convertible/ redeemable bonus preference shares or debentures:**

FEMA envisages issue of non-convertible/redeemable preference shares or debentures to non-resident shareholders by an Indian company by way of distribution as bonus from its general reserves under a Scheme of Arrangement approved by a Court in India under the provisions of the Companies Act, as applicable, subject to no objection from the Income Tax Authorities.

If the aforesaid securities are issued in the normal course other than the method mentioned above, companies will have to comply with A.P. (DIR Series) Circular Nos.73 and 74 dated June 8, 2007. In other words these will be treated as ECBs.

**Remittance of sale proceeds**: AD Category – I bank can allow the remittance of sale proceeds of a security (net of applicable taxes) to the seller of shares resident outside India, provided the security has been held on repatriation basis, the sale of security has been made in accordance with the prescribed guidelines and NOC / tax clearance certificate from the Income Tax Department has been produced.

**Remittance on winding up/liquidation of Companies**

AD Category – I banks have been allowed to remit winding up proceeds (net of applicable tax) of companies in India, which are liquidated pursuant to any order issued by the court winding up the company or the official liquidator in case of voluntary winding up under the provisions of the Companies Act, 2013.

## 12.4 Foreign investments under Portfolio Investment Scheme (PIS)

**Entities**

(i) Foreign Portfolio (FPIs) registered with SEBI are eligible to purchase shares, convertible debentures and warrants issued by Indian companies under the Portfolio Investment Scheme (PIS).

(ii) NRIs are eligible to purchase shares, convertible debentures and warrants issued by Indian companies under PIS, if they have been permitted by the designated branch of any AD Category - I bank.

**Investment in listed Indian companies by FPIs**

(a) An Individual FPI and SEBI approved sub accounts of FIIs together can invest up to

- a maximum of 10 per cent of the total paid-up capital or
- per cent of the paid-up value of each series of convertible debentures issued by the Indian company, acquired through any mode.

(b) Total holdings of all FPIs / SEBI approved sub accounts of FPIs put together shall not exceed24% of the paid-up capital or paid-up value of each series of convertible debentures.

The aforesaid limit can be increased to upto the limits of sectoral cap, after obtaining the approval of the Board of Directors and the shareholders of the Company.

**NRIs**

NRIs can invest through designated ADs, on repatriation and non-repatriation basis under PIS route

- up to 5 per cent of the paid- up capital / paid-up value of each series of debentures of listed Indian companies.

The aggregate paid-up value of shares / convertible debentures purchased by all NRIs cannot exceed 10 per cent of the paid-up capital of the company / paid-up value of each series of debentures of the company.

The aggregate ceiling of 10 per cent can be raised to 24 per cent by passing a resolution by its Board of Directors followed by a special resolution of the shareholders of the Company.

**Transfer of shares acquired under PIS under private arrangement**

Shares purchased by NRIs and FPIs on the stock exchange under PIS cannot be transferred by way of sale under private arrangement or by way of gift to a person resident in India or outside India without prior approval of the Reserve Bank.

**Exception**: NRIs can transfer shares acquired under PIS to their relatives as defined in Section 6 of Companies Act, 2013 or to a charitable trust duly registered under the laws in India

**Monitoring of investment position by RBI and AD banks**

The Reserve Bank monitors the investment position of FPIs/NRIs in listed Indian companies, reported by Custodian/designated AD banks, on a daily basis.

The respective designated bank (NRIs) / Custodian bank (FIIs) should monitor the individual limit of NRI / FPI to ensure that

i. it does not breach the prescribed limits.

ii. the trades are not undertaken in the prohibited sectors

iii. all trades are reported to them by monitoring the transactions in the designated account.

The onus of reporting of FPI and NRI transactions is on the designated custodian/AD bank, depository participant as well as the FPI/NRI making these investments. Caution List When the aggregate net purchases of equity shares of the Indian company by FIIs/NRIs/PIOs reaches the cut-off point of 2 per cent below the overall limit, the Reserve Bank cautions all the designated bank branches not to purchase any more equity shares of the respective company on behalf of any FPIs/ FIIs/ NRIs/ PIOs without prior approval of the Reserve Bank.

**Caution List**

When the aggregate net purchases of equity shares of the Indian company by FIIs/NRIs/PIOs reaches the cut-off point of 2 per cent below the overall limit, the Reserve Bank cautions all the designated bank branches not to purchase any more equity shares of the respective company on behalf of any FPIs/ FIIs/ NRIs/ PIOs without prior approval of the Reserve Bank.

## 12.5 Foreign Venture Capital Investments

**Investments by Foreign Venture Capital Investor**

A SEBI registered Foreign Venture Capital Investor (FVCI) with specific approval from the Reserve Bank can invest in equity / equity linked instruments / debt / debt instruments, debentures of an (a) Indian Venture Capital Undertaking (IVCU) or (b)Venture Capital Fund (VCF) or (c) in a scheme floated by such VCFs (subject to the condition that the domestic VCF is registered with SEBI), through initial public offer or private placement or by way of private arrangement or purchase from third party.

**Other Foreign Investments**

**<u>In cases of purchase of other securities by NRIs On non-repatriation basis</u>**

(a) NRIs can purchase shares, convertible debentures and warrants issued by an Indian company on non-repatriation basis without any limit.

(b) NRIs can also, without any limit, purchase on non-repatriation basis

- Government dated securities,

- treasury bills,
- units of domestic mutual funds,
- units of Money Market Mutual Funds.

NRIs can also invest in non-convertible debentures, redeemable preference shares issued by an Indian Company, both on repatriation basis and on non-repatriation basis.[31]

**NRI can purchase on repatriation basis, without limit,**

- Government dated securities or
- treasury bills or
- units of domestic mutual funds;
- bonds issued by a public sector undertaking (PSU) in India and
- shares in Public Sector Enterprises being disinvested by the Government of India.

## 12.6 Foreign Exchange Management (Debt Instruments) Regulation, 2019 (DI Regulations):

This was introduced to regulate investment in India by a Person Resident Outside India, in Debt instruments. Person resident outside India are classified into-

A. Foreign Portfolio Investor (FPI)
B. Non-Resident Indians or Overseas Citizens of India

Entities eligible to receive Debt funds:

- Indian Company
- Limited Liability Partnership
- Asset Reconstruction Companies
- Mutual Funds
- Venture Capital Fund

**Permission to Foreign Portfolio Investors (FPIs)**

An FPI may purchase the following debt instruments on repatriation basis subject to the terms and conditions specified by the Securities and Exchange Board of India and the Reserve Bank:

a) dated Government securities/ treasury bills;
b) non-convertible debentures/ bonds issued by an Indian company;
c) commercial papers issued by an Indian company;
d) units of domestic mutual funds or Exchange-Traded Funds (ETFs) which invest less than or equal to 50 percent in equity;

[31] Note: The amount invested under the scheme and the capital appreciation thereon will not be allowed to be repatriated abroad and the sale proceeds shall be credited to NRO account

e) Security Receipts (SRs) issued by Asset Reconstruction Companies; )
f) debt instruments issued by banks, eligible for inclusion in regulatory capital;
g) Credit enhanced bonds;
h) Listed non-convertible/ redeemable preference shares or debentures issued in terms of Regulation 6 of these Regulations;
i) Securitised debt instruments, including (i) any certificate or instrument issued by a special purpose vehicle (SPV) set up for securitisation of asset/s with banks, Financial Institutions or NBFCs as originators;
j) Rupee denominated bonds/ units issued by Infrastructure Debt Funds; Provided this will include such instruments issued on or after November 22, 2011 and held by deemed FPIs.
k) Municipal Bonds
l) exchange traded derivative contracts approved by SEBI.

**Permission to Non-resident Indians (NRIs) or Overseas Citizens of India (OCIs) – Repatriation basis**

Non-resident Indian (NRI) or an Overseas Citizen of India (OCI) may, without limit, purchase the following instruments on repatriation basis,

a) Government dated securities (other than bearer securities) or treasury bills or units of domestic mutual funds or Exchange-Traded Funds (ETFs) which invest less than or equal to 50 percent in equity;
b) Bonds issued by a Public Sector Undertaking (PSU) in India;
c) Bonds issued by Infrastructure Debt Funds;
d) Listed non-convertible/ redeemable preference shares or debentures
e) debt instruments issued by banks, eligible for inclusion in regulatory capital.

An NRI may subscribe to National Pension System governed and administered by PFRDA provided such person is eligible to invest as per the provisions of the PFRDA Act. The annuity/ accumulated saving will be repatriable.

**Permission to Non-resident Indians (NRIs) or Overseas Citizens of India (OCIs) – Non-Repatriation basis**

An NRI or an OCI may, without limit, purchase on non-repatriation basis, the following instruments:

a) dated Government securities (other than bearer securities), treasury bills, units of domestic mutual funds or Exchange-Traded Funds (ETFs) which invest less than or equal to 50 percent in equity, or National Plan/ Savings Certificates.
b) listed nonconvertible/ redeemable preference shares or debentures
c) subscribe to the chit funds authorised by the Registrar of Chits or an officer authorised by the State Government in this behalf.

**Taxes and Remittance of sale proceeds**: All transaction under these regulations shall be undertaken through banking channels in India and subject to payment of applicable taxes and other duties/ levied in India.

**Mode of Payment:**

1. The amount of consideration for purchase of instruments by FPIs shall be paid out of inward remittance from abroad through banking channels or out of funds held in a foreign currency account and/ or Special Non-Resident Rupee (SNRR) account maintained in accordance with the Foreign Exchange Management (Deposit) Regulations, 2016.
2. The amount of consideration for purchase of instruments by NRIs or OCIs on repatriation basis shall be paid out of inward remittances from abroad through banking channels or out of funds held in NRE/ FCNR(B) account maintained in accordance with the Foreign Exchange Management (Deposit) Regulations, 2016.
3. The amount of consideration for (a) purchase of instruments by NRIs or OCIs on non-repatriation basis and (b) subscriptions to the National Pension System by NRIs shall be paid out of inward remittances from abroad through banking channels or out of funds held in NRE/ FCNR(B)/ NRO account maintained in accordance with the Foreign Exchange Management (Deposit) Regulations, 2016.

**Remittance/ credit of sale/ maturity proceeds**:

**By FPI:**

(1) The sale/ maturity proceeds (net of taxes) of instruments held by FPI) may be remitted outside India or may be credited to the foreign currency account or SNRR account of the FPI.

**By NRI/OCI:**

(2) The net sale/ maturity proceeds (net of taxes) of instruments held by NRIs or OCIs, may be:

a. Credited to the NRO account person concerned where the instruments were held on non-repatriation basis

b. Credited to the NRO account person concerned where the payment for the purchase of the instruments sold was made out of funds held in NRO account, or

c. Remitted abroad or at the NRI/ OCI investor's option, credited to his NRE/FCNR(B)/NRO account, where the instruments were purchased on repatriation basis.

Remitted abroad or at the NRI/ OCI investor's option, credited to his NRE/ FCNR(B)/NRO account, where the instruments were purchased on repatriation basis.

In all other cases, the sale/ maturity proceeds (net of taxes) may be remitted abroad or credited to an account opened with the prior permission of the Reserve Bank.

## 12.7 Foreign Exchange Management (Non-debt Instruments) Rules, 2019

Non-debt Instruments means the following instruments; namely:-

a. all investments in equity instruments in incorporated entities: public, private, listed and unlisted;

b. capital participation in LLP;

c. all instruments of investment recognized in the FDI policy notified from time to time;

d. investment in units of Alternative Investment Funds (AIFs), Real Estate Investment Trust (REITs) and Infrastructure Investment Trusts (InvITs);

e. investment in units of mutual funds or Exchange-Traded Fund (ETFs) which invest more than 50% in equity;

f. junior-most layer (i.e. equity tranche) of securitization structure;

g. acquisition, sale or dealing directly in immovable property;

h. contribution to trusts; and

i. depository receipts issued against equity instruments

### 12.7.1 Reporting guidelines for Foreign Investments in India

**Fresh issuance of shares**:

Indian companies are required to report the details of the receipt of the amount of consideration for issue of shares / convertible debentures/ warrants , through an AD Category - I bank, together with a copy/ies of the FIRC/s evidencing the receipt of the remittance along with the KYC report on the non-resident investor from the overseas bank remitting the amount, within 30 days from the date of the receipt of the money.

The report would be acknowledged by the Regional Office concerned, which will allot a Unique Identification Number (UIN) for the amount reported.

**Annual Return on Foreign Liabilities and Assets:**

All Indian companies which have received FDI and/or made FDI abroad in the previous year(s) including the current year, should file the annual return on Foreign Liabilities and Assets (FLA) in the soft form to the Reserve Bank, Department of Statistics and Information Management, Mumbai by July 15 every year.

**Time frame within which shares have to be issued**

The equity instruments should be issued within 180 days from the date of receipt of the inward remittance or by debit to the NRE/FCNR (B) /Escrow account of the non-resident investor. Else, the amount of consideration so received should be refunded immediately to the non-resident investor

**Exception:** In exceptional cases, refund / allotment of shares for the amount of consideration outstanding beyond a period of 180 days from the date of receipt may be considered by the Reserve Bank, on the merits of the case.

**Reporting of issue of shares**

(a) After issue of shares (including bonus and shares issued on rights basis)/ partly paid shares to the extent equity shares are called up/ convertible debentures / convertible preference shares/warrants to the extent equity shares are called up , the Indian company has to file Form FC-GPR, through it's AD Category I bank, not later than 30 days from the date of issue of shares**.**

(b**) Form FC-GPR** has to be duly filled up and signed by Managing Director/Director/Secretary of the Company and submitted to the Authorised Dealer of the company, who will forward it to the concerned Regional Office of the Reserve Bank.

**Reporting of FDI for Transfer of shares**

Reporting of transfer of shares/ convertible debentures and partly paid shares and warrants to the extent the equity shares are called up between residents and non-residents and vice- versa

is to be made in Form FC-TRS . The Form FCTRS should be submitted to the AD Category – I bank, within 60 days from the date of receipt of the amount of consideration. The onus of submission of the Form FC-TRS within the given timeframe would be on the transferor / transferee, resident in India.

**Reporting of ESOPs for allotment of equity shares**

An Indian company issuing

- sweat equity shares
- employees' stock option
- shares issued against exercise of stock options

  -to its employees/directors or employees/directors of its holding company or joint venture or wholly owned overseas subsidiary/subsidiaries who are resident outside India

  -shall furnish to the Regional Office concerned of the Reserve Bank of India under whose jurisdiction the registered office of the company operates,

  -within 30 days from the date of issue of employees' stock option or sweat equity shares, in Form-ESOP.

**FII reporting:**

The AD Category – I banks have to ensure that the FIIs registered with SEBI who are purchasing various securities should report all such transactions details in the Form LEC (FII) to Foreign Exchange Department, Reserve Bank of India.

**Reporting of NRI investments under Portfolio Investment Scheme (PIS):**

The designated link office of the AD Category – I bank shall furnish to the Reserve Bank, a report on a daily basis on PIS transactions undertaken on behalf of NRIs for their entire bank.

**Review Questions**

1. Under FEMA, 'Import of goods of an entity' qualifies under which type of transaction?

**(a) Current account**

(b) Capital account

(c) Foreign direct investment

(d) Portfolio investment

2. In the case of partly paid up shares under the FDI scheme, the forfeiture of the amount paid upfront on non-payment of call money shall be in accordance with the provisions of _____.

(a) **Companies Act**

(b) SEBI Act

(c) SEBI Regulations

(d) RBI Regulations

3. Pick the INCORRECT answer: Indian companies can issue _____ to foreign investors under the FDI norms of FEMA.

(a) equity shares

(b) warrants

(c) **optionally convertible shares**

(d) fully and mandatorily convertible debentures

# CHAPTER 13: DEPOSITORIES ACT 1996

**LEARNING OBJECTIVES:**

After studying this chapter, you should know about:

- Rights and Obligations f 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.

## 13.1 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.

## 13.2 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. Thereafter, the depository shall make appropriate entries 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.

## 13.3 Enquiry and Inspection

SEBI may call upon any issuer, depository, depository participant or beneficial owner to furnish information in writing relating to the securities held in a depository. SEBI may also 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 the period specified by SEBI.

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 or participant or any person associated with securities market or to any issuer 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.

### 13.3.1 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;

Under Section 19B of the Depositories Act, 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 can be imposed;

Under Section 19C of the Depositories Act, if an entity (depository or participant or issuer or its agents or intermediary) fails to address investors' grievances after being asked by SEBI within the given time, a penalty will be imposed. The penalty 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;

Under Section 19D of the Depositories Act, for delay in dematerialization or issue of a certificate of securities, a penalty may be imposed. The penalty 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;

Further, as per Section 19F of the s Act, if any person fails to comply by the SEBI directions issued under section 19 of the Depositories 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, can be imposed on that person;

As per Section 19FA of the Depositories Act, a penalty for failure to conduct business in a fair manner can be imposed. If 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 made rules, regulations or the directions issued by SEBI under this Act, then it shall be liable to a 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.

As per Section 20 of the Act, without prejudice to any award of penalty 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 for a term which may extend up to 10 years, or with fine up to Rs. 25 crores, or with both.

## 13.4 Miscellaneous Issues

### 13.4.1 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.

### 13.4.2 Power to Grant Immunity

The 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.

### 13.4.3 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

## PART B- FUND BASED INTERMEDIARY SPECIFIC REGULATIONS

# CHAPTER 14: SEBI (MUTUAL FUNDS) REGULATIONS

**LEARNING OBJECTIVES:**

After studying this chapter, you should know about:

- Legal Structure and Key Features of Mutual Fund in India
- Types of Mutual fund products
- Scheme related disclosures, Portfolio disclosures, Board and Committees
- Risk Management Framework
- Investor Rights and Obligations

**Introduction**

Mutual fund is a vehicle (in the form of a "Trust") which mobilizes money from investors, for investing in different markets and securities, in accordance with the stated investment objectives. In other words, through investment in a mutual fund, an investor can invest in equities, bonds, money market instruments and/or other securities that may otherwise be unavailable to them and avail of the professional fund management services offered by an asset management company.

Mutual funds offer different kinds of schemes to cater to the need of diverse investors.

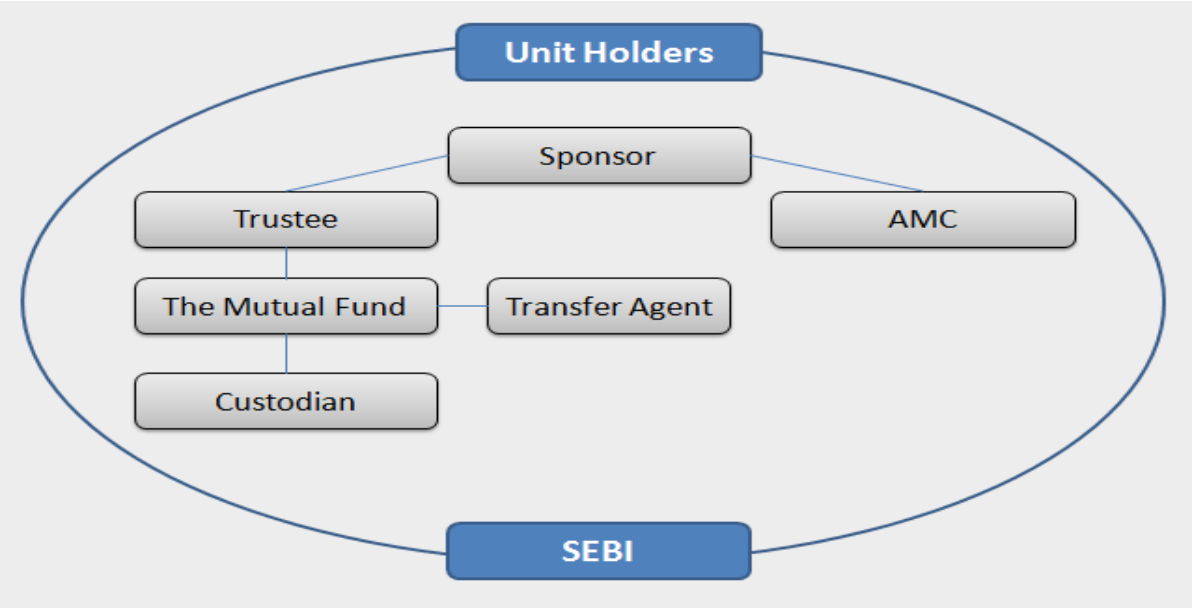
Every scheme of mutual fund has a pre-announced investment objective. Investors invest in a mutual fund scheme whose investment objective reflects their own needs and preference.

## 14.1 Structure of Mutual Fund

SEBI prescribes comprehensive set of guidelines for the functioning of a mutual fund through the "SEBI Mutual Funds (MF) regulations 1996". These regulations stipulate that a mutual fund must be a three-tiered structure consisting of:

- A Sponsor
- A Trustee
- An Asset Management Company (AMC)

While the above play the most important roles in creating and running a fund house, the custodian, registrar and transfer agent (RTA), auditors and the fund accountants play a vital supporting role in aiding the smooth functioning of a mutual fund.




As defined in SEBI (Mutual Fund) Regulations:

- **"Mutual fund"** means a fund established in the form of a trust to raise monies through the sale of units to the public or a section of the public under one or more schemes for investing in securities, money market instruments, gold or gold related instruments, silver or silver related instruments, real estate assets and such other assets and instruments as may be specified by SEBI from time to time.
- **"Sponsor"** means any person who, acting individually or in concert with another body corporate, establishes a mutual fund;
- **"Trustees"** mean the trustee company that holds the property of the mutual fund in trust for the benefit of the unit holders

## 14.2 Key Features of a Mutual Fund (MF)

- A mutual fund shall be constituted in the form of a Trust
    - The Deed is registered under the provisions of the Indian Registration Act, 1908,
    - The mutual fund trust is created by one or more Sponsors.
- Every Trust has beneficiaries.
    - The beneficiaries, in the case of a mutual fund trust, are the investors who invest in various schemes of the mutual fund, called unit-holders.
- The operations of the mutual fund trust are governed by a Trust Deed, which is executed between the sponsors and the trustees.

- MFs raise money through the sale of units to the public or a section of the public
- The units are sold under one or more schemes
- The schemes invest in securities (including money market instruments) or gold or gold-related instruments or silver or silver related instruments or real estate assets.
- Every mutual fund shall be registered with SEBI.
- A single mutual fund can float different schemes, but they have to be individually approved by the trustees and all offer documents have to be filed with the SEBI.
- SEBI lays down certain restrictions on the fees that AMCs can charge for mutual funds and there is also a cap on the expenses that can be added to the fund.
- Mutual funds can advertise, but advertisements cannot have statements that are misleading. For instance, no mutual fund can guarantee a return since returns depend on market performance.
- Day to day management of the scheme is handled by an Asset Management Company (AMC). The AMC is appointed by the sponsor or the Trustees.
- Investors invest in various schemes of the mutual fund. The record of investors and their unit-holding may be maintained by the AMC itself, or through appointed Registrar & Transfer Agent (RTA).

## 14.3 Important Concepts / Terminologies

- **Units:** The investment that an investor makes in a scheme is in the form of a certain number of 'Units' in the scheme. Thus, an investor in a scheme is issued units of the scheme.
- **Face Value** -Typically, every unit has a face value of Rs. 10.
- The total number of units issued by a scheme multiplied by its face value (Rs. 10) is the capital of the scheme–its Unit Capital.
- **Recurring Expenses** -The fees or commissions paid for various expenses are charged to the mutual fund scheme. These are known as recurring expenses.
    - These expenses are charged as a percentage to the scheme's assets under management (AUM).
    - The scheme expenses are deducted while calculating the NAV.
- **Net Asset Value-** The true worth of a unit of the mutual fund scheme is otherwise called Net Asset Value (NAV) of the scheme and is computed in the manner provided in sub-regulation (1) of regulation 48 of Mutual fund regulations
- **Assets Under Management** The sum of all investments made by investors in the mutual fund scheme is the entire mutual fund scheme's size, which is also known as the scheme's Assets

Under Management (AUM).

- **Mutual fund scheme categorization**
    - MF Lite for passively managed schemes
    - Equity Schemes
    - Debt Schemes
    - Hybrid Schemes
    - Solution Oriented Schemes
    - Other Schemes
- **"Capital protection oriented scheme"** means a mutual fund scheme which is designated as such and which endeavours to protect the capital invested therein through suitable orientation of its portfolio structure;
- "**Close-ended scheme**" means any scheme of a mutual fund in which the period of maturity of the scheme is specified;
- **"Custodian"** means a person who has been granted a certificate of registration to carry on the business of custodian of securities under the SEBI (Custodian of Securities) Regulations, 1996;
- **"Equity related instruments**" include convertible debentures, convertible preference shares, warrants carrying the right to obtain equity shares, equity derivatives and such other instrument as may be specified by SEBI from time to time;
- **"Exchange traded fund**" means a mutual fund scheme that invests in securities in the same proportion as an index of securities and the units of exchange traded fund are mandatorily listed and traded on exchange platform
- "**Fund of funds scheme**" means a mutual fund scheme that invests primarily in other schemes of the same mutual fund or other mutual funds;
- "**Gold exchange traded fund scheme**" shall mean a mutual fund scheme that invests primarily in gold or gold related instruments;
- "**Gold related instrument**" shall mean such instrument having gold as underlying, as may be specified by SEBI from time to time;
- **"Index fund scheme"** means a mutual fund scheme that invests in securities in the same proportion as an index of securities;
- **"InvIT" or "Infrastructure Investment Trust"** shall have the meaning assigned in clause (za) of sub-regulation (1) of regulation 2 of the Securities and Exchange Board of India (Infrastructure Investment Trusts) Regulations, 2014

- **"Money market instruments"** includes commercial papers, commercial bills, treasury bills, Government securities having an unexpired maturity up to one year, call or notice money, certificate of deposit, usance bills, and any other like instruments as specified by the Reserve Bank of India from time to time;
- **"Money market mutual fund"** means a scheme of a mutual fund which has been set up with the objective of investing exclusively in money market instruments;
- **"Networth"** means the aggregate of the paid up capital and free reserves after deducting therefrom, miscellaneous expenditure to the extent not written off or adjusted or deferred revenue expenditure, intangible assets and accumulated losses;
- **"Offer document"** means any document by which a mutual fund invites public for subscription of units of a scheme;
- **"Open-ended scheme"** means a scheme of a mutual fund which offers units for sale without specifying any duration for redemption;
- **"REIT" or "Real Estate Investment Trust"** mean a trust registered as such under the SEBI (Real Estate Investment Trusts) Regulations, 2014.
- **"Real estate mutual fund scheme"** means a mutual fund scheme that invests directly or indirectly in real estate assets or other permissible assets in accordance with these regulations;
- **"Silver exchange traded fund scheme"** shall mean a mutual fund scheme that invests primarily in silver or silver related instruments;
- **"Silver related instrument"** shall mean such an instrument as may be specified by SEBI from time to time, which has silver as the underlying product;
- **"Unit"** means the interest of the unit holders in a scheme, which consists of each unit representing one undivided share in the assets of a scheme.
- **"Unit holder"** means a person holding unit in a scheme of a mutual fund.

## 14.4 Role of Stakeholders In A Mutual Fund:

The role of the main stakeholders viz., Sponsor, Trustees and Asset Management Company (AMC) are detailed below:

### 14.4.1 Sponsor

- The Sponsor is the main body that establishes the Mutual fund and can be compared to a promoter of a company. It could be a bank, a corporate or a financial institution. A private equity fund or a pooled investment vehicle or a pooled investment fund may also be permitted to sponsor mutual funds.
- The responsibility of the Sponsor includes appointing the Trustees with the approval of

SEBI and setting up an AMC under the Companies Act, 2013

***Eligibility***: The sponsor

- should have a sound track record of carrying out business in the financial services space for not less than five years.
- Shall ensure that the networth is positive in all the immediately preceding 5 years;
- ensure that the positive liquid networth is more than the proposed capital contribution of the sponsor in the AMC
- ensure that in case of change in control of the existing AMC due to acquisition of shares, the positive liquid net worth of the sponsor or funds tied up by the sponsor is to the extent of aggregate par value or market value of the shares proposed to be acquired, whichever is higher
- has net profit after providing for depreciation, interest and tax in each of the immediately preceding 5 years;
- has average net annual profit after depreciation, interest and tax during the immediately preceding five years of at least Rs 10 crores.
- is a fit and proper person;
- should contribute a minimum of 40% to the net worth of the AMC.
- or any of its directors or the principal officer to be employed by the mutual fund should not have been guilty of fraud or has not been convicted of an offence involving moral turpitude or has not been found guilty of any economic offence

**In case of Non-fulfillment of the above conditions related to sound track record**:

The Sponsor should:

- capitalize the asset management company such that the net worth of the AMC is not less than Rs 150 crores.
- ensure that the initial capital contributed by the Sponsor to the extent of Rs.150 crores is locked in for 5 years
- appoint experienced personnel in asset management company such that the total combined experience of Chief Executive Officer, Chief Operating Officer, Chief Risk Officer, Chief Compliance Officer and Chief Investment Officer should be at least thirty years

### 14.4.2 Trustee

***"Trustees" mean the trustee company that holds the property of the mutual fund in trust for the benefit of the unit holders:"*** *(In other words, the main role of a trustee is to ensure that the interest of the unit holders is protected while making sure that the mutual fund complies with all the regulations of SEBI.* Trustees play a critical role as far as maintaining the investors' trust and tracking the fund's growth.

Some of the key responsibilities of the Trustees include, entering into an investment management agreement with the AMC to define its functioning.

- All the schemes require prior approval of the Trustees before their launch.
- The trustees review all the transactions of the AMC on a quarterly basis before filing reports to SEBI on a half-yearly basis.
- The Trustees would be responsible for the appointment of an AMC to manage the assets of the Fund.
- SEBI mandates a minimum of 2/3rd independent directors on the AMC Board.
- Trustees are required to meet at least 4 times a year to review the functioning of AMC.

**Two-thirds of the trustees shall be independent persons** and shall not be associated with the Sponsor in any manner.

In case a company is appointed as the Trustee of a mutual fund, the Chairperson of the board of directors of that Trustee company shall be an independent director.

**Disqualification from being appointed as a Trustee:**

No person shall be eligible to be appointed as a Trustee unless—
(a) he is a person of ability, integrity, and standing; and
(b) has not been found guilty of moral turpitude; and
(c) has not been convicted of any economic offence or violation of any securities laws; and
(d) has furnished particulars as specified in Form C of the SEBI MF Regulations

No asset management company and no director (including independent director), officer or employee of any other asset management company shall be eligible to be appointed as a Trustee of any mutual fund.

A Trustee of a mutual fund cannot be a trustee of any other mutual fund

**<u>Agreements:</u>**

- The trustees and the asset management company shall with the prior approval of SEBI enter into an investment management agreement.
    - The investment management agreement shall contain such clauses as are mentioned in the Fourth Schedule to the Mutual Fund Regulations

**Rights of Trustees:**

Trustees shall -

- approve each new scheme floated by AMC.
- request any necessary information from the AMC concerning the operations of various schemes.
- take any necessary action against AMC if they found AMC operations are not as per the SEBI regulations.
- receive fee for their services.
- hold the investments of the Fund in trust.
- seek remedial actions from AMC
- approve the policy for empanelment of brokers by the asset management company

**Obligations of Trustees**:

Each trustee shall file the details of his transactions with the Mutual Fund. The Trustees:

a) Shall be accountable for and be the custodian of the funds and property of the respective schemes and shall hold the same in trust for the benefit of the unitholders.

b) Shall take steps to ensure that the transactions of the mutual fund are in accordance with the provisions of the trust deed.

c) Shall obtain the consent of the unitholders—

(a) whenever required to do so by SEBI in the interest of the unitholders; or
(b) whenever required to do so on the requisition made by three-fourths of the unit- holders of any scheme; or
(c) when the majority of the trustees decide to wind up a scheme

d) Shall ensure that no change in the fundamental attributes of any scheme, the fees and expenses payable or any other change which would modify the scheme and affect the interest of the unit holders is carried out by the asset management company.

Shall call for the details of transactions in securities by

- the key personnel of the asset management company in his own name or on behalf of the asset management company and shall report to the Board, as and when required.

e) Shall quarterly review all transactions carried out between the mutual funds, asset management company and its associates

f) Shall periodically review the service contracts relating to custody arrangements

- the investor complaints received and

- the redressal of the same by the asset management company

g) Shall ensure that

- the asset management company has been managing the mutual fund schemes independently of other activities;
- adequate steps have been taken to ensure that the interest of investors of one scheme are not being compromised with those of any other scheme or of other activities of the asset management company;
- there is no conflict of interest between the manner of deployment of its networth by the asset management company and the interest of the unit- holders.
- Shall approve the policy for empanelment of brokers by the AMC and shall ensure that the AMC has been diligent in empanelling the brokers
- AMC has not given any undue or unfair advantage to any associates
- AMC enters into transactions only in accordance with these regulations and the scheme.

h) Shall abide by the Code of Conduct as specified in the Fifth Schedule to the Mutual Fund Regulations

i) Shall furnish to the Board on a half-yearly basis,—

(a) a report on the activities of the mutual fund;
(b) a certificate stating that the trustees have satisfied themselves that there have been ***no instances of self-dealing or front running by any of the trustees, directors and key personnel of the asset management company;***
(c) a certificate to the effect that the asset management company has been managing the schemes independently of any other activities.

The independent trustees shall give their comments on the report received from the asset management company regarding the investments by the mutual fund in the securities of group companies of the Sponsor

**14.4.3 Other Obligations and Due Diligences**

There are some general due diligences and some specific ones which the Trustees and the AMC directors need to exercise

- General Due Diligence &
- Specific Due Diligence

**General Due Diligence**

- Appointment / formation of AMC & its directors
- Observance of AMC functioning and desirability of its continuance

- Protection of Trust property
- Ensuring that all constituents and associations are registered entities
- Review of service contracts and terms
- Reporting to SEBI any special developments in the mutual fund

**Specific Due Diligence**

- Appoint independent auditor and obtain from them I nternal audit reports of AMC at regular intervals
- Obtain compliance certificates at regular intervals from the asset management company. Prepare and adhere to a code of ethics for trustees and for AMC and its personnel
- Maintain records of the decisions of the Trustees and the minutes of the meetings
- Communicate in writing to the asset management company of the deficiencies and checking on the rectification of deficiencies

**Duties of Independent Directors of the Trustees/ AMC**: They shall pay attention to:

i. the Investment Management Agreement and the compensation paid under the agreement,

ii. service contracts with associates - whether the asset management company has charged higher fees than outside contractors for the same services,

iii. selection of the asset management company's independent directors,

iv. securities transactions involving associates to the extent such transactions are permitted,

v. selecting and nominating individuals to fill independent director's vacancies

vi. code of ethics which is designed to prevent fraudulent, deceptive or manipulative practices by insiders in connection with personal securities transactions,

vii. the reasonableness of fees paid to sponsors, asset management company and any others for services provided,

viii. principal underwriting contracts and their renewals,

ix. any service contract with the associates of the AMC.

**14.4.4. Asset Management Company (AMC):** AMC is the investment manager of the Trust. It takes care of the day-to-day operations of the mutual fund and managing the investor's money as well.

**Formation**: AMC, which is approved by SEBI, is appointed/ formed either by the trustee or the Sponsor.

**Supervision:** The AMC is supervised by its own board of directors and also the directors of Trustees.

AMC can be terminated by majority of the trustees or by 75% of the unitholders of the scheme.

**The AMC consists of**

- the Chief Investment Officer, the fund managers and analysts, who are together responsible for managing the various schemes launched.
- The compliance officer ensures compliance of all the activities of the AMC in line with SEBIs rules and regulations.

**Net worth Requirement**: The AMC of a MF must have a net worth of at least Rs.50 Crores at all times.

**Requisites:**

- Director of AMC should have experience in finance and financial services related field.
- Key personnel of the AMC should have not been found guilty of moral turpitude or convicted of economic offence or violation of securities laws.
- The board of directors of AMC should have at least 50% directors, who are not associate of, or associated in any manner with, the sponsor or any of its subsidiaries or the trustees.

**Fees:** The AMC gets a fee for managing the funds.

**Restriction on AMC**

- An AMC cannot engage in any business other than management and advisory services.
- A Director of an Asset Management company cannot be on another AMC.
- An AMC cannot act as a Trustee of any Mutual Fund.

**Obligation of AMC & its directors**

- Take all reasonable steps and exercise due diligence to ensure that the investment of funds pertaining to any scheme is not contrary to the provisions of the regulations and the trust deed.
- Exercise due diligence and care in all its investment decisions
- Obtain prior in-principle approval from the recognized stock exchange(s) where units are proposed to be listed.

- Submit to the trustees, quarterly reports on its activities and the compliance with the regulations.
    - Appoint registrars and share transfer agents who are registered with SEBI.
    - Shall invest such amounts in such schemes of the mutual fund, based on the risks associated with the schemes, as may be specified by SEBI.
    - The asset management company and the sponsor of the mutual fund shall be liable to compensate the affected investors and/or the scheme for any unfair treatment to any investor as a result of inappropriate valuation.

**The Chief Executive Officer** of the Asset Management Company shall ensure that,

- the mutual fund complies with all the provisions of these regulations and the guidelines or circulars issued;
- has adequate systems in place to ensure that the Code of Conduct for Fund Managers and Dealers.

The **fund managers** shall ensure that the funds of the schemes are invested to achieve the objectives of the scheme and in the interest of the unit holders.

**AMC shall not -**

**Purchase or sell securities** through any broker associated with the sponsor, in case deals executed through him is average of 5 per cent or more of the aggregate purchases and sale of securities made by the mutual fund in all its schemes, justification is to be recorded in case it exceeds 5 percent.

- **Invest in any of its scheme**, unless full disclosure of its intention to invest has been made in the offer documents.
- **Utilise the services** of the sponsor or any of its associates, employees or their relatives, for the purpose of any securities transaction and distribution and sale of securities.
- **Appoint any person** as key personnel who has been found guilty of any economic offence or involved in violation of securities laws.

**AMC shall file with the Trustees / Board:**

- The details of transactions in securities by the key personnel of the asset management company in their own name or on behalf of the asset management company and shall report the same to the Board
- Detailed bio-data of all its directors along with their interest in other companies within fifteen days of their appointment;
- Any change in the interests of directors to be provided every six months; and

- A quarterly report to the trustees giving details and adequate justification about the purchase and sale of the securities of the group companies of the sponsor or AMC, as the case may be, by the mutual fund during the said quarter.
- Each director of the AMC shall file with the trustees on a quarterly basis the details of his transactions of dealing in securities

### 14.4.5 Role of other Intermediaries

**Custodian**

- Is appointed by the mutual fund and SEBI shall be intimated within 15 days of the appointment.
- Is responsible for the safe keeping of all the securities bought by the AMC.
- Is liable for keeping the investment account of the mutual fund.
- Shall collect dividends and investment payments due on the mutual funds investment
- Shall track corporate actions like bonus issues, right offers, offer for sale, buy back and open offers for acquisition.

**Registrar And Transfer Agent (RTA)**

- Maintains and updates all the investors records.
- Processes investor application, handle purchase and redemption transactions by investors in various schemes and plans.

**Distributors**

- AMC appoints a distributor who sells mutual fund units to investors on behalf of the fund house.
- A sponsor or an associate may act as distributors of AMC. (For example, Bank which is a sponsor of Mutual Fund Company may act as distributor also for selling its mutual funds products).
- AMC has the right to empanel the Distributor for selling its MF scheme.
- AMC fixes the commission structure which is offered to the distributors
- A distributor can act as a distributor for several MFs
- For all employees and distributors of MF, NISM certification examination has been made mandatory by SEBI.
- All distributors are required to be registered with AMFI and obtain AMFI Registration Number (ARN) pursuant to qualifying the NISM certification examination.

## 14.5 Schemes of Mutual Fund

Broadly, the Schemes have been formulated as under:

- **Mutual fund scheme categorization**

    - Equity Schemes (11 sub-categories)
    - Debt Schemes (16 sub-categories)
    - Hybrid Schemes (6 sub-categories)
    - Solution Oriented Schemes (2 sub-categories)
    - Other Schemes (2 sub-categories)

Within the aforesaid categorisation, the Schemes can further be classified as

"**Close-ended funds**" have fixed maturity. Investors can buy units of a close-ended scheme, from the fund, only during its NFO In case of a Close ended scheme/Interval scheme -the Scheme(s) and individual Plan(s) under the Scheme(s) shall have (a) A minimum of 20 investors and (b) no single investor shall account for more than 25% of the corpus of the Scheme(s)/Plan(s).

**"Open-ended funds"** allows the investors to enter and exit at any time, after the NFO; Investors can buy additional units in the scheme any time after the scheme opens for ongoing transactions. In case of an open-ended scheme, the Scheme/Plan shall have (a) a minimum of 20 investors and (b) no single investor shall account for more than 25% of the corpus of the Scheme/Plan(s).

**"Interval Funds"** combine features of both open-ended and close-ended schemes. They are largely close-ended but become open-ended at pre-specified intervals.

**Specialized Investment Funds (SIF)[32]:**

Specialized Investment Funds (SIFs) are a category of investment vehicles introduced by SEBI in India to bridge the gap between Mutual Funds and Portfolio Management Services (PMS). They offer a hybrid structure that combines the regulatory oversight of mutual funds with the flexibility and customization of PMS. SIF has a limit of Minimum ₹10 lakh per investor at the PAN level across all SIF strategies of an AMC. The Accredited Investors are extempt from this limit.

**Eligibility criteria for Specialized Investment Fund :**
According to Regulation 49W(1) of the SEBI (Mutual Funds) Regulations, 1996, a mutual fund registered under Regulation 9 may be allowed to set up a Special Investment Fund (SIF), provided it meets the eligibility criteria and follows the process specified by SEBI.

[32] https://www.sebi.gov.in/legal/circulars/feb-2025/regulatory-framework-for-specialized-investment-funds-sif-_92299.html

The fund manager of Specialized Investment Funds shall have the relevant NISM certification as may be specified by the Board from time to time.

Route 1: Strong Track Record

- The mutual fund must have been operational for at least 3 years.
- It must have maintained an average Asset Under Management (AUM) of at least ₹10,000 crore over the last 3 years.
- No action should have been taken against the sponsor or Asset Management Company (AMC) under Sections 11, 11B, or 24 of the SEBI Act, 1992 in the past 3 years.

Route 2: Alternate Route

- The AMC must appoint:
    - A Chief Investment Officer (CIO) for the SIF with at least 10 years of fund management experience and an average AUM of ₹5,000 crore.
    - An additional Fund Manager for the SIF with at least 3 years of fund management experience and an average AUM of ₹500 crore.

- No action should have been taken against the sponsor or AMC under Sections 11, 11B, or 24 of the SEBI Act, 1992 in the past 3 years.

**Other Specialised Fund Schemes**

**Mutual Fund Lite:**
The provisions of this Chapter shall be applicable to mutual funds lite and mutual fund lite schemes.
**Eligibility Criteria for Mutual Fund Lite (MFL)**
An applicant seeking a **Certificate of Registration as a Mutual Fund Lite** must satisfy the following eligibility conditions:

1. **Application to SEBI**
- The applicant must submit a formal application to SEBI in the prescribed format seeking registration as a Mutual Fund Lite.

2. **Sponsor Criteria**
- The applicant must have a **sponsor/promoter** with adequate financial strength and a proven track record in financial services or capital markets.

3. **Net Worth Requirement**
- The applicant must meet the **minimum net worth criteria** specified by SEBI at the time of application.

4. **Management and Infrastructure**

- The applicant must demonstrate the availability of **qualified professionals, systems, technology, and infrastructure** required to run the Mutual Fund Lite efficiently and compliantly.

### 14.5.1 Real Estate Mutual Fund Schemes

**"Real estate asset**" means an identifiable immovable property-

(i) which is located within India in such city as may be specified by the Board from time to time or in a special economic zone within the meaning of clause (za) of section 2 of the Special Economic Zones Act, 2005 (28 of 2005);
(ii) on which construction is complete and which is usable;
(iii) which is evidenced by valid title documents;
(iv) which is legally transferable;
(v) which is free from all encumbrances;
(vi) which is not subject matter of any litigation;

but does not include-

I. a project under construction; or
II. vacant land; or
III. deserted property; or
IV. land specified for agricultural use; or
V. a property which is reserved or attached by any Government or other authority or pursuant to orders of a court of law or the acquisition of which is otherwise prohibited under any law for the time being in force;

**Permissible investments**

(1) Every real state mutual fund scheme shall invest at least 35% of the net assets of the scheme directly in real estate assets.
(2) Subject to the above, every real estate mutual fund scheme shall invest-

(a) at least 75% of the net assets of the scheme in-
(i) real estate assets;
(ii) mortgage backed securities (but not directly in mortgages);
(iii) equity shares or debentures of companies engaged in dealing in real estate assets or in undertaking real estate development projects, whether listed on a recognized stock exchange in India or not;
(b) the balance in other securities;

(3) Unless otherwise disclosed in the offer document, no mutual fund shall, under all its real estate mutual fund schemes, invest

1. more than 30% of its net assets in a single city.
2. more than 15% of its net assets in the real estate assets of any single real estate project.
3. more than twenty five per cent of the total issued capital of any unlisted company.

4. more than fifteen per cent of the net assets of any of its real estate mutual fund schemes in the equity shares or debentures of any unlisted company.

(4) No real estate mutual fund scheme shall invest in –

(a) any unlisted security of the sponsor or its associate or group company;

(b) any listed security issued by way of preferential allotment by the sponsor or its associate or group company;

(c) any listed security of the sponsor or its associate or group company, in excess of twenty five per cent of the net assets of the scheme.

(5) No mutual fund shall transfer real estate assets amongst its schemes

(6) No mutual fund shall invest in any real estate asset which was owned by the sponsor or the asset management company or any of its associates during the period of last five years or in which the sponsor or the asset management company or any of its associates hold tenancy or lease rights.

### 14.5.2 Infrastructure Debt Fund Schemes

"Infrastructure debt fund scheme" means a mutual fund scheme that invests primarily (minimum 90% of scheme assets) in the debt securities or securitized debt instrument of -

a. infrastructure companies or

b. infrastructure capital companies or

c. infrastructure projects or

d. special purpose vehicles which are created for the purpose of facilitating or promoting investment in infrastructure, and

e. other permissible assets in accordance with these regulations or

f. bank loans in respect of completed and revenue generating projects of infrastructure companies or projects or special purpose vehicles.

Balance may be invested in equity shares, convertibles including mezzanine financing instruments of companies engaged in infrastructure, infrastructure development projects, whether listed on a recognized stock exchange in India or not; or money market instruments and bank deposits.

Investment in debt instruments or assets of any single infrastructure company or project or SPVs which are created for specific purposes shall not exceed 30% of its net assets

**No infrastructure debt fund scheme shall invest in**

(i) Any unlisted security of the sponsor or its associate or group company;

(ii) Any listed security issued by way of preferential allotment by the sponsor or its associate or group company;

(iii) Any listed security of the sponsor or its associate or group company or bank loan in respect of completed and revenue generating projects of infrastructure companies or special purpose vehicles of the sponsor or its associate or group companies,

a. in excess of twenty five per cent of the net assets of the scheme,

b. subject to approval of trustees and

c. full disclosures to investors for investments made within the aforesaid limits; or

(iv) any asset or securities owned by the sponsor or asset management company or their associates in excess of 30% of the net assets of the scheme, provided that-

(a) such investment is in assets or securities not below investment grade;

(b) the sponsor or its associates retains at least 30% of the assets or securities, in which investment is made by the scheme, till the assets or securities are held in the scheme portfolio; and

(c) approval for such investment is granted by the trustees and full disclosures are made to the investors regarding such investment

### 14.5.3 Launching of a Mutual Fund Scheme

- As per SEBI Mutual Fund Regulation, mutual fund scheme shall be launched by the AMC after the approval of the Trustees and filing of the copy of the offer document with SEBI.
- In case no modifications are suggested by SEBI in the offer document within 21 working days from the date of filing, the AMC may issue the offer document.
- Application Form for units of a mutual fund should be accompanied by the memorandum containing such information as may be specified by SEBI.
- The Asset management company shall obtain 'in-principle' approval from the recognised stock exchange(s) and execute Listing agreement with such exchange(s).
- The offer document shall contain disclosures which are adequate in order to enable the investors to make informed investment decision.
- The offer document and advertisement materials shall not be misleading or contain any statement or opinion which are incorrect or false.
- No scheme of a mutual fund other than the initial offering period of any equity linked savings schemes shall be open for subscription for more than 15 days

### 14.5.4 Allotment of units and refunds of moneys

The asset management company shall specify in the offer document, the minimum subscription amount and in case of oversubscription the extent of subscription it may retain.

**Provided** that where the asset management company retains the oversubscription, all the applicants applying upto 5000 units shall be given full allotment.

Any amount to be refunded to the applicants shall be done within 5 working days from the date of closure of subscription list and in the event of such failure, interest at a rate of 15% per annum from the expiry of five working days from the date of closure of the subscription list shall be paid.

### 14.5.5 Transfer of units

A unit unless otherwise restricted or prohibited under the scheme, shall be freely transferable by act of parties or by operation of law.

A unitholder, in a close ended scheme listed on a recognized stock exchange, who desires to trade in units shall hold units in dematerialised form.

### 14.5.6 Winding up of the Schemes

A close-ended scheme shall be wound up on the expiry of duration fixed in the scheme on the redemption of units unless it is rolled over for a further period.
OR
A scheme of a mutual fund is to be wound up,—
(a) on the happening of any event which, in the opinion of the trustees, requires the scheme to be wound up; or
(b) if 75% of the unit holders of a scheme pass a resolution that the scheme be wound up; or
(c) if SEBI so directs in the interest of the unitholders.

Where a scheme is to be wound up under above conditions, the trustees shall give notice within one day, disclosing the circumstances leading to the winding up of the scheme, —
(a) to SEBI; and
(b) in two daily newspapers having circulation all over India, a vernacular newspaper circulating at the place where the mutual fund is formed:

## 14.6 Redemption and Reporting Redemptions

Redemptions effected pursuant to Guidelines which are applicable at portfolio level and not applicable to Exchange Traded Funds, as per Master Circular shall be completed within 10 days from the day of winding up of the scheme(s) and/or plan(s).

**Reporting to the Board**

Compliance with these Guidelines s which are applicable at portfolio level and not applicable to Exchange Traded Funds shall be reported in Compliance Test Reports (CTRs) and Half Yearly Trustee Reports (HYTRs)

Minimum Assets under Management (AUM) of Debt Oriented Schemes

The minimum subscription amount of debt oriented and balanced schemes at the time of new fund offer shall be at least Rs.20 crore and that of other schemes shall be at least Rs.10 crore.

The confirmation on compliance of the above shall be reported to SEBI in the Half Yearly Trustee Reports.

## 14.7 Investment Objectives

A mutual fund may invest moneys collected under any of its schemes only in—
(a) securities;
(b) money market instruments;
(c) privately placed debentures;
(d) securitised debt instruments, which are either asset backed or mortgage backed securities;
(e) gold or gold related instruments
(ea) silver or silver related instruments
(f) real estate assets
(g) infrastructure debt instrument and assets as specified
(h) any other assets or instruments as may be specified by SEBI from time to time

Mutual fund scheme **shall not invest** in unlisted debt instruments including commercial papers (CPs), other than (i) government securities, (ii) other money market instruments and (iii) derivative products such as Interest Rate Swaps (IRS), Interest Rate Futures (IRF), etc. which are used by mutual funds for hedging.

Mutual fund schemes may however invest in unlisted Non Convertible Debentures (NCDs) not exceeding 10% of the debt portfolio of the scheme, subject to the condition that such unlisted NCDs have a simple structure (i.e. with fixed and uniform coupon, fixed maturity period, without any options, fully paid up upfront, without any credit enhancements or structured obligations) and are rated and secured with coupon payment frequency on monthly basis.

However, in order to increase the liquidity on the exchange platform, on monthly basis, Mutual Funds shall undertake minimum 25% of their total secondary market trades by value (excluding Inter Scheme Transfer trades) in Corporate Bonds by placing/seeking quotes through one-to-many mode on the Request for Quote (RFQ) platform of stock exchanges. Further, Mutual Funds shall undertake minimum 10% of their total secondary market trades by value (excluding Inter Scheme Transfer trades) in Commercial Papers by placing/seeking quotes through one-to-many mode on the Request for Quote (RFQ) platform of stock exchanges.

**Prudential Norms for investing**:

No Mutual Fund under all its schemes shall own more than 10% of such instruments issued by a single issuer;

The restrictions are for debt instruments with special features like subordination to equity and/or convertible to equity upon trigger of a pre-specified event for loss absorption.

### 14.7.1 Borrowings, Loans

The mutual fund shall not borrow except to meet temporary liquidity needs of the mutual funds for the purpose of repurchase, redemption of units or payment of interest or dividend to the

unitholders. Provided that the mutual fund shall not borrow more than 20 per cent of the net asset of the scheme and the duration of such a borrowing shall not exceed a period of six months Further, the mutual fund shall not advance any loans for any purpose if not explicitly specified under the SEBI MF Regulation that it can do so.

**14.7.2 Overseas Investments:** Mutual Funds can make overseas investments subject to a maximum of US $ 1 billion per Mutual Fund, within the overall industry limit of US $ 7 billion

Permissible Overseas Investments:

- ADR(s) and/or GDR(s) issued by Indian or foreign companies.
- Equity of overseas companies listed on recognized Stock Exchanges overseas.
- Initial and Follow on Public Offerings for listing at recognized Stock Exchanges overseas.
- Foreign debt securities in the countries with fully convertible currencies, short term as well as long term debt instruments with rating not below investment grade by accredited/ registered credit rating agencies.
- Money Market Instruments rated not below investment grade.
- Repos in form of investment, where the counterparty is rated not below investment grade; repo shall not however involve any borrowing of funds by Mutual Funds.
- Government securities where the countries are rated not below investment grade.
- Derivatives traded on recognized stock exchanges overseas only for hedging and portfolio balancing with underlying as securities.
- Short term deposits with banks overseas where the issuer is rated not below investment grade

## 14.8 Scheme Related Disclosures

Mutual Funds shall provide the following additional disclosures in the offer documents (Scheme Information Document (SID) / Key Information Memorandum (KIM)) of Mutual Fund scheme (for existing scheme / new scheme, as applicable):

- The tenure for which the fund manager has been managing the scheme shall be disclosed, along with the name of scheme's fund manager(s);
- Scheme's portfolio holdings (top 10 holdings and fund allocation towards various sectors), along with a website link to obtain scheme's latest monthly portfolio holding;
- Scheme's portfolio turnover ratio.

**Additional disclosures** shall be provided in SID of the MF scheme:

The aggregate investment made in the scheme by:

a) AMC's Board of Directors

b) Concerned scheme's Fund Manager(s) and

c) Other key personnel

**Disclosures on website:** Separate SID / KIM for each MF scheme managed by AMC shall also be made available on MFs / AMCs website.

A dashboard on its website shall provide the performance and key disclosures pertaining to each scheme managed by AMC such as (a) Scheme's AUM, (b) investment objective, (c) expense ratios, (d) portfolio details, (e) scheme's past performance, among others.

AMCs shall also disclose the performance of all schemes on the website of AMFI.

The said disclosure should be made for all plans and shall be updated daily based on previous day NAV.

Trustees shall confirm the same to SEBI in the half yearly trustee report.

**Annual report of the AMC**

The annual report containing accounts of the AMC should be displayed on the websites of the mutual funds immediately after approval in Annual General Meetings within a period of 4 months, from the date of closing of the financial year. Physical copies can also be provided on request

**Disclosure Of Executive Remuneration**

MFs /AMCs shall make the following disclosures pertaining to a financial year on the MF/AMC website under a separate head – 'Remuneration'. It shall contain the Name, designation and remuneration of the (i) Chief Executive Officer (CEO); (ii) Chief Investment Officer (CIO) and Chief Operations Officer (COO) or their corresponding equivalent by whatever name called; (iii) Top ten employees in terms of remuneration drawn for that financial year.

The AMCs/MFs shall disclose this information within one month from the end of the respective financial year

**Disclosure of investor complaints with respect to Mutual Funds**

Mutual Funds shall disclose on their websites and on the AMFI website within 7 days of the succeeding month details of investor complaints received by them from all sources. The same has to be included in the Report of the Trustees also (as a part of the Annual report).

**Disclosure of the Investor Charter** to be displayed on the websites and at prominent places in the office.

Note: SEBI has prepared an Investor Charter for Mutual Funds inter-alia specifying services provided to Investors, Rights of Investors, and various activities of Mutual Funds with timelines, DOs and DON'Ts for Investors and Grievance Redressal Mechanism.

Mutual Funds are advised to display link/option to lodge complaint with them directly on their websites and mobile apps, link to SCORES website/ link to download mobile app (SEBI SCORES) shall also be provided on their website.

**Filing of Advertisements**

Mutual Funds to submit to SEBI, the advertisements issued by them, within 7 days from the date of issue through e-mail to SEBI at mf_advertisement@sebi.gov.in.

## 14.9 Portfolio Disclosures

Mutual Funds/ AMCs shall disclose portfolio (along with ISIN) as on the last day of the month / half-year for all their schemes on its website and on the website of AMFI within 10 days from the close of each month/ half-year.

For debt schemes- both the portfolio and the yield of the instrument shall be disclosed on fortnightly basis within 5 days of every fortnight.

Disclosure to Unitholders: to be mailed to the unitholders within 10 days from the close of each month/ half-year.

**Advertisements**

Advertisement on the half yearly portfolio shall be published which shall disclose the hosting of the half-yearly statement of its scheme's portfolio on its website and on the website of AMFI. It shall also be published in all India edition of a daily newspaper (both in English and Hindi) and should be sent to the Unitholders through SMS, telephone, email or written request of the Unitholder.

Mutual Funds/ AMCs shall provide a physical copy of the statement of its scheme portfolio, without charging any cost, on specific request received from a unit holder.

**Unaudited Half Yearly Financials**

All Mutual Funds shall display their Unaudited half-yearly results on the website of AMFI before the expiry of 1 month before the close of each half year. *(For e.g. -31$^{st}$ August for the half year ended 30$^{th}$ September and 28$^{th}$ February for the half year ended March 31.)*

**Annual Report or Abridged Summary**

The scheme wise annual report shall be hosted on the website of the Mutual Funds/ AMCs and on the website of AMFI and a Link should be provided.

Scheme wise annual reports or abridged summary thereof shall be emailed to the unit holders and physical copy shall be given for those who have opted to receive in such a mode.

**Disclosure of large unit holdings**

The number of investors holding over 25 % of the NAV in a scheme and their total holdings in percentage terms shall be disclosed in the Statement of Accounts issued after the NFO and also in the Half Yearly and Annual Results.

**Commission disclosure**

Mutual Funds / AMCs shall disclose on their respective websites the total commission and expenses paid to distributors

## 14.10 Board & Committees

### 14.10.1 Audit Committee of Trustees

**Constitution:** Trustees with an Independent Trustee being the Chairman

**Role/ Terms of reference:**

a) to review the internal audit systems

b) consider the recommendations of the internal and statutory audit reports and

c) ensure that the rectifications as suggested by internal and external auditors are acted upon.

### 14.10.2 Audit Committee of Asset Management Companies

AMCs of mutual funds shall be required to constitute an Audit Committee. The role, responsibility, membership and other features of the Audit Committee of AMC are –

**Constitution:**

a. Minimum 3 directors as members to be appointed by the AMC;

b. At least two-third members of the Audit Committee shall be independent directors;

(*If two-third of the total strength results into fraction, then higher number after rounding up shall be considered. )*

**Chairperson of the Committee** shall be an independent director, with adequate experience in the areas of finance and financial services.

All members of Audit Committee shall be financially literate.

**Role/ Terms of reference**:

a. oversight of financial reporting process,

b. audit process,

c. company's system of internal controls,

d. compliance to laws and regulations and other related process

e. To review the financial reporting processes, the system of internal controls and the audit

processes for the Mutual Fund operations of the AMC;

f. To ensure that the rectifications, if any, suggested by internal and external auditors, etc. are acted upon.

**Meetings:**

At least 4 meetings shall be called in a financial year. The time gap between meetings shall not be more than one hundred and twenty days between two meetings.

**Quorum** for meeting shall either be two members or one third of the members of the Audit Committee, whichever is greater, with at least two independent directors.

(If one-third of the total strength results into fraction, then higher number after rounding up shall be considered for the quorum).

**Reporting:**

The internal auditor shall submit its report to the Audit Committees of AMC and the Board of AMC;

The Audit Committee of AMC shall forward their observations on internal audit report, if any, to the Trustees.

**Powers and Responsibility:**

**I. Financial Reporting**

a. Oversight of the Mutual Fund Schemes' and AMC's financial reporting process.

b. Considering and recommending for approval of AMC Board, all accounting policies with respect to the Schemes and the AMC, policy for transactions with related parties, etc.

c. Review of audit opinion issued by the statutory auditors.

d. Considering and recommending to the AMC Board, adoption of financial statements including half yearly unaudited financial results prepared for the Scheme and the financial statements of the AMC.

**II. Audit (Internal and Statutory) and Internal Controls**

a. Recommending the appointment, re-appointment of statutory auditor and internal auditor.

b. Reviewing the Internal Audit Reports of the Schemes of Mutual Fund (Including Internal Audit Report of critical activities outsourced by the AMC such as Custodian, Fund Accounting, the Registrar and Transfer Agent activities, ).

c. Reviewing the findings of any internal investigations by the AMC / internal auditors into matters where there is suspected fraud or irregularity or a failure of internal control systems of a material nature or issues highlighted or referred through whistle blower complaints, etc.

d. Reviewing Regulatory Inspection Reports.

e. Reviewing the adequacy of the internal control systems, including defining metrics for measuring internal controls, seeking comments of the internal auditors about Internal Control Systems, etc. and the steps taken towards improving the effectiveness of internal control system including through automation.

f. Interacting with the statutory and internal auditors of the Mutual Fund, at least once annually without engagement of management of the AMC

g. The Audit Committee of the AMC should interact with the Audit Committee of the Trustees at least once annually.

**III. Regulatory Compliance and other Functions**

a. Evaluating various internal control measures in terms of applicable SEBI (Mutual Funds) Regulations and various circulars issued thereunder.

b. Reviewing periodic report on compliance with applicable laws and regulations, including the details of non-compliance along with the corrective actions, as applicable.

c. Reviewing the Annual Compliance Report in relation to the "Policy on Prohibition of Insider Trading" of the AMC.

d. Assess that the AMC has been managing the mutual fund schemes independently of other activities and have taken adequate steps to ensure that the interest of investors of one scheme are not being compromised with those of any other scheme or of other activities of the asset management company.

**14.10.3 Valuation Committee**

**Constitution**: In house committee consisting of senior executives including personnel from accounts, fund management and compliance departments.

**Role:** This committee shall, on a regular basis review the systems and practices of valuation of securities.

**Review and Reporting of Transactions**

Transaction(s) by directors of the AMC: Directors of the AMC shall file with the trustees on a quarterly basis details of transactions in securities exceeding Rs.1 lakh.

**14.10.4 Trustee(s) Directors**

Trustees are required to report to Mutual Funds only those transactions in securities *that exceed Rs 5 lakhs in value.* The same shall be filed by the trustees within one month from the end of respective quarters (March, June, September and December).

**Review of transactions**

Trustees shall review all transactions of the Mutual Fund with the associates on a regular basis and ensure that Regulations are complied with

**14.10.5 Role of Independent Director on the Board of the AMC and Independent Trustees**

An Independent Trustee shall not be associated in any manner with the Sponsor(s).

The independent directors on the Board of the AMC shall not be associate of, or associated in any manner with, the sponsor or any of its subsidiaries or the trustees.

**Independent Directors**

**AMC**: at least half of the Board should comprise of Independent Directors

**Trustee Board:** two-third independent directors on the Board.

Resignation and filling of vacancy: vacancy to be filled in within a period of 3 months.

On appointment of new directors of the AMC or Trustee, their biodata shall be filed with the SEBI for information or approval respectively.

**Tenure of independent trustees and independent directors**

An independent trustee and independent director shall hold office for a maximum of 2 terms with each term not exceeding a period of 5 consecutive years.

Cooling off period for appointment on the same AMC & Trustee: 3 years

**14.10.6 Auditors of Mutual Funds**

Any audit firm including a limited liability partnership can be auditors of mutual funds.

Period of appointment: not more than 2 terms of maximum five consecutive years. Such auditor may be reappointed *after cooling off period of 5 years*.

## 14.11 Norms for Shareholding in Mutual Funds

(1) No sponsor of a mutual fund, its associate or group company including the asset management company of the Fund, through the schemes of the mutual fund or otherwise, individually or collectively, directly or indirectly, have –

(a) 10% or more of the share-holding or voting rights in the asset management company or the trustee company of any other mutual fund; or

(b) representation on the board of the asset management company or the trustee company of any other mutual fund**.**

(2) Any shareholder holding 10% or more of the share-holding or voting rights in the asset management company or the trustee company of a mutual fund, shall not have, directly or indirectly, -

(a) 10% or more of the share-holding or voting rights in the asset management company or the trustee company of any other mutual fund; or

(b) representation on the board of the asset management company or the trustee company of any other mutual fund.

## 14.12 Stewardship Code-Public Listed Companies:

AMCs shall disclose their general policies and procedures for exercising the voting rights in respect of shares held by them on the website of the respective AMC as well as in the annual report distributed to the unit holders the actual exercise of their proxy votes in the AGMs/EGMs of the investee companies in respect of the following matters:

- Corporate governance matters, including changes in the state of incorporation, merger and other corporate restructuring, and anti-takeover provisions.
- Changes to capital structure, including increases and decreases of capital and preferred stock issuances.
- Stock option plans and other management compensation issues;
- Social and corporate responsibility issues.
- Appointment and Removal of Directors.

AMCs shall be required to record and disclose specific rationale supporting their voting decision (for, against or abstain) with respect to each vote proposal.

AMCs shall additionally be required to publish summary of the votes cast across all its investee company and its break-up in terms of total number of votes cast in favour, against or abstained from.

AMCs shall be required to make disclosure of votes cast on their website (in machine readable spreadsheet format) on a quarterly basis, within 10 working days from the end of the quarter as per the format enclosed.

Further, on an annual basis, AMCs shall be required to obtain certification on the voting reports being disclosed by them. Such certification shall be obtained from a “scrutinizer”

In case of the Mutual Funds having no economic interest on the day of voting, it may be exempted from compulsorily casting of votes.

The vote shall be cast at Mutual Fund Level. The voting at scheme level shall be allowed subject to recording of detailed rationale for the same.

Fund Managers/Decision makers shall submit a declaration on quarterly basis to the Trustees that the votes cast by them have not been influenced by any factor other than the best interest

of the unit holders. Further, Trustees in their Half Yearly Trustee Report to SEBI, shall confirm the same.

All Mutual Funds shall mandatorily follow the Stewardship Code in relation to their investment in listed equities.

## 14.13 Risk Management Framework

The Risk Management Framework (RMF) shall provide a set of principles or standards, which inter alia comprise the policies, procedures, risk management functions and roles & responsibilities of the management, the Board of AMC and the Board of Trustees

RMF shall have ‘mandatory elements' which should be implemented by the AMCs and ‘recommendatory elements' which address other leading industry practices that can be considered for implementation by the AMCs, to the extent relevant to them.

AMC shall perform a self-assessment of their RMF and practices and submit a report, thereon, to its Board along with the roadmap for implementation of the framework.

Compliance with the RMF should be reviewed annually by the AMC. Reports of such reviews shall be placed before the Board of AMC and Trustees for their consideration and appropriate directions, if any. Trustees may forward the findings and steps taken to mitigate the risk along with their comments to SEBI in the half-yearly trustee reports.

### 14.13.1 Stress Tests

AMCs should have stress testing policy in place to conduct stress test on all Liquid Fund and Money Market Mutual Fund (MMMF) Schemes. The stress test should be carried out internally at least on a monthly basis, and if the market conditions require so, AMC should conduct more frequent stress test.

The concerned schemes shall be tested on the following risk parameters, among others deemed necessary by the AMC: a) Interest rate risk; b) Credit risk; c) Liquidity & Redemption risk.

While conducting stress test, it will be required to evaluate impact of the various risk parameters on the scheme and its Net Asset Value (NAV).

Trustees shall be required to report compliance with the above and steps taken to deal with adverse situations faced, if any, in the Half Yearly Trustee Report submitted to SEBI.

All AMCs are required to have an appropriate policy and system in place to conduct an in-house credit risk assessment/ due diligence of debt and money market instruments/ products at all points of time i.e. before investing in such instruments/ products and also on continuous basis in order to have proper assessment of the credit risk of the portfolio.

### 14.13.2 Cyber Security and Cyber Resilience Framework for Mutual Funds/ AMCs

As part of the operational risk management, the Mutual Funds / Asset Management Companies (AMCs) need to have robust cyber security and cyber resilience framework in order to provide essential facilities and services and perform critical functions in securities market.

Mutual Funds/ AMCs are mandated to conduct comprehensive cyber audit at least 2 times in a financial year. Along with the cyber audit reports, henceforth, all Mutual Funds/ AMCs are directed to submit a declaration from the Managing Director (MD)/ Chief Executive Officer (CEO) certifying compliance by the Mutual Funds/ AMCs with all SEBI Circulars and advisories related to cyber security from time to time.

**14.13.3 Technology Committee**

In order to deal with various technology related issues, AMCs are advised to constitute a Technology Committee comprising experts proficient in technology with at least one independent external expert with adequate experience in the area of technology in Mutual Fund industry and the committee shall, inter alia, review the cyber security and cyber resilience framework for Mutual Funds / AMCs

All registered Mutual Funds offering or using applications or systems, should participate in the reporting process by completing the AI / ML reporting format

## 14.14 Reports

| S.NO | PARTICULARS | TIMELINE |
|---|---|---|
| 1 | **Monthly Cumulative Report-SEBI** | by 3rd working day of each month |
| 2 | **New Scheme Report-SEBI** | within 10 working days from the date of allotment |
| 3 | **Quarterly Compliance Test Reports-SEBI** | Quarterly basis-by 21st day of succeeding month |
| 4 | **Half Yearly Trustee Report by Trustees-** corrective steps taken with respect to the non-compliance reported in the earlier HYTR | within 2 months of the end of the half year. |
| 5 | **Quarterly Report by AMC to Trustees (QR)—** on its activities and compliance with the MF Regulations | Quarterly basis-by 21st of succeeding month |
| 6 | AMC- annual statistical report-SEBI | By 30th of April each year through email only. |
| 7 | **Daily Transaction Report-**details of transactions in secondary market on daily basis in respect of total repurchases/ sales of equity/ debt *and not of each scrip* | by 3 pm on the following working day (T+1) |

**Responsibilities of AMC(s) and Trustees**

AMC(s) shall develop a suitable Management Information System for reporting to the Trustees.

The report shall contain specific comments on all issues related to the operation of the Mutual Fund as undertaken by the AMC

The half-yearly report on the activities of the mutual fund to be submitted by the trustees to SEBI shall cover all issues mentioned in the prescribed format as well as any other issue relevant to the operation of the Mutual Fund. The report shall mention that the Trustees have satisfied themselves about the adequacy of compliance systems in the Mutual Fund.

**Filing of Annual Information Return by Mutual Funds (with Income Tax authority)**

Mutual funds are required to submit the Annual Information Return (AIR) under section 285 BA of the **Income Tax Act,** and various guidelines notified by Central Board of Direct Taxes (CBDT) and report on the specified financial transactions through electronic medium to Income Tax Department giving PAN of the transacting parties.

**Reporting of offsite inspection data to SEBI**

Mutual Funds shall submit the daily data in monthly file as per the specified formats on quarterly basis within 10 calendar days from end of the quarter. RTAs shall submit the said data on an ongoing basis

## 14.15 SEBI Prohibition of Insider Trading Regulations

*Restrictions on Communication in Relation to and Trading by Insiders in the Units of Mutual Funds*

**SEBI Prohibition of Insider Trading Regulations**: SEBI vide amendment to these Regulations introduced Chapter II A in November 2022, making the Regulations strictly applicable in relation to the dealing in the units of a mutual fund by Insiders.

Some of the important definitions are given below:

***Connected Person shall mean*** any person who is or has during the two months prior to the concerned act been associated with the mutual fund, asset management company and trustees, 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 employee of the asset management company and trustee or holds any position including a professional or business relationship with the mutual fund or asset management company or the trustees, whether temporary or permanent, that allows such a person, direct or indirect access to unpublished price sensitive information or is reasonably expected to allow such access;

**Deemed to be connected persons:**

a) an immediate relative of connected persons

b) Sponsor, holding company or associate company or subsidiary company of the Sponsor or Asset management company and Trustees;

(c) Board of Directors and key management personnel of sponsor of the mutual fund;

(d) Directors or employees of registrar and share transfer agents, custodians or valuation agencies of the mutual fund

(e) an official of a stock exchange for dissemination of information;

(f) Directors or employees of auditor, legal advisor or consultants of the mutual fund or asset management company

(g) a banker of the mutual fund or asset management company;

(h) a concern, firm, trust, HUF, company or association of persons wherein a director of an asset management company and Trustees or his immediate relative or banker of the company, has more than ten per cent of the holding or interest;

"Unpublished Price Sensitive Information (UPSI)" shall mean any information, pertaining to a scheme of a mutual fund which is not yet generally available and which upon becoming generally available, is likely to materially impact the net asset value or materially affect the interest of unit holders and includes instances when there is likely to be

- a change in the accounting policy,
- a material change in the valuation methodology,
- restrictions on redemptions,
- winding up of schemes,
- creation of segregated portfolio,
- the triggering of the swing pricing framework and the applicability of the swing factor
- material changes in the liquidity position of the concerned mutual fund schemes,
- default in the underlying securities material to the concerned mutual fund scheme.

*Restriction on Communication or procurement of unpublished price sensitive information*

No insider shall communicate, provide, or allow access to any unpublished price sensitive information to any person including other insiders except where such communication is in furtherance of legitimate purposes, performance of duties or discharge of legal obligations

**Obligations of the Board of AMC:**

The Board of Directors of the asset management company shall

1. With the approval of the Trustees frame a policy for determination of legitimate purpose[33]

[33] "legitimate purpose" shall include sharing of unpublished price sensitive information in the ordinary course of business by an insider with Trustees, Registrars and Share Transfer Agents, Custodians, Valuation Agencies, Fund Accountants, Association of Mutual funds of India, Credit Rating Agencies, legal advisors, auditors or other advisors or consultants, except where such sharing has been carried out to evade or circumvent the prohibitions of these regulations.

2. Ensure that parties execute NDAs and the recipient of UPSI is explained about the obligations arising therefrom, including abstaining from dealing in the MF units when in possession of UPSI.

3. Ensure maintenance of Structured Digital Database (SDD) and making of an entry in the same each time there is an instance of sharing of UPSI, relating to every scheme, internally or externally. The SDD, should have a feature of audit trail, time-stamping and preservability for 8 years.

4. Frame Code of Conduct under this Regulations

5. Determine the Designated Persons in consultation with the compliance officer.

***Trading when in possession of unpublished price sensitive information***

No insider shall trade in the units of a scheme of a mutual fund, when in possession of unpublished price sensitive information, which may have a material impact on the net asset value of a scheme or may have a material impact on the interest of the unit holders of the scheme.

***Disclosure Requirements***

Asset management companies (AMCs) will have to disclose the details of holdings in the units of its mutual fund schemes, on an aggregated basis, held by the designated persons of the AMC, trustees, and their immediate relatives on the platform of stock exchanges.

Details of all transactions in the units of their own mutual funds executed by designated persons of the AMC, trustees, and their immediate relatives must be reported by the concerned person to the compliance officer of the AMC within 2 business days.

**Code of Conduct**

Chief executive officer or managing director of every AMC shall formulate a code of conduct to regulate, monitor and report dealings in mutual fund units by the Designated Persons and their immediate relatives.

The Compliance officer shall be designated to administer the Code of Conduct

Designated Persons shall include:

i. Head of the asset management company

ii. Directors of the asset management company or the trustee company,

iii. Chief Investment Officer, Chief Risk Officer, Chief Operation Officer, Chief Information Security Officer, Fund Managers, Dealers, Research Analysts, all employees in the Fund Operations Department, Compliance Officer and Heads of all divisions and/or departments or any other employee as designated by the asset management company and/or trustees.

**Institutional Mechanism for Prevention of Insider trading.**

The Chief Executive Officer / Managing Director of an asset management company with the approval of the trustee shall put in place adequate and effective system of internal controls to prevent insider trading.

**Review of compliance with the Insider Trading Regulations**:

The Audit Committee of an asset management company **shall review compliance** with the provisions of Insider Trading regulations **at least once in a financial year** and shall verify that the systems for internal control are adequate and are operating effectively.

Every asset management company shall with the approval of the Trustees formulate

a. written policies and procedures for inquiry in case of leak of unpublished price sensitive information or suspected leak of unpublished price sensitive information

b. whistle-blower policy that is brought to the notice of their employees to enable them to report instances of leak of such unpublished price sensitive information

c. initiate appropriate inquiries

d. promptly inform SEBI promptly of such leaks, inquiries and result of such inquiries.

**Compliance Officer and obligations:**

**Trading window closure:** The compliance officer of the AMC is responsible for determining the closure period during which a designated person cannot transact in units of the mutual Fund.

**Pre deal approval**: Every designated person is required to take prior approval of the Compliance Officer before dealing in the Units of the Mutual Fund Scheme and such approval is valid for 7 trading days from date of approval.

The compliance officer shall report to the board of directors of asset management company and provide reports to the Chairman of the Audit Committee of the asset management company and to the trustees, at such frequency as may be stipulated by the board of directors, but in any case not less than once in a year

**Contra-trade Restrictions for Mutual Fund Employees**

Contra trade means entering into an opposite transaction within a prescribed deadline. Designated persons (DPs) are restricted from entering into opposite transactions within two months of the previous transaction.

## 14.16 General Obligations

### 14.16.1 To maintain proper books of account and records, etc.

Every asset management company shall keep and maintain proper books of account, records and documents, for each scheme and preserved for 8 years.

The financial statements and accounts of the mutual fund schemes shall be prepared in accordance with Indian Accounting Standards (IND AS) and any addendum thereto, as notified by the Companies (Indian Accounting Standards) Rules, 2015, as amended from time to time:

The financial year for all the schemes shall end as of March 31st of each year;

The exit load charged, if any, shall be credited to the scheme.

All expenses should be clearly identified and appropriated in the individual schemes.

Investment and advisory fees may be charged by the AMC which shall be fully disclosed in the offer document.

### 14.16.2 Declaration of Dividends

A mutual fund may declare dividends. The payment of dividend to the unitholders shall be made within such period as specified in the SEBI Mutual Fund Regulations from time to time.

### 14.16.3 Auditor's Report

Every mutual fund shall have the annual statement of accounts audited by an auditor who is not in any way associated with the auditor of the asset management company and is appointed by the Trustees.

### 14.16.4 Copies of Annual Report and Summary Thereof

The scheme wise Annual Report of a mutual fund or an abridged summary thereof shall be provided within 4 months from the date of closure of the relevant accounting year, to all unitholders.

### 14.16.5 Annual Report to be Forwarded To SEBI

Every asset management company shall within 4 months from the date of closure of each financial year forward to SEBI, a copy of the Annual Report and other information including details of investments and deposits held by the mutual fund to disclose the entire scheme wise portfolio of the mutual funds.

## 14.17 Investor Rights & Obligations

***Transfer of Redemption or Repurchase Proceed***

a. The transfer of redemption or repurchase proceeds to the unitholders shall be made within three working days from the date of receipt of such requests

b. For schemes investing at least 80% of total assets in such permissible overseas investments, the transfer of redemption or repurchase proceeds to the unitholders shall be made within five working days form the date of redemption or repurchase.

***Payment of interest for delay in dispatch of redemption and/or repurchase proceeds and/or dividend***

Interest for the period of delay in transfer of redemption or repurchase or dividend shall be payable to unitholders at the rate of 15% per annum along with the proceeds of redemption or repurchase or dividend, as the case may be. Such Interest shall be borne by AMCs.

The details of such payments shall also be sent to SEBI as part of Compliance Test Reports in the prescribed format. Investors shall also be informed about the rate and amount of interest paid to them.

***Dematerialization of existing units held by investors***

Investors may convert their existing physical units (represented by statement of account) into dematerialized form. Demat statement given by depository participant would be deemed to be adequate compliance with requirements for account statement prescribed by SEBI.

***Consolidated Account Statement***

The consolidated account statement for each calendar month, is to be issued on or before 15th day of the succeeding month.

***AMC's Annual Reports for unitholders***

The annual report containing accounts of the AMCs should be displayed on the website of Mutual Fund.

***Dispatch of Statement of Accounts***

AMCs shall allot the units to the applicant whose application has been accepted and also send confirmation specifying the number of units allotted to the applicant by way of email and/or SMS's to the applicant's registered email address and/or mobile number as soon as possible but not later than 5 working days from the date of closure of the initial subscription list and/or from the date of receipt of the request from the unitholders.

***Change of Mutual Fund Distributor***

In case an investor wishes to change his distributor or wishes to go direct, Mutual Funds/AMC's shall ensure compliance with the instruction of the investor informing his desire to change his distributor and / or go direct, without compelling that investor to obtain a 'No Objection Certificate' from the existing distributor.

***Procedure***

***Online Registration Mechanism for Mutual Funds***

All applications for registration of Mutual Fund is required to be made through SEBI Intermediary Portal which shall include online application for registration, processing of application, grant of in-principle approval, grant of final registration.

**Procedure for change in control of AMC:**

For any change in control of AMC, directly or indirectly the following are to be complied with:

- Prior approval of the trustees and SEBI
- A written communication about the proposed change is sent to each unitholder and an advertisement is given in one English daily newspaper having nationwide circulation and in a newspaper published in the language of the region where the Head Office of the mutual fund is situated; and
- The unitholders are given an option to exit on the prevailing Net Asset Value (NAV) without any exit load within a time period not less than 30 calendar days from the date of communication.

**New Sponsor**

- New Sponsor proposing to take the control of an AMC shall apply to the Board for approval of taking over control of an existing AMC under MF Regulations.

**Disclosures to Unitholders:**

- While seeking the approval of SEBI for change in the control of the AMC, the mutual fund handing over the control to another person, should also file the draft letter / email to be sent to the unitholders along with draft advertisement to be published in the newspaper

## 14.18 Certification and Registration of Intermediaries

No Mutual Fund shall deal with any intermediary (i.e. distributors, agents, brokers, sub brokers or called by any other name, whether individuals or belonging to any other organization structure) in relation to selling and marketing of Mutual Fund units unless they have cleared the mandatory certification examination being offered by NISM. **Exemptions:** Senior citizens with experience in distributing Mutual Funds units are exempt from taking the mandatory certification examination if they have completed 50 years of age and have experience of 5 years as on September 30, 2003.

They are also required to follow the guidelines prescribed by SEBI and AMFI, attend a mutual fund training programme and a certificate to that effect endorsed by a mutual fund should be submitted to AMFI.

**Distributors of Mutual Fund products**

The AMCs shall regulate the distributors by putting in place a due diligence process for Distributors. At the time of empanelling distributors and during the period i.e. review process, Mutual Funds/AMCs shall undertake a due diligence process to satisfy 'fit and proper' criteria.

**Code of Conduct**

Mutual Funds are required to monitor the activities of their distributors, agents, brokers to ensure that they do not indulge in any malpractice or unethical practice while selling or marketing Mutual Funds units.

Any non-compliance shall be reported to the Board of AMC and in the Half yearly Reports.

AMFI has prescribed a Code of Conduct for Mutual Fund intermediaries, which should be strictly adhered to, and no Mutual Fund shall deal with intermediaries contravening the prescribed Code of Conduct.

**Empanelment of Intermediaries by Mutual Funds**

Empanelment of intermediaries by Mutual Funds, payment of commissions, brokerage and/or sub-brokerage etc. shall be in accordance with parameters and guidelines specified by SEBI and AMFI from time to time.

**Certification Programme for sale and/ or distribution of mutual fund products**

The NISM-Series-V-A: Mutual Fund Distributors Certification Examination is the requisite examination for distributors, agents or any other persons employed or engaged or to be employed or engaged in the sale and/or distribution of mutual fund products. Further, SEBI notified the new cadre of distributors who shall be allowed to sell units of simple and performing MF schemes. The new cadre of distributors shall be postal agents, retired government and semi-government officials (class III and above or equivalent) with a service of at least 10 years OR retired teachers with a service of at least 10 years, OR retired bank officers with a service of at least 10 years, OR and other similar persons (such as Bank correspondents), OR as may be notified by AMFI/AMC from time to time. These new cadre of distributors would be required to take the NISM-Series-V-B: Mutual Fund Foundation Certification examination and then approach AMFI for registration.

**Review Questions**

1. Trustees are required to review all transactions between mutual funds, asset management company and its associates on a _____ basis.

**(a) Quarterly**

(b) Monthly

(c) Half Yearly

(d) Yearly

2. Funds can make overseas investments subject to a maximum of _____ per Mutual Fund, within the overall industry limit of _____.

**(a) US $ 1 billion; US $ 7 billion**

(b) US $ 1 billion; US $ 8 billion

(c) US $ 3 billion; US $ 8 billion

(d) US $ 2 billion; US $ 7 billion

3. Vacancy in the office of the independent director of the MF must be filled within a period of _____.

**(a) 3 months**

(b) 1 month

(c) 2 months

(d) 6 months

# CHAPTER 15: SEBI (ALTERNATIVE INVESTMENT FUNDS) REGULATIONS, 2012

**LEARNING OBJECTIVES:**

After studying this chapter, you should know about:

- Alternative Investment Funds
- Classification of AIFs
- Investment Strategy and Compliance requirements in AIFs
- General Obligations, Responsibilities and Transparency in AIFs
- Special Types of Funds

## 15.1 Introduction

**Alternative assets** are investments that lie outside the realm of traditional asset classes commonly accessed by most investors, such as stocks, bonds, or cash. These types of investments tend to be less liquid and typically require a longer holding period before any returns are realized.Companies normally can raise funds either through debt or equity. Both have their own merits and certain disadvantages due their natural characteristics. An Alternative Investment Fund, or AIF, provides one more avenue for companies to raise funds.

Alternate Investment Fund ("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.

In Mutual Funds, avenues are available to retail investors to invest in small amounts. For eg, a Systematic Investment Plan can be started with Rs 500/-. However, in AIF, the ticket size or the minimum investment size is higher (Rs 1 cr) and hence open only to sophisticated investors.

Initially, a corpus is built with the money committed by the investors, and this money is invested in different venues. AIF has different schemes, and the investment is undertaken based on the objective of each scheme. As this avenue is open to Indians, non-resident Indians, and foreign persons for investment in unlisted and debt securities, the investee companies can raise funds from this source as well.

The AIF ecospace in India is governed by the SEBI (Alternative Investment Funds) Regulations, 2012.

## 15.2 Important Terminologies

Some of the key definitions/terminologies under the AIF Regulations is discussed hereunder:

**(a) "Alternative Investment Fund**" means any fund established or incorporated in India.

*The legal form in which AIF could be set up shall be a:*

Trust established under the Indian Trusts Act, 1882 or under an Act of Parliament or State Legislation; **OR**

a company incorporated under the Companies Act, 2013; **OR**

a limited liability partnership incorporated under the Limited Liability Partnership Act, 2008;

**OR**

a body corporate.

AIF is a privately pooled investment vehicle that collects funds from investors, whether Indian or foreign, for investing them in accordance with a defined investment policy for the benefit of its investors.

**(i) Corpus** means the total amount of funds committed by investors to the Alternative Investment Fund by way of a written contract or any such document as on a particular date;

*(Normally, investors commit a certain amount to the Fund, which they shall contribute in tranches as and when the AIFs make a demand)*

**(ii) Investable funds** means the corpus of the scheme of the Alternative Investment Fund, net of expenditure for administration and management of the fund, estimated for the tenure of the fund.

**(iii) Investee company** means any company, special purpose vehicle or limited liability partnership or body corporate or real estate investment trust or infrastructure investment trust in which an Alternative Investment Fund makes an investment;

**Unit**: As the funds collected from all the investors are pooled together, the beneficiaries/ investors are issued an instrument/ security called "Units" *(similar to equity shares of a company—implying a share in the share capital of the company*). It means the beneficial interest of the investors in the AIF or scheme of AIF.

(The amount invested by an investor is divided by the Face Value of each Unit and arrived at the number of units invested). The Units issued can be fully paid and when it is partly paid up, it implies the portion of committed capital invested by the investor in Alternative Investment Fund or scheme of the Alternative Investment Fund;

**15.2.1 Different Funds Formed By AIF**

**Debt fund** means an Alternative Investment Fund which invests primarily in debt or debt securities of listed or unlisted investee companies or in securitised debt instruments according to the stated objectives of the Fund;

**Equity linked instruments** include instruments convertible into equity shares or share warrants, preference shares, debentures compulsorily or optionally convertible into equity.

**Hedge fund** means an Alternative Investment Fund 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 an Alternative Investment Fund which invests primarily in unlisted securities or partnership interest or listed debt or securitized debt instruments of investee companies or special purpose vehicles engaged in or formed for the purpose of operating, developing or holding infrastructure projects; 'infrastructure' shall be as defined by the government of India from time to time.

**Private equity fund** means an Alternative Investment Fund which invests primarily in equity or equity linked instruments or partnership interests of investee companies according to the stated objective of the fund;

**SME fund** means an Alternative Investment Fund which invests primarily in unlisted securities of investee companies which are SMEs or securities of those SMEs which are listed or proposed to be listed on a SME exchange or SME segment of an exchange;

***(SME** means Small and Medium Enterprise and shall have the same meaning as assigned to it under the Micro, Small and Medium Enterprises Development Act 2006 as amended from time to time)*

**Social Impact Fund** means an Alternative Investment Fund which invests primarily in securities, units or partnership interest of social ventures or securities of social enterprises and which satisfies the social performance norms laid down by the fund.

**Social venture** means a trust, society or company or venture capital undertaking or limited liability partnership formed with the purpose of promoting social welfare or solving social problems or providing social benefits and includes,-

(i) public charitable trusts registered with Charity Commissioner.

(ii) societies registered for charitable purposes or for promotion of science, literature, or fine arts;

(iii) company registered under section 8 of the Companies Act, 2013.

(iv) micro finance institutions.

**Venture capital fund** means an Alternative Investment Fund which invests primarily in unlisted securities of start-ups, emerging or early-stage venture capital undertakings mainly involved in new products, new services, technology or intellectual property right based activities or a new business model and shall include an angel fund as defined under Chapter III-A of the SEBI (AIF) Regulations, 2012 as amended from time to time*;*

***(Venture Capital Undertaking** means a domestic company which is not listed on a recognised stock exchange in India at the time of making investments.)*

**Startup** means a private limited company or a limited liability partnership which fulfills the criteria for startup as specified by the Department of Promotion of Industry and Internal Trade, Ministry of Commerce and Industry, Government of India, vide notification no. G.S.R. 127(E) dated February 19, 2019 or such other policy of the Central Government issued in this regard from time to time;

**Exceptions –which are not to be considered as AIF:**

There are many schemes that resemble AIF, and an investor should not get confused with such schemes. Accordingly, the following are not considered as an Alternative Investment Fund

- A **mutual fund** established *under the SEBI (Mutual Funds) Regulations, 1996*
- **Scheme**s covered under SEBI (**Collective Investment Schemes) Regulations, 1999**
- **Other Regulations of the SEBI** that regulate fund management activities
- **Holding Companies** as defined under Section 2 of the Companies Act, 2013
- **ESOP Trusts** set up under the SEBI (Share Based Employee Benefits) Regulations, 2014 or as permitted under the Companies Act, 2013;
- **Family Trusts** set up for the benefit of 'relatives' as defined under 2 of the Companies Act, 2013;
- **Employee Welfare Trusts or Gratuity Trusts** set up for the benefit of employees;
- **Other SPVs not established by fund managers,** including securitisation trusts, are regulated under a specific regulatory framework
- **Funds managed by a securitisation company** or reconstruction company that 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;
- Any such pool of funds which is directly regulated by any other regulator in India;

### 15.2.2 Key Players in AIF Ecospace

| | |
|---|---|
| **Sponsor** | means any person or persons who set up the Alternative Investment Fund *and includes promoter in case of a company and designated partner in case of a limited liability partnership;* |

| | |
|---|---|
| **Manager** | means any person or entity who is appointed by the Alternative Investment Fund to manage its investments by whatever name called and may also be same as the sponsor of the Fund;<br><br>***(A Sponsor is the promoter of the Fund and a Manager administers the Fund and is in charge of managing the investments)*** |
| **Custodian** | means a person who has been granted a certificate of registration to carry on the business of custodian under the SEBI (Custodian) Regulations, 1996; |

**Other terms:**

- **Co-investment** means investment made by the Managers or Sponsor or investors of Category I or Category II Alternative Investment Fund(s) which are making the investment in investee companies.
- **Accredited investor** means any person who is granted a certificate of accreditation by an accreditation agency-- *(they are certain special type of investors whose networth exceeds a threshold and hence called by a different name).*

(i) In case of an individual, a Hindu Undivided Family, family trust, or sole proprietorship has annual income of at least **Rs 2 crores**;

**or**

net worth of at least Rs. **7.5 crores** (out of which Financial assets > Rs. 3.75crs);

**or**

annual income of at least **Rs 1 crore and minimum net worth of Rs 5 crores** (out of which Financial assets > Rs. 2.5 crs)

(ii) In the case of a body corporate, it has a net worth of at least Rs 50 crores

(iii) In case of a trust other than a family trust, it has a net worth of at least Rs 50 crores;

(iv) In case of a partnership firm set up under the Indian Partnership Act, 1932, each partner independently meets the eligibility criteria for accreditation:

- **Deemed Accredited Investors**
  - Central Government and the State Governments,
  - Developmental agencies set up under the aegis of the Central Government or the State Governments,

- Funds set up by the Central Government or the State Governments, Qualified Institutional Buyers as defined under the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018
- Category I foreign portfolio investors
- Sovereign wealth funds
- Multilateral agencies

- **Control in relation to a company or a body corporate means:**
  (i) in case of listed companies: control as defined in Regulation 2(1)(e) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011; (SAST/ Takeover Code).
  (ii) in any other case, control as defined in Section 2(27) of the Companies Act, 2013.
  (iii) other than that of a body corporate, control means any change in its legal formation or ownership or change in controlling interest.

- **Controlling interest**- holding of not less than 50% of the voting rights or interest in a company directly/indirectly.
- **Accreditation Agency (AA)**

**Accreditation:** Persons desirous of being reckoned as Accredited Investors (AIs) shall approach an Accreditation Agency for accreditation.

**"Accreditation agency**" means a subsidiary of a recognized stock exchange or a subsidiary of a depository or any other entity as may be specified by SEBI from time to time.

**Responsibilities of Accreditation Agencies**

a) Verification of documents submitted by applicants for accreditation,

b) Timely processing of applications for accreditation and issuance of the accreditation certificate,

c) Maintaining data of accredited investors,

d) Verification of accreditation status,

e) Maintaining confidentiality of investor information at all times, and

f) Any other responsibilities as may be specified by SEBI from time to time.

Accreditation Agencies shall have the requisite infrastructure, including systems and manpower.

**Eligible entities to carry out the accreditation process:**

(i) **Subsidiaries of recognized Stock Exchanges**, provided the Stock Exchange meets the following criteria:

a) Minimum 20 years of presence in the Indian securities market,

b) Minimum net worth of 200 crore rupees,

c) Presence of nation-wide terminals,

d) Having Investor grievance redressal mechanisms in place, including arbitration,

e) Presence of Investor Service Centers (ISCs) in at least 20 cities, and

f) Any other criteria as specified by SEBI from time to time.

(ii) **Subsidiaries of Depositories.**

The framework for AAs shall be made available on the websites of accreditation agencies.

- **Large value fund for accredited investors** means an Alternative Investment Fund or scheme of 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) is an accredited investor and invests not less than Rs 25 crores;

### 15.3 Classification of AIFs

The AIFs are classified into 3 categories based on certain parameters given below:

(a) **"Category I Alternative Investment Fund"** 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, "social venture funds, infrastructure funds, special situation funds, and such other Alternative Investment Funds as may be specified);*

(b) **"Category II Alternative Investment Fund"** does not fall in
a. Category I and III and
b. does not undertake leverage or borrowing other than to meet day-to-day operational requirements and as permitted in these regulations;

(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. *(These types of Funds can carry out "hedging activities").*

(d) AIFs specified under Regulation 19 of the AIF Regulations is a recently introduced category and includes a "Corporate Debt Market Development Fund" that (i) invests in liquid and low-risk debt instruments and undertakes any other activity related to the corporate debt market; (ii) during periods of market dislocation, purchases corporate debt securities from specified debt-oriented schemes of mutual funds which meet the eligibility criteria prescribed in the AIF Regulations.

**15.3.1 Eligibility criteria:**

*Basic conditions:*

The AIF activity should be permissible under the Charter documents of the entities viz.,

- In case of a company: by the Memorandum of Association
- In case of a Trust: by the Trust Deed
- In case of a registered Partnership firm and LLP: by the Partnership deed

**Restriction:** The regulation prohibits making an invitation to the public to subscribe to its securities; *AIFs cannot make a public issue, and the money collected is always in the form of private placement, therefore called a privately pooled vehicle*.

*Other Conditions:*

**Fit & proper criteria:** The applicant, Sponsor and Manager should be fit and proper persons based on the criteria specified in Schedule II of the SEBI (Intermediaries) Regulations, 2008;

**Expertise:** The key investment team of the Manager of Alternative Investment Fund shall have-

- at least one key personnel with relevant certification as may be specified by SEBI from time to time;
  Provided that the provisions of this sub-clause shall not apply to Accredited Investors only fund; and
- 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:

*Note: The same Key personnel can fulfil both the above conditions.*

**Infrastructure**: The Manager or Sponsor shall have the necessary infrastructure and manpower to effectively discharge its activities.

### 15.3.2 Conditions of certificate

- The AIF shall not carry on any other activity other than permitted activities.
- The AIF shall forthwith inform SEBI if there is any material change in the information already submitted.
- AIF cannot change its category subsequent to registration, except with the approval of SEBI.

**Validity of the Certificate issued by SEBI**: The certificate of registration of an AIF shall be valid till the AIF is wound up.

## 15.4 Investment Strategy

Even before applying for registration, all AIFs shall have a well-defined investment strategy, investment purpose and its investment methodology and the same should be mentioned in its placement memorandum to the investors. This will enable the investors to know where their contribution is getting invested.

*Eg: The primary objective of the Fund shall be to carry out the activities of a Category II AIF, as permissible under the AIF Regulations, to make a diversified spread of investments in the form of making equity investments, quasi-equity investments or any capital market instrument of whatsoever nature in Portfolio Companies in the target market i.e., energy sector/ infrastructure etc. Such investments may be in entities specialising in such businesses.*

***Any material alteration to the strategy***: For the said purpose, consent of atleast two-thirds of unit holders by value of their investment in the Alternative Investment Fund and permission of SEBI is required.

### 15.4.1 Investment in Alternative Investment Fund

**Eligible investors** Any investor whether Indian, foreign or non-resident Indians are eligible to invest in AIF.

**Mode of issuance**: Units to be issued only in dematerialised form.

**Minimum corpus of a Fund**: Each Scheme of an AIF shall have corpus of at least Rs 20 crores.

For ***Social Impact Funds***: The minimum corpus shall be Rs 5 crores.

**Minimum investment size**: At least Rs 1 crore by each investor, except for accredited investors.

**Exceptions**:

> ***Rs 25 lacs****:* Investors who are employees or Directors of AIF or employees or directors of the Manager.

***Rs 2 Lacs*:** A social impact fund which invests only in securities of not for profit organizations registered or listed on a social stock exchange.

**Investment norms for Category-II AIFs:**

Category II Alternative Investment Funds (AIFs) were originally mandated to invest "primarily" in unlisted investee companies. This restricted their ability to hold listed debt instruments, even when such instruments were part of private credit strategies.

SEBI has now clarified that Category II AIFs may include **listed debt securities**—including **securitized debt instruments**—in their portfolios, provided these are rated **'A' or below** by a SEBI-registered credit rating agency. This change allows the >50% "primary" investment requirement to be fulfilled through a **combination of unlisted securities and lower-rated listed debt**.[34]

**Continuing interest of the Manager or Sponsor**: (*This is intended so that Manager or Sponsor are also focussed on the quality and performance of the investments made.)* The Manager or Sponsor shall have a continuing interest in the Alternative Investment Fund of not less than

- 2.5% of the corpus or Rs 5 crores whichever is lower, in the form of investment in the Alternative Investment Fund. This should not be through waiver of management fees. ***(For Category I & II).***
- 5% of the corpus or Rs 10 crores, whichever is lower ***(For Category III)***.

**Maximum number of investors in a Scheme**: 1000 investors

Provided that accredited investors shall be excluded while computing the number of investor in a scheme of an Alternative Investment Fund.

Provided further that the provisions of the Companies Act, 2013 shall apply to the Alternative Investment Fund, if it is formed as a company.

**Solicitation:** Only by way of Private Placement

**Applicability of the Companies Act, 2013**: Applicable for AIFs in the form of a company

**Guidelines for borrowing by Category I and Category II AIFs:**

1. In terms of Regulation 16(1)(c) and Regulation 17(c) of AIF Regulations, Category I and Category II AIFs shall not borrow funds directly or indirectlyorengageinanyleverageforthepurposeofmakinginvestments or otherwise,except for borrowing funds to meet temporary funding requirements and day-to-day operational requirements for not more than thirty days, on not more than four occasions in a year and not

[34] https://www.sebi.gov.in/legal/regulations/may-2025/securities-and-exchange-board-of-india-alternative-investment-funds-amendment-regulations-2025_94132.html

more than ten percent of the investable funds and subject to such conditions as may be specified by SEBI from time to time.

2. In this regard, in order to facilitate ease of doing business and provide operationalflexibility,it has been decided to allow Category I and Category II AIFs to borrow for the purpose of meeting temporary shortfall in amount called from investors formaking investments in investee companies ('drawdown amount').

3. Category I and Category II AIFs may borrow for the purpose of meeting shortfall in drawdown amount, subject to the following additional conditions:

3.1 If AIF intends to borrow funds for meeting shortfall in drawdown amount, the same shall be disclosed in the PPM of the scheme.

3.2. Such borrowing shall be done only in case of emergency and as a last recourse, when the investment opportunity is imminent and the drawdown amount from investor(s)has not been received by the AIF before the date of investment, in spite of best efforts by manager to obtain the drawdown amount from the delaying investor(s).

3.3. The amount borrowed shall not exceed twenty per cent of the investment proposed to be made in the investee company, or ten per cent of the investable funds of the scheme of AIF, or the commitmentpending to be drawn down from investors other than the investor(s) who hasfailed to provide the drawdown amount, whichever is lower.

3.4.The cost of such borrowing shall be charged only to investor(s) who failed to provide the drawdown amount for making investments.

3.5. The flexibility of borrowing to meet shortfall in drawdown amount shall not be used as a means to provide different drawdown timelines to investors.

3.6. The manager shall disclose the details with respect toamount borrowed, terms of borrowing and repayment to all the investors of the AIF/scheme, on a periodic basis asper theterms ofagreementwith the investors of the AIF.

4. Further, all Category I and Category II AIFs shall maintain thirty days cooling off period between two periods of borrowing as permissible underAIF Regulations. The cooling off period of thirty days shall be calculated from the date of repayment of previous borrowing[35]

**Capping of Tenure Extensions for Large Value Funds:**

Large Value Funds (LVFs) for Accredited Investors—defined as AIF schemes where each investor commits a substantial minimum investment of ₹25 crore or more—were previously permitted to operate with flexible or even indefinite tenures, based on investor agreements. This raised

[35] https://www.sebi.gov.in/legal/circulars/aug-2024/guidelines-for-borrowing-by-category-i-and-category-ii-aifs-and-maximum-permissible-limit-for-extension-of-tenure-by-lvfs_85909.html

regulatory concerns about the emergence of quasi-perpetual funds. To address these concerns, SEBI, introduced a cap on tenure extensions for LVFs, limiting them to a maximum of five years beyond the original term.

Large Value Funds (LVFs)—AIF schemes for Accredited Investors with a minimum commitment of ₹25 crore per investor—are now subject to a maximum extension limit of five years beyond their original tenure. Any proposed extension must still be approved by at least two-thirds of the unit holders by value, maintaining the standard threshold applicable to other AIFs.

**15.4.2 Offer document:**

An AIF has to prepare an Offer document enabling the investors to peruse the objective and to know the details of the scheme in which the proposed investment is going to be made. This is similar to a Prospectus in case of an IPO of equity shares.

**Placement Memorandum:** An Offer document through which an AIF shall raise funds is called the Private Placement Memorandum **(PPM).** This is the primary document in which all the necessary information about the AIF is disclosed to prospective investors.

**PPM** shall have two parts viz.

Part A – Section for minimum disclosures, and

Part B – Supplementary section to allow full flexibility to the Fund in order to provide any additional information, which it deems fit.

Contents of the PPM:

- All material information about the AIF and the Investment Manager (IM)
- Details of all the Key Management Personnel (KMPs)[36] of the AIF and the Manager
- Background of key investment team of the IM
- Investment strategy
- Targeted investors
- Tenure of the AIF or scheme
- Fees and all other expenses proposed to be charged
- Conditions or limits on redemption
- Risk management tools and parameters employed
- Key service providers
- Terms of reference of the committee constituted for approving the decisions of the AIF

[36] 'key management personnel' shall mean: (a) members of key investment team of the Manager, as disclosed in the PPM of the fund; (b) employees who are involved in decision making on behalf of the AIF, including but not limited to, members of senior management team at the level of Managing Director, Chief Executive Officer, Chief Investment Officer, Whole Time Directors, or such equivalent role or position; (c) any other person whom the AIF (through the Trustee, Board of Directors or Designated Partners, as the case may be) or Manager may declare as key management personnel.

- Conflict of interest and procedures to identify and address them
- Disciplinary history
- The terms and conditions on which the IM offers investment services
- Its affiliations with other intermediaries
- Manner of winding up of the AIF or the scheme
- Litigations and disciplinary actions by any Regulator
- Penalties more than Rs 5 Lacs

**Disclosure of the name of KMPs.:**

AIFs shall disclose the names of all the key management personnel of the AIF and the Manager in their PPMs. Any change in key management personnel shall be intimated to the investors and the Board.

**Filing the PPM with SEBI**: The PPM shall be filed with SEBI atleast 30 days prior to the launch of the scheme.

**Intermediary:** Appointment of a Merchant Banker is mandatory. The Merchant Banker's functions include:

- Filing of PPM with SEBI.
- Independently exercise due diligence of all the disclosures in the PPM, satisfy itself with respect to veracity and adequacy of the disclosures and provide a due diligence certificate.
- Submit 'due diligence' certificate by the merchant banker at the time of registration or prior to launch of new scheme on the SEBI intermediary portal.
- Disclosing the details of the Merchant Banker in the PPM.
- Merchant banker not being an associate of the AIF, its sponsor, Manager or Trustee.

**15.4.3 Tenure of the Schemes:**

- ***Category I & II AIFs***: It shall be close ended with a minimum of 3 years tenure.
- ***Category III AIF****:* It shall be either open ended or close ended.
- ***Extension of the tenure of the close ended AIFs***: The tenure is extendable by 2 years subject to approval of 2/3$^{rd}$ of the unit holders by value of their investment in the Alternative Investment Fund.

*Exception: Large value funds for accredited investors can extend beyond 2 years*

**15.4.4 Listing:**

The units of close ended AIF may be listed on stock exchange. The minimum tradable lot shall be of Rs 1 crore and shall be permitted only after final close of the fund or scheme.

**15.4.5 Investment Conditions and other Restrictions:**

- **General Investment conditions**:

- AIFs can invest in
    - unlisted
    - listed securities and
    - in the securities of companies incorporated outside India subject to conditions or guidelines of the RBI and SEBI from time to time;

**Other investment avenue and a key role of AIF:**

AIF may act as a Nominated Investor and also a Qualified Institutional Buyer as specified in the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009.

- **Restriction on investments:**

**Category I and II AIFs** cannot invest more than 25% of the investable funds in one Investee Company directly or through investment in the units of other AIF:

- Exception: large value funds for accredited investors of Category I and II AIF may invest up to 50% of the investable funds in an investee company directly or through investment in the units of other AIFs;

- **Category III AIF**: not more than 10% of the investable funds can be invested in an Investee Company, directly or through investment in units of other AIFs.

For investment in listed companies: 10% of either Investable Funds or NAV of the Scheme.

- Exception: The large value funds for accredited investors of Category III AIFs may invest up to 20 percent of the investable funds in an Investee Company, directly or through investment in units of other AIFs:

**Other Restrictions:**

AIFs shall not invest in:

(a) associates; or
(b) schemes of AIFs managed or sponsored by its Manager, Sponsor or associates of its Manager or Sponsor;

Un-invested portion of the investable funds and divestment proceeds pending distribution to investors may be invested in-

- liquid mutual funds
- bank deposits
- other liquid assets of higher quality such as Treasury bills, Triparty Repo Dealing and Settlement, Commercial Papers, Certificates of Deposits, etc.

Till 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;

**15.4.6 Maximum limit prescribed for Overseas Investment by Alternative Investment Funds**:

Overseas investments by AIFs shall not exceed 25% of the investable funds of the scheme of the AIF subject to overall limit of USD 1500 million (combined limit for AIFs and Venture Capital Funds registered under the erstwhile SEBI (Venture Capital Funds) Regulations, 1996).

The same has to be utilised within 6 months from the date of SEBI approval. Else, SEBI may allocate such unutilized limit to other applicants.

## 15.5 Compliance Requirements

**a) Compliance requirements under SEBI (Prevention of Insider Trading) Regulations.**

As AIFs also trade in listed securities, they are bound to comply with the provisions of SEBI (Prevention of Insider Trading) Regulations. Accordingly, AIFs should put in place a Policy for prevention of Insider Trading and inform all the employees about the impact of the Insider Trading Employees to seek pre-clearance approval from the Compliance Officer before trading in listed securities in which the Scheme has a position.

**b) Compliance requirements under PMLA and the Rules framed thereunder**

To have KYC and AML Policy and to make them available on the website, the Company/Trust have to be registered with Financial Intelligence Unit (FIU)- India as a Registered intermediary.

Intimation of appointment of (and changes in) the Designated Director and the Principal Officer of the Company to FIU- India shall also be made.

The Principal Officer (PO) shall identify Suspicious Transactions and file Suspicious Transactions Report (STR) with /to FIU- India.

**c) Other compliance requirements:**

Some other compliances like appointment of SEBI Registered Intermediaries such as Custodian, Stock Brokers and DPs for securities transactions and settlement need to be adhered to.

A copy of the SEBI Registration Certificate should be displayed at the Registered Office (and the Branch Office, if any).

Prior approval should be sought from SEBI for effecting change in the control of the Company as an Investment Manager. Monthly/ Quarterly Returns shall be filed on the SEBI Portal.

d) Every AIF shall have a Compliance Officer who shall be responsible for monitoring compliance

## 15.6 General Obligations, Responsibilities and Transparency

### 15.6.1 Conflict of Interest

All AIF shall ensure transparency and disclosure of information to investors on the following:

- financial, risk management, operational, portfolio, and transactional information regarding fund investments shall be disclosed periodically to the investors.

- any fees ascribed to the Manager or Sponsor; and any fees charged to the AIF or any investee company by an associate of the Manager or Sponsor shall be disclosed periodically to the investors;
- any inquiries/ legal actions by legal or regulatory bodies in any jurisdiction, as and when occurred;
- any material liability arising during the tenure of AIF shall be disclosed, as and when occurred;
- 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;
- change in control of the Sponsor or Manager or Investee Company.

**15.6.2 Reports to the Investors**

AIF shall provide at least on an annual basis, within 180 days from the year end, reports to investors including the following information:

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) 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.

Category III AIF shall provide quarterly reports to investors in respect of the above within 60 days of end of the quarter;

**15.6.3 Valuation**

As the investors get only the Units and not the actual scrips in which investments have been made, it is essential that they are aware on how the investments are valued. Hence it is imperative on the part of AIF to provide investors, a description of its valuation procedure and of the methodology for valuing assets.

- **Category I & II AIF** shall undertake valuation of their investments, at least once in every 6 months, by an independent valuer appointed by the AIF, (such period may be enhanced to one year on approval of at least 75% of the investors by value of their investment in the AIF).

- **Category III** AIF shall ensure that calculation of the net asset value (NAV) is independent from the fund management function of the Alternative Investment Fund and (such NAV shall be disclosed to the investors on a quarterly basis for close ended funds and every month for open ended funds).

The Manager shall ensure that the Alternative Investment Fund appoints an independent valuer who satisfies the criteria specified by SEBI from time to time and who cannot be affiliated with the manager, sponsor, or trustee of the AIF.

**15.6.4 Obligation of Manager**

The Investment Manager shall be obliged to:

(a) address all investor complaints;

(b) provide to SEBI any information sought by SEBI;

(c) maintain all records as may be specified by the 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.

**15.6.5 Dispute resolution**

All claims, differences or disputes between investors and the Alternative Investment Fund or the Manager arising out of or in relation to the activities of the Alternative Investment Fund or the Manager in the securities market shall be submitted to a dispute resolution mechanism that includes mediation and/or conciliation and/or arbitration, in accordance with the procedure specified by SEBI.

**15.6.6 Maintenance of Records**

The Manager or Sponsor shall keep the following records for a period of 5 years after the winding up of the fund 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

**15.6.7 Winding up**

An AIF set up as a trust shall be wound up:

- After the tenure of the AIF or the schemes as mentioned in the PPM is over, or
- Wound up in the interests of investors in the units ---based on the opinion of the Trustees / the Trustee company
- If the winding up proposal is accepted at a meeting of the unitholders by 75% of the investors by the value of their investment
- If SEBI so directs in the interests of investors.

**15.6.8 Distribution of proceeds**

The assets shall be liquidated within the liquidation period, and the proceeds accruing to investors in the AIF or the scheme of the Alternative Investment Fund shall be distributed to them after satisfying all liabilities.

**Dissolution:**

The "dissolution period" refers to the timeframe that begins after the liquidation period of a scheme has ended. It is designated specifically for winding down any remaining unliquidated investments held within the scheme of the Alternative Investment Fund (AIF).

Under Regulation 29(9) of the AIF Regulations, the AIF may either distribute these investments in specie to its investors or initiate the dissolution period, provided that at least 75% of the investors by value give their consent.

## 15.7 Special Type of Funds

**15.7.1 Angel Funds:**

These are a sub-category of Venture Capital Fund under Category I- AIF that raises funds from angel investors and invests in accordance with the provisions of SEBI AIF Regulations.

This Fund is created for certain special types of investors satisfying certain criteria.

"Angel investor" means a person who proposes to invest in an angel fund. This person could be an individual, a body corporate, an AIF, or a company which has "family connection". The conditions to be satisfied are:

(a) an individual investor who has net tangible assets of at least Rs 2 crores excluding value of his principal residence, **and** who has either of:

(i) has early-stage investment experience, [37]

(ii) has experience as a serial entrepreneur,

[37] 'early stage investment experience' shall mean prior experience in investing in start-up or emerging or early-stage ventures and 'serial entrepreneur' shall mean a person who has promoted or co-promoted more than one start-up venture.

(iii) is a senior management professional with at least ten years of experience;

(b) a body corporate with a net worth of at least Rs.10 crores; or

(c) an Alternative Investment Fund registered under these regulations or a Venture Capital Fund registered under the SEBI (Venture Capital Funds) Regulations.

"Company with family connection" means:

a. if the angel investor is an individual,

i. any company which is promoted by such an individual or his relative; or

ii. any company where the individual or his relative is a director; or

iii. any company where the person or his relative has control, or shares or voting rights which entitle them to fifteen percent or more of the shares or voting rights in the company.

b. if the angel investor is a body corporate,

i. any company which is a subsidiary or a holding company of the investor; or

ii. any company which is part of the same group or under the same management of the investor; or

iii. any company where the body corporate or its directors/partners have control, or shares or voting rights which entitle them to fifteen percent or more of the shares or voting rights in the company.

An Angel fund has to register itself with SEBI.

**Schemes:** When launching schemes, it has to file a Term Sheet with SEBI containing material information regarding the scheme. There is restriction on the number of investors in a particular scheme. The number should not exceed 200.

**15.7.1.1 Investments by Angel Funds:**

Angel funds shall invest in startups which are not promoted or sponsored by or related to an industrial group [38], whose group turnover (combined) exceeds Rs 300 crores

**Restriction on investment in a VC by an Angel Fund:**

[38] "Industrial group" shall include a group of body corporates with the same promoter(s)/promoter group, a parent company and its subsidiaries, a group of body corporates in which the same person/ group of persons exercise control, and a group of body corporates comprised of associates/ subsidiaries/holding companies.

- The minimum investment value in a Venture Capital undertaking by an Angel fund is Rs. 25 lakhs and maximum investment value is Rs. 10 crores.
- Investment by an angel fund in the venture capital undertaking shall be locked-in for a period of one year.
- They shall not invest in associates.
- These funds shall not invest more than 25% of the total investments under all its schemes in one venture capital undertaking.
- Investment in the securities of companies incorporated outside India is permitted subject to such conditions or guidelines that may be stipulated or issued by the RBI and SEBI.

Prohibition of Listing: Units of angel funds shall not be listed on any recognised stock exchange.

**15.7.1.2 Obligations of Sponsors and Managers of Angel Fund:**

**Interest in the Angel Fund:** The manager or sponsor shall have a continuing interest in the angel fund of not less than 2.5% of the corpus or fifty lakh rupees, whichever is lesser, and such interest shall not be through the waiver of management fees.

The sponsors and managers shall ensure obtaining undertaking from the angel investors confirming his approval for making such investment, prior to making such an investment.

**15.7.2 Special Situation Funds**

"Special situation fund" means a Category 1 Alternative Investment Fund that invests in special situation assets in accordance with its investment objectives.

**Investment by special situation funds:** It shall invest in stressed loans, Security Receipts issued by Asset Reconstruction Company registered with RBI, Securities of investee companies whose borrowings are subject to corporate insolvency resolution process/ credit rating downgraded to 'D'.

**Registration of special situation funds** with SEBI is mandatory.

**Investment in special situation funds**

- Corpus: Minimum corpus of Rs. 100 crores.
- Minimum investment value: Minimum investment by an investor to be Rs. 10 crores and Rs. 5 crores in case of an accredited investor.
- Acceptance of investments: Not from any other AIF other than a special situation fund.

Other important features of the regulatory framework for Special Situation Funds include:

- Exemption from investment concentration norms in a single investee company;
- No restriction on investing investable funds in unlisted or listed securities;

- Initial and continuous due diligence requirements mandated by RBI for asset reconstruction companies shall also be applicable to Special Situation Funds while acquiring stressed loans in terms of RBI (Transfer of Loan Exposures) Directions, 2021.

### 15.7.3 Specified Alternative Investment Funds

**Corporate Debt Market Development Fund**

SEBI has notified chapter III-C i.e., Corporate Debt Market Development Fund, of the SEBI (Alternative Investment Funds) Regulations, 2012. The Corporate Debt Market Development Fund (CDMDF) will be a backstop facility for the purchase of investment-grade corporate debt securities in times of stress or in case of market dislocation. Basically, this type of AIF will invest only in debt securities.

**Registration of Corporate Debt Market Development Fund**

- The CDMDF shall be constituted in the form of a Trust and the instrument of Trust shall be in the form of a deed duly registered under the provisions of the Indian Registration Act, 1908.
- CDMDF shall be a closed-ended fund.
- Tenure is 15 years from the date of its first closing. (The tenure may be extended with the prior approval of the Board.)
- The fund shall be wound up with the prior approval of the Board.
- Investment in the Corporate Debt Market Development Fund to be made through 'units'.

**Manager or sponsor will have a continuing interest in CDMDF**

The Manager or Sponsor shall have a continuing interest in the CDMDF of not less than Rs 5 crores in the form of investment in the fund but such continuing interest shall not be through the waiver of management fees.

**Disclosure norms for CDMDF**

The portfolio of the Corporate Debt Market Development Fund shall be disclosed to the unitholders on a fortnightly basis. Net Asset Value shall be disclosed to the unitholders on a daily basis.

**Governance mechanisms**

- The CDMDF shall appoint a trustee company.
- The Board of directors of the trustee-company and the Manager of the CDMDF shall be appointed with the prior approval of the Board.
- The trustee company shall not engage in any activity other than acting as a trustee of the CDMDF, except with the prior written consent of the Board:
- Two-thirds of the members of the Board of the trustee company shall be independent directors and shall not be associated with the Sponsor or the Manager.

- An audit committee of the trustee company shall be constituted to review compliance with the provisions of placement memorandum.

**Impact of the CDMDF**

- Boosting the confidence in the corporate bond market.
- By providing a mechanism to support the purchase of investment-grade corporate debt securities, the fund helps instill trust among investors, encouraging their participation in the market.
- Improved liquidity in the secondary market.
- Registration of the CDMDF as an Alternative Investment Fund in the form of a Trust ensures proper governance and regulatory oversight.

## 15.8 General Obligations and Responsibilities and Transparency – For All AIFs

**(A) Code of Conduct**:

Alternative Investment Fund, key management personnel of the Alternative Investment Fund, trustee, trustee company, directors of the trustee company, designated partners or directors should abide by the Code of Conduct as given under the SEBI AIF Regulations.

Each AIF shall have detailed Policies and procedures and shall be periodically reviewed.

The AIF shall inform SEBI material change if any than what has already been disclosed.

For change of Sponsor or Manager, or change in control of the Alternative Investment Fund, Sponsor or Manager, prior approval of SEBI is required.

**All managers of AIF shall:**

i. organise, operate and manage the AIFs and its schemes in the interest of unitholders of the AIF/scheme.
ii. carry out all the activities of the AIF in accordance with the placement memorandum circulated to all unit holders and as amended from time to time in accordance with AIF Regulations and circulars issued by SEBI.
iii. ensure that the placement memorandum is provided to the investors prior to providing commitment or making the investment in the AIF and ensure that an appropriate acknowledgement is received from the investor for such receipt.
iv. ensure scheme-wise segregation of bank accounts and securities accounts.
v. not make any exaggerated statement, whether oral or written, either about their qualifications or capability to render investment management services or their achievements.
vi. manager of the AIF shall be responsible for compliance with such circulars/guidelines.

**The AIF, manager, trustee and sponsor shall:**

(i) act in the interest of unitholders of the AIF/scheme;

(ii) maintain high standards of integrity and fairness;
(iii) exercise due diligence and exercise independent professional judgment;
(iv) not offer any assured returns to any prospective investors/unitholders;
(v) all categories of AIFs shall mandatorily follow the Stewardship Code in relation to their investment in listed equities.

**(B) Responsibilities of the Manager:**

In addition to the General obligations, the Manager has also to ensure:

- That the decisions are in compliance with the provisions of these regulations, terms of the placement memorandum, agreements made with investors, other fund documents, policies and applicable laws.
- that an investment committee is constituted and all decisions are taken as per the AIF Regulations.

**(C) The Sponsor or Manager of the Alternative Investment Fund shall**

- All AIFs are mandatorily required to appoint a custodian registered with SEBI;
- The AIFs may appoint a custodian who is an associate of Manager or Sponsor of the AIF, provided the Manager or Sponsor has a minimum networth of Rs 20000 crores and ensuring the Custodians independence from the Manager or Sponsor;
- The Manager shall not provide advisory services to any investor other than the clients of Co-investment Portfolio Manager;
- Ring fencing the assets and liabilities of each scheme of an Alternative Investment Fund;
- Bank Accounts are segregated from other schemes of the Alternative Investment Fund;

**(D) The Manager shall appoint a Compliance Officer**

- The AIF and the Manager shall appoint a Compliance officer in addition to the Chief Executive Officer. The Compliance Officer shall be responsible for monitoring compliance with the provisions of the Act, rules, regulations, notifications, circulars, guidelines, instructions or any other directives issued by the Board.
- adhering to the eligibility criteria as may be specified by the SEBI from time to time.
- immediately and independently report to SEBI any non-compliance observed by him, as soon as possible but not later than 7 working days from the date of observing such non-compliance.

**(E) Books of accounts of the Alternative Investment Fund shall be audited annually by a qualified auditor.**

**(F) Maintenance of Records**

Records are to be maintained for a period of five years even after the winding up of the Fund.

The Manager or Sponsor shall be required to maintain following records:

- Description of the assets under the scheme/fund;
- valuation policies and practices;
- investment strategies;
- particulars of investors and their contribution;
- rationale for investments made;

The Manager is also required to:

- submit reports to the SEBI;
- obtain Legal Entity Identifier (LEI) of the AIF;
- report on Stewardship Activities on implementation of every principle (Upload on website /annual intimation to client);
- provide periodical Report and Tax Certificate and statement of accounts and valuation Reports to the AIF Contributors
- handling of clients / customers grievances/complaints, if any
- obtaining SCORES Id from SEBI
- monitoring of complaints received / lodged on Scores Platform of SEBI
- providing of periodical Report (Annual within 180 days from the end of the Financial Year and Quarterly within 60 days from the end of the respective quarter) and Tax Certificate and statement of accounts and valuation Reports to the AIF Contributors

**Other obligations**: to abide by all the circulars/guidelines issued by SEBI with respect to KYC requirements, Anti-Money Laundering and Outsourcing of activities shall be applicable to AIFs.

**(G) Reporting of investment activities by AIFs**

All AIFs shall submit Quarterly report on their activity as an AIF to SEBI within 10 calendar days from the end of each quarter.

Category III AIFs shall also submit report on leverage undertaken, on quarterly basis.

**(H) Compliance Test Report (CTR)**

**Annual:** At end of financial year, the manager of an AIF shall prepare a compliance test report on compliance with AIF Regulations and circulars issued thereunder.

**Time period for submission:**

- The CTR shall be submitted within 30 days from the end of the financial year, to (i) the trustee and sponsor, in case the AIF is a trust; (ii) the sponsor, in case of AIF set up in the form other than a trust.
- Observations if any has to be intimated to the manager within 30 days from the receipt of the CTR.
- The Manager shall respond within 15 days of receipt of such observations/comments,

- Any kind of violation observed by the Trustee/Sponsor has to be intimated to SEBI as soon as possible.

**Investor Charter (IC) and Disclosure of complaints by AIFs**

The Investor Charter is a brief document containing details of services provided to investors, details of grievance redressal mechanism, responsibilities of the investors etc., at one single place, in lucid language for ease of reference.

Investor Charter has to be disclosed in the Private Placement Memorandum (PPM).

Data on investor complaints received against AIFs and each of their schemes and redressal status thereof shall be disclosed by all AIFs as a separate chapter in the PPM.

AIFs shall maintain data on investor complaints which shall be compiled latest within 7 days from the end of quarter.

Stamp duty shall be collected on issue, transfer and sale of units of AIFs.

The Registrars to an Issue and/or Share Transfer Agents (RTA) shall be responsible for collection of stamp duty for transactions done other than through the Stock Exchange.

For transaction done through demat mode Stock Exchange/authorized Clearing Corporation or a Depository is empowered to collect stamp duty

## 15.9 Miscellaneous

***Change in sponsor and/or manager or change in control of sponsor and/or manager of AIF***

**Prior approval of SEBI is mandatory** in case of change of Sponsor or Manager, or change in control of the AIF, Sponsor or Manager.

***Fees***

Same fees need to be paid to SEBI which is payable as at the time of Registration. (The cost shall not be passed on to the investors).

**Exemption from payment of fees** shall be made only in cases where;

(i) The manager is acquiring control in or replacing the sponsor and
(ii) Sponsor(s) are exiting in case of AIF having multiple sponsors.

***Time period for payment of fees:***

The aforesaid fee shall be paid within 15 days of effecting the proposed change in manager/sponsor or change in control of manager/sponsor.

**Validity of approval**: The approval is valid for 6 months from the date of SEBI communication for the approval.

**Change in control of Sponsor and/or Manager of AIF involving scheme of arrangement under Companies Act, 2013**

- Prior approval of SEBI before filing the petition with National Company Law Tribunal (NCLT).
- Prior Approval is valid for 3 months from the date of issuance.
- Post sanction of the scheme by NCLT, final approval of SEBI is mandatory.

**15.9.1 Registration related matters**

**Fresh approval of SEBI** is required in case of non-submission of documents within the prescribed period.

**Change in category of AIF:**

An Alternative Investment Fund which has been granted registration under a particular category cannot change its category subsequent to registration, except with the approval of the SEBI.

Only AIFs who have not made any investments under the category in which they were registered earlier shall be allowed to make application for change in category.

Any AIF proposing to change its category shall make an application to SEBI for the same along with an application fees of 1 lakh rupees.

If the AIF has received commitments/ raised funds prior to application for change in category, the AIF shall be required to send letters/emails to all its investors providing them the option to withdraw their commitments/ funds raised without any penalties/charges.

Any fees collected from investors seeking to withdraw commitments/ funds shall be returned to them.

Partial withdrawal may be allowed subject to compliance with the minimum investment amount required under the AIF Regulations.

**Investment restrictions:** The AIF shall not make any investments other than in liquid funds/ banks deposits until approval for change in category is granted by SEBI.

AIF shall send a copy of the revised PPM and other relevant information to all its investors and SEBI.

**Review Questions**

1. What is the minimum investment amount (ticket size) required for investing in an Alternate Investment Fund (AIF)?

(a) **1 crore**
(b) 10 lakh
(c) 5 crore
(d) 10 crore

2. The following is not considered to be an Alternative Investment Fund?

**(a) Funds managed by securitisation company**

(b) Trust under Indian Trusts Act

(c) Limited Libility Partnership

(d) Body Corporate

3. Which category of Alternative Investment Fund is into hedging activities?

**(a) Category III Alternative Investment Fund**

(b) Category I Alternative Investment Fund

(c) Category II Alternative Investment Fund

(d) Corporate Debt Market Development Fund

4. Angel investor can be a body corporate with a net worth of at least Rs._____.

**(a) 10 crores**

(b) 5 crores

(c) 2 crores

(d) 3 crores

# CHAPTER 16: SEBI (INVIT) REGULATIONS

**LEARNING OBJECTIVES:**
After studying this chapter, you should know about:

- Infrastructure Investment Trusts (INVITs)
- Structure and Key Players of INVITs
- Rights & Responsibilities of the parties to an InViT
- Fund raising, Listing and Delisting and Other Significant Matters
- Inspection of INVITs activities by SEBI

Infrastructure development is a key indicator of the growth of an economy. A well-developed infrastructure set-up propels the overall development of a country. It also enables a steady inflow of foreign investments and thereby augments the capital base available for the growth of key sectors of an economy in a sustained manner. As India strives to take a long journey towards the path of high economic growth, there is a need to develop infrastructure to support the growth. Given the long gestation period, the infrastructure sector needs long-term capital. Presently, the bulk of our infrastructure funding needs are being met by the domestic commercial banks and financial institutions, who find it difficult to provide such long-term funding, constrained by asset-liability mismatches.

## 16.1 Introduction to Infrastructure Investment Trusts (InvITs)

SEBI (Infrastructure Investment Trusts) Regulations, 2014 ("InvIT Regulations") try to alleviate the burden on the banking system by making available fresh capital for the infrastructure sector. Further, with a view to aid long-term funds for the infrastructure projects, the Companies Act, 2013 also provides issuance of non-convertible debentures for a period exceeding 10 years but not exceeding 30 years, and redeemable preference shares for a period exceeding 20 years but not exceeding 30 years.

InvITs envisage the formation of a Trust and other key players, like the project manager and the investment manager. The Trustees owe a fiduciary duty and have to ensure that the functions of the InvIT, investment manager, and project manager comply with SEBI rules and regulations.

The units issued by an InvIT provide a window to developers to unlock their invested capital in completed infrastructure projects by transferring the majority of their ownership to an InvIT at a price based on valuation done by an independent valuer. Very simply put, InvIT is a mechanism that enables infrastructure developers to monetize their assets by pooling multiple projects in a single entity, which is a Trust. It plays a crucial role in providing wider, long-term refinancing

avenues, thereby creating headroom for banks to fund new projects and releasing developers' capital for further deployment in new projects. From an investor standpoint, InvITs will not only provide risk adjusted exposure to large infrastructure assets but shall also provide high levels of liquidity.

An Infrastructure Investment Trust (InvITs) is a Collective Investment Scheme similar to a mutual fund, which enables direct investment of money from individual and institutional investors in infrastructure projects to earn a certain portion of the income as return. SEBI (Infrastructure Investment Trusts) Regulations, 2014 provide a regulatory framework for registration and regulation of InvITs in India.

The units issued by an InvIT provide a window to developers to unlock their invested capital in completed infrastructure projects by transferring the majority of their ownership to an InvIT at a price based on valuation done by an independent valuer. Very simply put, InvIT is a mechanism that enables infrastructure developers to monetize their assets by pooling multiple projects in a single entity, which is a Trust. It plays a crucial role in providing wider, long-term refinancing avenues, thereby creating headroom for banks to fund new projects and releasing developers' capital for further deployment in new projects. From an investor standpoint, InvITs will not only provide risk adjusted exposure to large infrastructure assets but shall also provide high levels of liquidity.

The regulations, inter alia, prescribe conditions for making a public offer and private placement, initial and continuous disclosures, investment conditions, unit-holder approval requirements, related party disclosures, etc. Often, infrastructure projects such as roads or highways take some time to generate steady cash flows. Meanwhile, the infrastructure company has to pay interest to banks for the loans taken out by it. An InvIT essentially gives the company the flexibility to fulfil its debt obligations quickly.

## 16.2 InvIT – Structure and Key Definitions

### 16.2.1 Structure of InvIT

The structure of InvIT is similar to that of a Mutual Fund (MF). The parties involved in setting up MF include a trustee company, a sponsor, and the asset management company, which floats different schemes by garnering money from the public and investing predominantly in capital market instruments, whereas InvITs invest only in infrastructure projects.

**"InvIT" or 'Infrastructure Investment Trust'** means the Trust formed under The Indian Trusts Act, 1882 and registered under the InvIT Regulations. The Trust is set up by the Sponsor, the ownership of the property vests in the Trustee and the beneficiaries of the Trust are the unit holders of the InvIT.

*"An infrastructure investment trust is a trust formed under The Indian Trusts Act and registered under the Registration Act. In accordance with the Trusts Act, a trust is an obligation attached to the ownership of property. The obligation is created by the author of the trust, accepted by the owner of property and owed to the beneficiaries identified in the Trust Deed. In the context of an InvIT, the Trust is created by the Sponsor, the ownership of the property vests in the Trustee and the beneficiaries are the Unit holders of the InvIT."*

"**Infrastructure**" includes all infrastructure sub-sectors as defined vide notification of the Ministry of Finance dated October 07, 2013 and shall include any amendments or additions made thereof;

--it includes sectors such as Transport, Energy, Water & sanitation, communication, social & commercial infrastructure.

"**Infrastructure project**" means any project in the infrastructure sector.

"**InvIT**" shall mean a trust registered as such under the InvIT Regulations.

"**InvIT assets**" means assets owned by the InvIT, whether directly or through a holdco and/or SPV, and includes all rights, interests and benefits arising from and incidental to ownership of such assets

**16.2.2 Key Players**

The following table depicts the parties involved in the establishment of InvIT viz., i.e. the Sponsor, the Investment Manager, the Project Manager and the Trustee. The Investment Manager of an InvIT plays the role as that of the Fund Manager in a Mutual Fund.

| **Key stakeholders** | |
|---|---|
| **Sponsor** | A sponsor can be a company /LLP / body corporate which sets up the InvIT. An application for grant of certificate of registration as InvIT is made by the sponsor on behalf of the trust.<br>Each sponsor and sponsor group must be clearly identified in the application for registration and in the offer document/placement memorandum.<br>for each sponsor group not less than one person shall be identified as a sponsor:<br>However, of the entities categorized as sponsor group, only the following entities may be considered:<br>a) a person or entity who is directly or indirectly holding an interest or shareholding in any of the assets or SPVs or holdco(s) proposed to be transferred to the InvIT;<br>b) a person or entity who is directly or indirectly holding units of the InvIT on post- issue basis;<br>c) a person or entity whose experience is being utilized by the sponsor for meeting with the eligibility conditions required under these regulations |

| | |
|---|---|
| | Each sponsor has:<br>1. Financial parameters:<br>(a) a net worth of not less than Rs. 100 crore if it is a body corporate or a company; or<br>(b) net tangible assets of value not less than Rs. 100 crore in case it is a limited liability partnership.<br>2. Experience:<br>Sound track record in development of infrastructure or fund management in the infrastructure sector.<br>'S*ound track record' means experience of at least 5 years and where the sponsor is a developer, at least two projects of the sponsor have been completed* |
| **Investment Manager** | Investment Manager can be a company /LLP/ body corporate which manages assets and investments of the InvIT and undertakes activities of the InvIT.<br>The Investment Manager inter alia has<br>1. Financial parameters:<br>a net worth of not less than Rs 10 crore if the Investment Manager is a body corporate or a company or<br>net tangible assets of value not less than Rs 10 crore rupees in case the Investment Manager is an LLP<br>2. Experience: not less than 5 years of experience in fund management or advisory services or development in the infrastructure sector or the combined experience of the directors/ partners/employees of the Investment Manager in fund management or advisory services or development in the infrastructure sector is not less than 30 years.<br>3. Two or more key personnel, having more than 5 years of experience in fund management/advisory services/development in infrastructure sector;<br>4. One or more employee who has at least 5 years of experience in relevant sub-sector in which InvIT proposes to invest;<br>Board:<br>5. Not less than half of its directors in case of a company/members in case of a LLP should be independent and they should not be directors/members of an Investment Manager of another InvIT;<br>Office:<br>6. An office in India from where operations pertaining to InvIT is proposed to be conducted |

| | |
|---|---|
| | Agreement:<br>7. Enter into an investment management agreement with the Trustee which provides for the responsibilities of the Investment Manager. |
| **Project Manager** | Project Manager can be company or LLP or a body corporate.<br>Project Manager is responsible for achieving execution /management of the project. |
| **Trustee** | Trustee<br>1. is a person who holds the InvIT assets in trust for the benefit of the unit holders<br>2. is registered with SEBI (Debenture Trustees) Regulations, 1993 and<br>3. is not an associate of the sponsor(s) or Investment Manager<br>4. Should have sufficient resources with respect to infrastructure, personnel etc. as specified by SEBI<br>The role of Trustee is supervisory in nature– overseeing the activities of the Investment Manager, the Project Manager and to ensure that InvIT is being operated in accordance with its constitutional documents. |

As number of parties are involved, the Regulations require them to enter into necessary agreements. Certain key agreements being Investment Management Agreement and Project Implementation Agreement. The scope of these are summed up in a nutshell:

(i) In case of the Investment Management Agreement, the task of entering into certain types of Projects lies with the Investment Manager. As Investment Management is entrusted such a task, this agreement governs the relationship, the terms and conditions, the Roles, responsibilities and the reporting mechanism of the IM to the Trustee. *"Investment management agreement*" means an agreement between the trustee and the investment manager which lays down the roles and responsibilities of the investment manager towards the InvIT;

(ii) In case of Project Implementation agreement as the Projects are managed by experts viz. Project Managers, it is necessary to ensure that the chosen Projects are implemented according to the Objects for which the money is intended to be collected from the Unit Holders. Hence the Regulations mandate entering into certain agreements which will specify the Projects, define the role, responsibilities of the Project Manager. "*Project implementation agreement*" or "project management agreement" means an agreement between the project manager, the SPV and the trustee which sets out obligations of the project manager with respect to execution of the project and/or management.

**16.2.3 Terminologies**

Some of the Key terminologies are given below:

- **"Holdco" or "holding company" means a company or LLP,-**

  (i) in which InvIT holds or proposes to hold controlling interest and not less than 51% of the equity share capital or interest and which in turn has made investments in other SPV(s), which ultimately hold the infrastructure assets;

  (ii) which is not engaged in any other activity other than holding of the underlying SPV(s), holding of infrastructure projects and any other activities pertaining to and incidental to such holdings;"

- **"Unit**" means beneficial interest of the InvIT;

- **"Unit holder"** means any person who owns units of the InvIT

- **"Completed and revenue-generating project"** means an infrastructure project, which prior to the date of its acquisition by, or transfer to, the InvIT, satisfies the following conditions:

  (i) The infrastructure project has achieved the commercial operations date as defined in the agreements

  (ii) the infrastructure project has received all the requisite approvals and certifications for commencing operations; and

  (iii) the infrastructure project has been generating revenue from operations for a period *of not less than one year;*

- **"Concession Agreement"** means an agreement entered into a person with a concessioning authority for the purpose of implementation of the project as provided in the agreement.

- **"Concessioning Authority"** means the public sector concessioning authority in PPP projects.

- **"Eligible Infrastructure Project"** means an infrastructure project, satisfies the following conditions, –

  (i) **For PPP projects**, (Public Private Partnership)

  1. the Infrastructure Project is a completed and revenue generating project;

     **OR**

     The Infrastructure Project, which has achieved commercial operations date and does not have the track record of revenue from operations for a period of not less than one year,

  **OR**

2. The Infrastructure Project is a pre-COD project.

(ii) **In non-PPP projects**,

The infrastructure project has received all the requisite approvals and certifications for commencing construction of the project.

- **"Institutional Investor"** means **–**
  - a qualified institutional buyer; or
  - family trust or systematically important NBFCs registered with RBI or
  - Intermediaries registered with SEBI,

all with net-worth of more than Rs 500 crores, as per the last audited financial statements.

- **"PPP Project"** means an infrastructure project undertaken on a Public- Private Partnership basis between a public concessioning authority and a private SPV concessionaire selected on the basis of open competitive bidding or on the basis of an MoU with the relevant authorities.

- **"Pre-COD project" means an infrastructure project which:**

  a) has not achieved commercial operation date as defined under the relevant project agreements and

  b) has (i) achieved completion of at least 50% of the construction of the infrastructure project as certified by an independent engineer of such project; or (ii) expended not less than 50% of the total capital cost set forth in the financial package of the relevant project agreement.

- "**Related Parties**"- same as defined under the Companies Act, 2013 or under the applicable accounting standards and shall also include,

  (i) Parties to the InvIT;

  (ii) Promoters, directors and partners of the Parties to the InvIT;

"**SPV**" or "**special purpose vehicle**" means any company or LLP,

(i) in which either the InvIT or the holdco holds or proposes to hold controlling interest and **not less than 51% of the equity share capital or interest**;

(ii) which holds **not less than 90% of its assets** directly in infrastructure projects and does not invest in other SPVs; and

(iii) which is **not engaged in any other activity** other than activities pertaining to and

incidental to the underlying infrastructure projects;

"**Under-Construction Project**" means an infrastructure project whether PPP or non-PPP, which

**a)** has either not achieved commercial operation date as defined under the relevant project agreements**, OR**

b) has achieved commercial operation date and does not have the track record of revenue from operations for a period of not less than one year.

"**Valuer**" means any person who is a "registered valuer" under section 247 of the Companies Act, 2013 or as specified by SEBI from time to time.

"**Value of the InvIT assets**" means value of assets of the InvIT as assessed by the valuer based on value of the infrastructure and other assets owned by the InvIT, whether directly or through holdco and/or SPV.

**16.2.4 Registration and Eligibility Requirements**

The following sets out the registration and eligibility requirement for InvIT:

An application for grant of certificate of registration as InvIT **shall be made by the sponsor on behalf of the Trust** in the form as specified in the Schedule I of InvIT Regulations and shall be accompanied by a non-refundable application fee as specified in Schedule II of InvIT Regulations.

(a) The instrument of trust is in the form of a deed duly registered in India under the provisions of the Registration Act, 1908;

(b) The Trust Deed has its main objective as undertaking activity of InvIT in accordance with these regulations and includes responsibilities of the Trustee.

**Conditions for registration**

(i) The proposed activities should be clearly described

(ii) The parties to the InvIT are fit and proper persons based on the criteria as specified in Schedule II of the SEBI (Intermediaries) Regulations, 2008;

(iii) In case any previous application for grant of certificate made by the InvIT or the parties to the InvIT have been rejected by the SEBI, then the details of the same should be provided, else an undertaking to this effect should be provided.

(iv) In case any disciplinary action has been taken by the SEBI or any other regulatory authority against the parties to the InvIT or their directors/members of governing board under any Act including SEBI the details of the same should be provided, else an undertaking to this effect should be provided.

**Granting of Registration Certificate**

SEBI on being satisfied that the applicant fulfils the requirements and after payment of the requisite fees, shall grant certificate of registration:

In some cases, where SEBI is not satisfied with the details provided, it ***may grant in-principle approval*** and after fulfilling all the requirements grant final registration to the trust.

**Conditions of Certificate**

The certificate granted shall, inter-alia, be subject to the following conditions-

- The InvIT shall abide by the provisions of the SEBI Act and InvIT Regulations;
- The InvIT 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;
- The InvIT and parties to the InvIT shall satisfy the eligibility conditions at all times;
- The InvIT and parties to the InvIT shall comply, at all times, with the Code of conduct as specified in the Schedule VI to the InvITs Regulations, wherever applicable

**On line filing system**

Registration & Reporting: In order to facilitate ease of operations in terms of applying for registration, reporting and various compliances under SEBI (InvIT) Regulations, SEBI has introduced an online system for filings related for InvITs. The online system can be used for application for registration, reporting and filing under the provision of aforesaid Regulations

## 16.3 Rights & Responsibilities of the parties to an InViT

**Trustees:** The Trustee shall

- hold the InvIT assets in the name of the InvIT for the benefit of the unit holders.
- enter into an investment management agreement with the investment manager on behalf of the InvIT.
- oversee activities of the investment manager in the interest of the unit holders,
- obtain **compliance certificate** from the investment manager, ***on a quarterly basis***.
- oversee activities of the project manager with respect to compliance with these regulations and the project implementation agreement/ project management agreement
- obtain **compliance certificate** from the Project manager, **on a quarterly basis.**
- ensure that the investment manager complies with reporting and disclosures requirements in accordance with these regulations.

- review the transactions carried out between the investment manager and its associates
- periodically review the status of unit holders' complaints and their redressal undertaken by the investment manager.
- make distributions and ensure that investment manager makes timely declaration of distributions to the unit holders in accordance with the InvITs regulations
- ensure that subscription amount is kept in a separate bank account in name of the InvIT and is only utilized for adjustment against allotment of units or refund of money to the applicants till the time such units are listed.
- ensure that the remuneration of the valuer is not linked to or based on the value of the assets being valued.
- ensure that the investment manager convenes meetings of the unit holders in accordance with these regulations and oversee the voting by unit holders
- the trustee may require the investment manager to set up such systems and procedures and submit such reports to the trustees, as may be necessary for effective monitoring of the functioning of the InvIT.
- The trustee may take up with SEBI or with the designated stock exchange, as may be applicable, any matter which has been approved in any meeting of unit holders, if the matter requires such action.
- In case of any change in investment manager due to removal or otherwise,–
    - prior to such change, the trustee shall obtain approval from unit holders
    - the trustee shall appoint the new investment manager within 3 months from the date of termination of the earlier investment management agreement;
- In case of any change in the project manager due to removal or otherwise,–
    - the trustee shall appoint the new project manager within three months from the date of termination of the earlier project implementation agreement/ project management agreement;
    - the trustee may, either suo motu or based on the advice of the concessioning authority appoint an administrator in connection with an infrastructure project(s) for such term and on such conditions as it deems fit;
- The trustee shall obtain prior approval from the unit holders in case of change in control of the investment manager.
- In case of change in control of the project manager in a PPP project, the trustee shall

ensure that written consent of the concessioning authority is obtained in terms of the concession agreement prior to such change, where applicable.

- The trustee of the InvIT shall not invest in units of the InvIT in which it is designated as the trustee.
- The trustee shall ensure that the activity of the InvIT is being operated in accordance with the provisions of the trust deed, InviTs Regulations and the offer documents
- The trustee shall immediately inform the Board in case any act which is detrimental to the interest of the unit holders is noted

**Investment Managers**

The Investment manager shall;

(1) make the investment decisions with respect to the underlying assets or projects of the InvIT including any further investment or divestment of the assets.

(2) oversee activities of the project manager with respect to compliance with InvIT Regulations and the project implementation agreement/ project management agreement

(3) obtain compliance certificate from the project manager on a quarterly basis.

(4) ensure that the infrastructure assets of the InvIT or holdco or SPV have proper legal titles

(5) ensure that the investments made by the InvIT are in accordance with the investment conditions specified in InviTs regulations and in accordance with the investment strategy of the InvIT.

(6) in consultation with Trustee, appoint the valuer(s), auditor, registrar and transfer agent, merchant banker, custodian and any other intermediary or service provider

(7) appoint an individual or a firm as the auditor

(8) arrange for adequate insurance coverage for the InvIT assets:

(9) ensure that it has adequate infrastructure and sufficient key personnel with adequate experience and qualification to undertake management of the InvIT at all times.

(10) alongwith the merchant banker(s) be responsible for all activities pertaining to issue of units and listing of units of the InvIT including,–

a. filing of placement memorandum with SEBI

b. filing of the offer document with SEBI and the exchanges within the prescribed time period;

c. dealing with all matters up to allotment of units to the unit holders;

d. obtaining in-principle approval and final listing and trading approvals from the designated stock exchanges;

e. dealing with all matters relating to issue and listing of the units of the InvIT as specified under Chapter IV and any guidelines as may be issued by SEBI in this regard.

(11) alongwith the merchant bankers(s)], ensure that disclosures made in the offer document or placement memorandum contains material, true, correct and adequate disclosures and are in accordance with these regulations and guidelines or circulars issued hereunder.

(12) declare distributions to the unit holders

(13) review the transactions carried out between the project manager and its associates

(14) ensure adequate and timely redressal of all unit holders' grievances pertaining to activities of the InvIT

(15) ensure that the disclosures or reporting to the unit holders, SEBI, trustees and designated stock exchanges, are in accordance with these regulations and guidelines or circulars issued hereunder.

(16) shall not obtain any commission or rebate or any other remuneration, in connection with issue of Units.

(17) ensure that the valuation of the InvIT assets is done by the valuer(s)

(18) submit to the trustee,-within 30 days of end of the quarter

a. quarterly reports on the activities of the InvIT including

i. receipts for all funds received by it and for all payments made,

ii. position on compliance with these regulations,

iii. performance report,

iv. status of development of under-construction projects

b. valuation reports as required under these regulations within 15 days of the receipt of the valuation report from the valuer;

c. decision to acquire or sell or develop or bid for any asset or project or expand existing completed assets or projects along with rationale for the same;

d. details of any action which requires approval from the unit holders as maybe required under the regulations;

e. details of any other material fact including change in its directors, change in its shareholding, any legal proceedings that may have a significant bearing on the

activity of the InvIT, within seven working days of such action.

(19) ensure that computation and declaration of NAV of the InvIT based on the valuation done by the valuer, shall be disclosed to the stock exchange(s), not later than fifteen days from the date of valuation.

(20) ensure that the audit of accounts of the InvIT by the auditor is done not less once in a year and such report is submitted to the stock exchange [s] within sixty days of end of financial year ending March 31st

(21) appoint a custodian in order to provide such custodial services as may be authorised by the trustees.

(22) place before its board of directors in case of company or the governing board in case of an LLP a report on activity and performance of the InvIT at least once every quarter within thirty days of end of every quarter.

(23) designate an employee or director as the compliance officer for monitoring of compliance with these regulations and guidelines or circulars issued hereunder and intimating SEBI in case of any non-compliance.

(24) convene meetings of the unit holders in accordance with regulation 22 and maintain records pertaining to the meetings in accordance with regulation 26.

(25) ensure that all activities of the intermediaries or agents or service providers appointed by the investment manager are in accordance with InvIT Regulations and guidelines or circulars issued hereunder.

**Project Manager**

(1) The project manager shall undertake operations and management of the InvIT

(2) If the InvIT invests in under construction projects, the project manager shall,–

undertake the operations and management of the projects, oversee the progress of development, approval status and other aspects of the project upto its completion, in case of appointment of agents for the purpose of execution.

(3) The project manager shall discharge all obligations in respect of achieving timely completion of the project implementation agreement/ infrastructure project

**Sponsors**

The sponsor shall

(1) (a) set up the InvIT; (b) appoint the trustees of the InvIT

(2) transfer or undertake to transfer to the InvIT, its entire shareholding or interest and rights in the holdco and/ or SPV or ownership of the infrastructure projects,

(3) the sponsor(s) together shall at all times collectively hold not less than 15% of the total outstanding units of the InvIT for a period of not less than 3 years from the date of the listing of such units. In such a scenario,

(i) sponsor(s) would be responsible for all acts, omissions and representations/covenants of the InvIT.
(ii) the InvIT/the trustee of the InvIT shall also have recourse against the Sponsor for any breach in this regard.
(iii) project Manager of the InvIT shall be the sponsor or an associate of the sponsor and shall continue to act in such capacity for a period of minimum 3 years from the date of listing of InvIT units unless suitable replacement is appointed by the unit-holders through the Trustee.

**Sponsor group** includes-

(i) the sponsor(s);
(ii) entities or person(s) which are controlled by such sponsor;
(iii) entities or person(s) who control such body corporate;
(iv) entities or person(s) which are controlled by entities or person(s) specified in clause (iii).

The responsibilities of the sponsor group is same as that of the sponsor.

**Valuer**

(1) The valuers shall at all times,–

a. ensure that the valuation of the InvIT assets is impartial, true and fair and is in accordance with these Regulations;

b. adequate and robust internal controls to ensure the integrity of its valuation reports;

c. ensure that it has sufficient key personnel with adequate experience and qualification to perform valuations;

d. ensure that it has sufficient financial resources to enable it to conduct its business effectively and meet its liabilities;

e. the valuer and any of its employees involved in valuing of the assets of the InvIT, shall not,–

i. invest in units of the InvIT or in the assets being valued; and

ii. sell the assets or units of InvITs held prior to being appointed as the valuer, till the time such person is designated as valuer of such InvIT and not less than six months after ceasing to be valuer of the InvIT;

f. the valuer shall conduct valuation of the InvIT assets with transparency and fairness and shall render, at all times, high standards of service, exercise due diligence

g. ensure proper care and exercise independent professional judgment;

h. act with independence, objectivity and impartiality in performing the valuation;

i. discharge its duties towards the InvIT in an efficient and competent manner,

j. not accept remuneration, in any form, for performing a valuation of the InvIT assets from any person other than the InvIT or its authorized representative;

k. before accepting any assignment, from any related party of the InvIT, disclose to the InvIT any direct or indirect consideration which the valuer may have in respect of such assignment

l. disclose to the InvIT any pending business transactions, contracts under negotiation and other arrangements with the investment manager or any other party whom the InvIT is contracting with and any other factors that may interfere with the valuer's ability to give an independent and professional valuation of the assets;

m. not make false, misleading or exaggerated claims in order to secure assignments;

n. not provide misleading valuation, either by providing incorrect information or by withholding relevant information;

o. not accept an assignment which interferes with its ability to do fair valuation;

**Auditor**:

The auditor shall comply with the following conditions at all times. They shall–

(a) conduct audit of the accounts of the InvIT and draft the audit report;

(b) ensure that the accounts and financial statements give a true and fair view of the state of the affairs of the InvIT;

(c) have a right of access at all times to the books of accounts and vouchers pertaining to activities of the InvIT;

(d) have a right to require such information and explanation pertaining to activities of the InvIT as he may consider necessary for the performance of his duties as auditor;

(e) undertake a limited review of the audit of all the entities or companies whose accounts are to be consolidated with the accounts of the InvIT as per the applicable Indian Accounting Standards (Ind AS).

## 16.4 Fund raising by InvIT

InvITs can raise funds through an Initial Public offer (IPO) or through Private Placement

### 16.4.1 If the InvIT raises funds by public issue–

(a) it shall be by way of Initial Public Offer (IPO);

(b) any subsequent issue of units after initial public offer shall be through (i) follow-on offer, (ii) preferential allotment, (iii) qualified institutional placement, (iv) rights issue (v) bonus issue, (vi) offer for sale or any other mechanism as may be specified by SEBI;

**(A) IPO**

For an InvIT to make an initial offer of units, it should fulfil the following criteria–

- The InvIT shall be registered with SEBI;
- The value of InvIT assets shall not be less than Rs. 500 crore

  *(Such value shall mean the value of the specific portion of the holding of InvIT in the underlying assets or holdco or SPVs;)*
- The offer size shall not be less than Rs. 250 crore.

**Note:** The requirement of value is to be fulfilled before filing the offer document with SEBI with an undertaking to this effect and adequate disclosures in offer document or placement memorandum.

***Minimum public unitholding***

The minimum offer and allotment to public through an offer document/placement memorandum shall be,–

(a) atleast 25% of the total outstanding units of the InvIT, if the post issue capital of the InvIT calculated at offer price is less than Rs. 1600 crore;

(b) of the value of atleast Rs. 400 crore, if the post issue capital of the InvIT calculated at offer price is equal to or more than Rs. 1600 crore and less than Rs. 4000 crore;

(c) atleast 10% of the total outstanding units of the InvIT, if the post issue capital of the InvIT calculated at offer price is equal to or more than Rs. 4000 crore.

**Exclusion**: However, any units offered to sponsor or the investment manager or the project manager or their related parties or their associates shall not be counted towards units offered to the public.

**If Minimum public shareholding is less than 25%:** any listed InvIT which has public holding below 25% shall increase its public holding to at least 25%, within a period of 3 years from the date of listing pursuant to initial offer.

***Subscription***

- **minimum subscription** amount from any investor in initial and follow-on offer shall be within the range of Rs. 10,000 to Rs. 15,000.
- **maximum subscription** from any investor should not be more than 25% total unit capital, (other than sponsor(s), its related parties and its associates).

***Steps prior to initial public offer and follow-on offer,***

Appointment of a Merchant Banker is the first step. Thereafter comes filing the offer document:

- The merchant banker is required to file the offer document along with prescribed fees with the designated stock exchange(s) and SEBI not less than 5 working days before opening the Issue.
- The draft offer document filed with SEBI shall be made public, for comments, if any, by hosting it on the websites of SEBI, designated stock exchanges, InvIT and merchant bankers associated with the issue for a period of not less than 21 days;
- Incorporate the comments, if any of SEBI, before filing the offer document with the designated stock exchanges;
- The draft offer document and offer document shall be accompanied ***by a due diligence certificate signed by the lead merchant banker;***

**Validity of SEBI approval**: InviT can open the issue within a period of not more than one year from the date of issuance of observations by SEBI;

The InvIT may invite for subscriptions and allot units to any person, whether resident or foreign. In case of foreign investors, such investment shall be subject to guidelines as may be specified by the RBI and the government from time to time.

***Strategic investors:*** Similar to an IPO of equity shares where Anchor Investor invest prior to the opening of the Issue to the public, in InviTs, Strategic investors play such a role. The key features being:

- The strategic investor(s) shall, either jointly or severally, invest not less than 5% and not more

than 25% of the total offer size and shall enter into binding unit subscription agreement with the Investment Manager

- The price at which the strategic investor(s) has/have agreed to buy units of the InvIT shall not be less than the issue price determined in the public issue.
- Broad details of the unit subscription agreement shall be disclosed in the draft offer document or offer document, as applicable.

**Minimum number of unit holders in an InvIT** (other than the sponsor(s), its related parties and its associates) shall be 20, in case units are listed through IPO.

**Lock in of the Units**: The units subscribed by strategic investors, pursuant to the unit subscription agreement, shall be locked-in for a period of 180 days from the date of listing in the public issue.

**The application** for subscription shall be together with abridged version of Offer document.

**Abridged offer document** will contain the risk factors and summary of the terms of issue;

**Offer period**: Initial public offer and follow-on offer shall be open for subscription for a minimum period of 3 days and maximum period of 30 days;

**Allotment** (In case of oversubscription): The InvIT shall allot units to the applicants on a proportionate basis rounded off to the nearest integer subject to minimum subscription amount per subscriber;

**Mode of allotment**: Units shall be allotted only in dematerialized form ;

**Pricing**: The pricing shall be determined through Book building process or any method prescribed by SEBI.

**Listing**: The units should be mandatorily be listed on the stock exchange within 6 working days of the close of the Issue in case of publicly offered units. However, with respect to listing of privately placed units, the units shall be listed on the exchange within 30 working days from the date of the allotment.

**Refunding the money to the applicants**:

- **In case of Under subscription**: Subscription money to be refunded to all the applicants if at least 90% of the fresh issue size is not received.
- **If the number of applicants is less than 20**: Subscription money to be refunded to all the applicants, in case the number of subscribers to the initial public offer forming part of the public is less than 20.

**Over subscription**:

- **Retention by the InviT**: The money to be retained in case of over subscription (maximum allowed is 25% of the issue size) and other disclosures must be made in the offer document.
- Money shall be refunded to applicants to the extent of the oversubscription.
- Adequate disclosures for utilisation of the excess money is to be made in the Offer document. The same cannot be used for General Corporate purposes.

**Payment of Interest**: InviTs shall pay interest at 15% per annum from the closure of the issue in case the Units are not listed or the money refunded within the specified time.

**Offer for sale:** Units may be offered for sale to public.

The amount earmarked for general purposes, as mentioned in objects of the issue in the draft offer document filed with SEBI, shall not exceed 10% of the amount raised by the InvIT by issuance of units.

**Failure to do an IPO--Surrender of registration certificate:**

Failure to do an IPO or Private Placement within 3 years (which can be extended for another year by SEBI) of registration shall entail surrender of Registration certificate.

**Contents of Offer document or Follow on Offer document – IPO/FPO**

The offer document shall include all information as specified under Schedule III- of SEBI InviTs Regulations

**Broadly, the offer document shall inter-alia include the following**:

- Basic details of the InvIT- Registered office, Registration number etc.,
- Details of the Sponsor, Investment Manager, Project Manager, Trustee and other parties.
- Background of InvIT, including the structure, details of any arrangements pertaining to underlying InvIT assets entered into with various parties prior to the issue and credit ratings, if any.
- Terms of issue including number of units, price, distribution policy, listing of units, commitment from strategic investors, if any.
- Description of assets under InvIT
- Business details including investment strategy, use of proceeds
- Leverage
- Related party transactions
- Valuation methodology

- Audited Financial statements of the InvIT, Investment Manager and sponsor for previous 3 years
- Sector or sub-sector specific information relevant for an investor to invest in the InvITs
- Rights of Unit Holders
- Title and approval disclosures, litigations and regulatory actions
- Risk factors
- Brief details on taxation and regulatory aspects

However, the offer document shall not be misleading or contain any untrue statements or mis-statements. Further, it should not provide for any guaranteed returns to the investors.

***IPO Advertisements***

The IPO advertisements shall not (a) be misleading; (b) contain anything extraneous to the contents of the offer document. Any positive highlights, shall also contain risk factors with equal importance.

The following d**ocuments need to be provided** alongwith draft offer document and offer document/placement memorandum:

- Declarations --to be signed by the board of directors of the investment manager and sponsor
- Full valuation report
- Project implementation/management agreement,
- Due diligence certificate
- In principle approval from the exchange(s)

**(B) Further Issues**

**Rights issue through Fast track methods**:

In case the InvITs fulfil certain parameters, it can file offer document under the Fast track Issue with Stock Exchanges and a copy needs to be filed with SEBI. Such parameters inter-alia include:

- the units of the InvIT should have been listed on any stock exchange for a period of at least 3 years immediately preceding the record date;
- all the units of the InvIT are held in demat form on the record date;
- the average market capitalisation of public unitholding of the InvIT shall be atleast Rs 250 crores;

- the InvIT is compliant with the listing and disclosure requirements of the InvIT Regulations;
- the InvIT has redressed at least ninety-five per cent of the complaints received from the investors till the end of the quarter immediately preceding the month of the record date;
- no show-cause notices issued by SEBI is pending against the InvIT, parties to the InvIT or their respective promoters or partners or directors as on the record date;
- the InvIT, parties to the InvIT or their respective promoters or partners or directors has not settled any alleged violation of securities laws with SEBI during 3 years immediately preceding the record date;
- units of the InvIT have not been suspended from trading as a disciplinary measure during last 3 years immediately preceding the record date.
- there are no audit qualifications on the audited accounts of the InvIT in respect of those financial years for which such accounts are disclosed in the letter of offer;

**(C) Private Placement:**

**The process of raising funds through private placement is given below:**

- InvITs shall file a draft placement memorandum with SEBI and stock exchange(s) through a merchant banker not less than thirty days prior to opening of the issue
- The placement memorandum shall contain all information as specified under Schedule III, to the extent applicable.
- The merchant banker shall submit a due diligence certificate
- SEBI shall issue observations, if any, on the Placement Memorandum within 15 days of filing.
- Issue open date shall not be at a date later than 3 months from the receipt of in-principle approval for listing, from exchange(s);
- Units shall be listed within 6 working days of the close of the Issue
- File the final placement memorandum with SEBI within a period of ten working days from the date of listing of the units issued therein.

**Minimum investment** from any investor shall be of Rs. 1 crore;
**Minimum & maximum investors**: The minimum number of investor shall not be less than 5 and maximum number shall not be more than 1000 investors;

No advertisement shall be issued pertaining to issue of units by an InvIT which makes a private placement of its units.

**Preferential Offer /Institutional Placement**: a listed InvIT can make a preferential offer only to Institutional Investors, as defined under InvIT Regulations.

**The trading lot** shall be of ONE unit of Rs. 25 lakh[39].

OR

ONE Unit of Rs. 2 crores, in cases where a minimum 80% of the value of the InvIT Assets shall be invested in completed and revenue-generating projects.

## 16.5 Listing - conditions

- **Listing of Units:**

It shall be mandatory for units of all InvITs to be listed on a recognized stock exchange having nationwide trading terminals, whether publicly issued or privately placed

- **Conditions post listing of Units:**
- The InvIT shall redeem units only by way of a buyback or at the time of delisting of units.
- The units shall remain listed on the designated Stock Exchanges unless delisted.
- The InvIT shall maintain the minimum public holding limit, failing which the units may be delisted by SEBI.

## 16.6 Delisting of Units:

***By the investment manager***

The investment manager shall apply for delisting of units of the InvIT to SEBI and the Stock Exchanges, if the:

- public holding falls below the specified limit
- number of unit holders of the InvIT falls below the limit of 20
- no projects or assets are remaining under the InvIT for a period exceeding six months and InvIT does not propose to invest in any project in future
- trustee and investment manager request such delisting and such request has been approved by unit holders.

[39] Amended Regulation as on September 27, 2024.

***By the SEBI or Stock Exchanges:*** The Exchanges or SEBI may initiate delisting of units of InvITs for violation of the listing agreement or these regulations or the Act. Delisting also may be initiated if it is in the interest of the unit holders.

### 16.6.1 Procedure for delisting

The procedure for delisting of units of InvIT including provision of exit option to the unit holders shall be in accordance with the listing agreement and in accordance with procedure as may be specified by SEBI and by the designated stock exchanges from time to time.

### 16.6.2 Effect of delisting

- The InviT has to surrender its certificate of registration to SEBI;
- The InvIT shall no longer undertake activity of an InvIT;
- The InvIT and parties to the InvIT shall continue to be liable for all their acts of omissions and commissions with respect to activities of the InvIT

## 16.7 Issuance of Debt Securities by InvITs

### 16.7.1 Applicable Regulations

InvITs shall follow the provisions of SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021 ("NCS Regulations") for the issue of debt securities. The provisions of the Companies Act, 2013, shall not be applicable to InvITs for the issuance of debt securities

**Debenture Trustees**: For the issuance of debt securities, InvITs shall appoint one or more debenture trustees registered under SEBI (Debenture Trustees) Regulations, 1993. However, a Trustee to the InvIT shall not be eligible to be appointed as debenture trustee to such issue of debt securities.

### 16.7.2 Security creation

Any secured debt securities issued by InvITs shall be secured by the creation of a charge on the assets of the InvIT or holdco or SPV, having a value which is sufficient for the repayment of the amount of such debt securities and interest thereon.

## 16.8 Borrowings

- The aggregate consolidated borrowings cannot exceed 70% of the value of the InviT Assets.
- If the borrowings are between 25% to 49% of the value of the InviT Assets, then the following is required
    - Credit rating
    - Approval of the Unit holders

- If the borrowings are between 49% and up to 70% of the value of InviTs, then the following is required
    - Credit rating of " AAA"
    - Utilize the funds only for the acquisition or development of infrastructure projects
    - Approval of Unit holders
    - Track record of 6 distributions

- InvITs having a net worth of INR 100 Crore or higher are eligible to issue Commercial Paper, in terms of Reserve Bank Commercial Paper Directions, 2017 dated August 10, 2017

## 16.9 Valuation of Assets

**Condition for a Valuer:**

- The valuer shall not be an associate of the sponsor(s) or investment manager or trustee and
- Valuer shall have not less than five years of experience in valuation of infrastructure assets.

**Valuation Report & submission:**

- Full valuation includes a detailed valuation of all assets of the InvIT by the valuer including physical inspection of every infrastructure project by the valuer.
- Full valuation report shall include the mandatory minimum disclosures as specified in Schedule V to the Regulations.

**Frequency of valuation:**

- A full valuation shall be conducted by the valuer once in every financial year
- Valuation should be done within 2 months from the end of the Financial year

However, for publicly listed Units, the valuation has to be conducted every 6 months and completed within one month of the end of each half year

**Filing timeline**:

Valuation Reports have to be filed by the Investment Manager within 15 days from the receipt of the Reports

## 16.10 Investment conditions

- The investment by an InvIT shall only be in Holding company and/ or SPVs or infrastructure projects or securities in India.

- The InvIT may invest in infrastructure projects through SPVs subject to the following,–

    - No other shareholder or partner of the SPV shall exercise any rights that prevents the InvIT from complying with the provisions of these regulations.

    - in case the SPV is a company/ LLP, the investment manager, in consultation with the Trustee, shall appoint the majority of the board of directors or governing board of such SPVs;

    - the investment manager shall ensure that in every meeting, including the annual general meeting of the SPV, ***the voting of the InvIT is exercised.***

**In case of dispute:**

- The shareholders' agreement or partnership agreement shall provide for an appropriate mechanism for the resolution of disputes between the InvIT and the other shareholders or partners in the holdco and/or the SPV:

  Provided further that the provisions of these regulations shall prevail in case of inconsistencies between such agreement(s) and the obligations cast upon an InvIT under these regulations

## 16.11 Other significant matters

**(A) Related Party Transactions**

All related party transactions shall be on an arm's-length basis in accordance with relevant accounting standards and shall be disclosed -

- in the offer document or placement memorandum

- to the designated stock exchanges and unit holders periodically

**(B) Post listing- prior approval of Unit holders**

Prior approval of Unit holders is necessary if,

- the total value of all the related party transactions, in a financial year, pertaining to acquisition or sale of assets or investments into securities exceeds 5% of the value of InvIT assets; or

- the value of the funds borrowed from related parties, in a financial year, exceeds 5% of the total consolidated borrowings of the InvIT, holdco and the SPV(s).

**(C) Rotation of Auditors**

No Valuer shall undertake valuation for the same Project for more than 4 years consecutively. In case of any material development having an impact on the valuation of assets, the following shall be considered:

- full valuation of the infrastructure project under consideration within 2 months from the date of such event
- disclosure of the valuation report to the trustee and the designated stock exchanges within 15 days of such valuation

**(D) Dispute Resolution**

Disputes between the investors and the Investment Manager --- is subject to a resolution mechanism that includes mediation and/or conciliation and/or arbitration, in accordance with the procedure specified SEBI.

No loss or damage or expenses incurred by the investment manager or officers of the investment manager, including those in relation to the resolution of claims or disputes of investors, shall be met out of the trust property.

**(E) Continual Disclosures to the Stock Exchange**

The investment manager of all InvITs shall submit-

a) an annual report to all unit holders electronically or by physical copies and to the designated stock exchanges within 3 months from the end of the financial year.

b) a quarterly report by the InviTs within 30 days from the end of the quarter when the borrowings exceed 49% of the value of the assets.

<u>Unit holding pattern for each class of unit holders needs to be disclosed</u>

(1) One day prior to listing of units on the stock exchanges

(2) Within 21 days from the end of each quarter. and

(3) Within 10 days of any capital restructuring of InvIT resulting in a change exceeding 2% of the total outstanding units of InvIT

**Financial Information**

- An InvIT shall submit its half yearly financial information (audited/unaudited) within 45 days from the end of the Half year, and
- Audited annual financial information within 60 days of the end of the financial year, to the Stock Exchanges.

**(F) Event based disclosure**

Some disclosures which are event based are listed below:

- acquisition or disposal of any projects, exceeding 5% of the value of the InviTs
- additional borrowing, exceeding 15% of the value of the InvIT assets;
- additional issue of units by the InvIT;
- details of any credit rating obtained by the InvIT and any change in such rating;
- any issue which requires approval of the unit holders;
- any legal proceedings which may have significant bearing on the functioning of the InvIT;
- notices and results of meetings of unit holders,
- any instance of non-compliance with these regulations
- any material issue that in the opinion of the investment manager or trustee needs to be disclosed to the unit holders.

**(G) Maintenance of records**

The investment manager shall maintain the following records in electronic form:

- all investments or divestments of the InvIT and documents supporting the same including rationale for such investments or divestments;
- agreements entered into by the InvIT or on behalf of the InvIT;
- documents relating to appointment of Trustee, Registrar etc.;
- insurance policies for infrastructure assets;
- investment management agreement;
- all the related documents pertaining to issue and listing of units;
- distributions declared and made to the unit holders;
- disclosures and periodical reporting made to the trustee, SEBI, unit holders and the designated stock exchanges;
- valuation reports including methodology of valuation;
- books of accounts and financial statements;
- audit reports;
- unit holders' grievances and actions taken thereon including copies of correspondences made with the unit holder and SEBI;

- any other material documents
- Documents pertaining to Registration
- Notices and agenda sent to the Unit holders

**(H) Investor Charter** and Disclosure of Investor Complaints by Merchant Bankers for public offers and Private Placement by InvITs

All the registered Merchant Bankers are advised to disclose on their websites,

- the Investor Charter for Public Offer and Private Placement of units by InvITs,
- Investor complaints and redressal of the same on their websites, latest by 7th of succeeding month.

**(I) Disclosures to the Investors**

The Investment Manager shall:

- submit annual report, half yearly report and valuation report to the Unit holders
- acquisition or disposal of any projects, directly or through holdco or SPV, value of which exceeds 5 percent of value of the InvIT assets;
- additional issue of units by the InvIT;
- details of any credit rating obtained by the InvIT and any change in such rating;
- any issue which requires approval of the unit holders;
- any legal proceedings which may have significant bearing on the functioning of the InvIT;
- notices and results of meetings of unit holders,
- any instance of non-compliance with these regulations including any breach of limits specified under the regulations;
- any material issue that in the opinion of the investment manager or Trustee needs to be disclosed to the unit holders.

**(J) Post listing compliance:**

**The Investment Manager of InviTs** have to comply with the provisions of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (LODR)

**(K) Board composition and role**

The InvIT Board should have minimum 6 Directors with one woman Independent Director.

**Quorum** for the board meeting shall be one-third of its total strength or three directors, whichever is higher, including at least one independent director.

**The minimum information** to be placed before the Board of Directors shall include the items specified in Part A of Schedule VII to the InvIT Regulations.

The Board shall review compliance reports every quarter pertaining to all laws applicable to the InvIT as well as steps taken to rectify instances of non-compliances.

The chief executive officer, the chief financial officer and the compliance officer shall provide the compliance certificate, including the items specified in Part B of Schedule VII to the InvIT Regulations

The **Board of Directors of the Investment Manager shall specify** the recommendation of Investment Manager in the notice to the unitholders for every item specified in the Regulations

**Nomination Rights**

Unitholder(s) holding 10% or more of the total outstanding units of the InvIT, either individually or collectively have a right but not the obligation to appoint a Nominee Director" (a non-independent director) on the Board of Directors of the Investment Manager.

If the unitholding of more than one unitholder is aggregated for this purpose, then Notice to the Investment Manger shall also identify up to two unitholders as authorized representative of the group of Eligible Unitholder(s).

**Exception**: A shareholder or a lender of the Investment manager or the InvIT (or its HoldCo(s) or SPVs), who is an entity will not have the right to nominate one or more directors on the Board of Directors of the Investment Manager even if the Units held are more than 10%.

**Policy for appointment:**

The Board of Directors of the Investment Manager shall formulate and adopt a policy for selection of Nominee Director, which shall inter-alia contain

- qualifications
- criteria for appointment
- evaluation parameters of individuals
- shall specify remuneration / sitting fees,
- process of removal or resignation of Unitholder Nominee Directors
- role of the Nomination and Remuneration Committee

Such policy shall be made available on the website of the InviT.

**Process of appointment**:

The eligibility of a Unitholder Nominee Director shall be confirmed by the Investment Manager, based on the evaluation done by the Nomination and Remuneration Committee and/or the Board of Directors of the Investment Manager in line with the policy formulated.

The appointment shall be made within 30 days of confirmation by the NRC or the Board.

**Conflict of interest:**

Unitholder Nominee Directors shall recuse themselves from voting on any transaction where either such director, such director's associates or the Eligible Unitholder(s) who nominated him / her or associate of such Eligible Unitholder(s) is a party.

**Checking the eligibility annually**:

The Investment Manager shall send a written intimation to all unitholders on their email address(es) registered either with the Investment Manager or with any depository, within 10 days from the end of each financial year, requesting them to inform the Investment Manager if any Eligible Unitholder(s) wish to exercise the right to nominate a Unitholder Nominee Director.

Eligible Unitholder(s) who wish to exercise this right shall inform the Investment Manager through a written notice within ten days of receipt of the intimation from the Investment Manager.

The Eligible Unitholder(s) shall be reckoned based on the unitholding pattern of the InvIT as on March 31st of the financial year.

**Monthly review on the eligibility:**

The Investment Manager of the InvIT shall, within 10 days from the end of each calendar month, review whether the Eligible Unitholder(s) who have exercised the board nomination right, continue to have/hold the required number of units of InvIT and shall submit such report to the Trustee of the InvIT.

**Trust Deed:**

The trust deed and the investment management agreement of the InvIT should provide for nomination and appointment of Unitholder Nominee Directors on the Board of Directors of the Investment Manager by Eligible Unitholder(s).

**Annual meeting of the Unit holders:**

An annual meeting of all unit holders shall be held not less than once a year within 120 days from the end of financial year and the time between two meetings shall not exceed 15 months.

The same can be held through audio video visual means.

The notice to the unit holders may be given through emails registered with the InvIT or with depositories.

**(L) Vigil Mechanism**

The investment manager shall formulate a vigil mechanism, including a whistle blower policy for directors and employees to report genuine concerns.

**(M) Secretarial Compliance Report**

A secretarial compliance report given by a practicing company secretary is required to be filed with the stock exchanges, within 60 days from end of each financial year and annexed to the Annual Report.

Quarterly compliance Report on Corporate Governance is to be filed with Exchanges within 21 days from the end of the each quarter.

## 16.12 Inspection by SEBI

SEBI has powers to conduct inspection on the activities of InvIT. The outcome/ final decision of the inspection may envisage requiring the InvIT to:

- delist its units from the stock exchanges and surrender its certificate of registration;
- InvIT to wind up;
- to sell its assets;
- to take appropriate action against the parties to InvIT
- prohibiting the InvIT or parties to the InvIT from operating in the capital market or from accessing the capital market for a specified period

**Review Questions**

1. What is meant by InvIT assets?

**(a) Assets owned directly or through holdco or SPV**
(b) Assets owned by the Trustee or SPV
(c) Manager on behalf of InvIT or InvIT through holdco and SPV
(d) Manager or holdco of InvIT

2. Investment Manager of InvIT must have atleast _____ key personnel with more than _____ of experience in infrastructure sector.

(a) 2; 10 years
(b) 3; 5 years
(c) 1; 5 years
**(d) 2; 5 years**

3. Other things remaining same, according to the SEBI InvIT Regulations, Delisting of InvIT can take place when such request of delisting has been made _____.

**(a) Trustee and Investment manager**
(b) Unit holders
(c) Sponsor
(d) Project Manager

4. Valuer for an InvIT is required to have experience of atleast _____ in valuation of infrasructure assets.

**(a) 5**
(b) 2
(c) 3
(d) 4

# CHAPTER 17: SEBI (REIT) REGULATIONS

**LEARNING OBJECTIVES:**

After studying this chapter, you should know about:

- Real Estate Investment Trusts (REITs)
- Structure and Key Players of REITs
- Rights & Responsibilities of the parties to an REITs
- Fund raising, Listing and Delisting and Other Significant Matters

## 17.1 Introduction:

India's economic growth in the last decade has been monumental. This has been mainly due to the dependence on infrastructure as a vehicle of growth which inter-alia includes the real estate sector. The pace with which the demand for commercial space/ building is increasing day by day is a witness to the robust growth in the real estate sector. In order to facilitate the developers in raising huge amount of funds required for such kind of projects and also to provide an alternative avenue of investment for the investors, the Capital market Regulator SEBI has brought a separate regulatory framework viz., SEBI (Real Estate Investment Trusts) Regulations, 2014. These Regulations enable fund raising through Initial Public offer, Private Placement of Units , borrowings through issue of Commercial papers.

## 17.2 REIT – Structure and Key Definitions

### 17.2.1 Structure of REITs

The structure of REIT is similar to that of a Mutual Fund (MF). The parties involved in setting up MF includes a trustee company, a sponsor and the asset management company which floats different schemes by garnering money from the public and investing predominantly in capital market instruments, whereas REITs invests only in real estate assets. The Trust is set up by the Sponsor, the ownership of the property vests in the Trustee and the beneficiaries of the Trust are the unit holders of the REIT.

**"REIT" or 'Real Estate Investment Trust'** means a person that pools rupees fifty crores or more for the purpose of issuing units to at least two hundred investors so as to acquire and manage real estate asset(s) or property(ies), that would entitle such investors to receive the income generated therefrom without giving them the day-to-day control over the management and operation of such real estate asset(s) or property(ies).Real Estate Investment Trust(REIT) includes Small and Medium (SM) REIT under these Regulations.

*The obligation is created by the author of the trust, accepted by the owner of property and owed to the beneficiaries identified in the Trust Deed.*

**Classification of Investments in REITs:**

With effect from January 1, 2026, any investment made by Mutual Funds and Specialised Investment Funds (SIFs) in Real Estate Investment Trusts (REITs) will be treated as an investment in equity-related instruments.

Grandfathering of Existing Investments:

Investments in REITs held by debt schemes of Mutual Funds and investment strategies of SIFs as on December 31, 2025, will be grandfathered. This means such existing investments will not be affected by the new classification.

That said, Asset Management Companies (AMCs) are encouraged to gradually divest REIT holdings from debt scheme portfolios, keeping in mind market conditions, liquidity, and the best interests of investors.[40]

"R**eal estate" or "Property**" means land and any permanently attached improvements to it, whether leasehold or freehold and includes buildings, sheds, garages, fences, fittings, fixtures, warehouses, car parks, etc. and any other assets incidental to the ownership of real estate but does not include mortgage. Provided that any asset falling under the purview of 'infrastructure' as defined vide Notification of Ministry of Finance dated October 07, 2013 including any amendments or additions made thereof shall not be considered as 'real estate' or 'property' for the purpose of these regulations; Notwithstanding the above, following captured within the abovementioned definition of infrastructure shall be considered under "real estate" or "property"-

(i) hotels, hospitals and convention centers, forming part of composite real estate projects, whether rent generating or income generating;

(ii) common infrastructure" for composite real estate projects, industrial parks and SEZ".

"**Real estate assets**" means properties held by REIT, on a freehold or leasehold basis, whether directly or through a holdco and/or a special purpose vehicle.

**"REIT assets**" means real estate assets and any other assets held by the REIT, on a freehold or leasehold basis, whether directly or through a holdco and/or a special purpose vehicle.

### 17.2.2 Key Players

The following table depicts the parties involved in the establishment of REIT viz., i.e. the Sponsor Group, the Manager and the Trustee. The Manager of an REIT plays the role as that of the Fund Manager in a Mutual Fund.

[40] https://www.sebi.gov.in/legal/circulars/nov-2025/reclassification-of-real-estate-investment-trusts-reits-as-equity-related-instruments-for-facilitating-enhanced-participation-by-mutual-funds-and-specialized-investment-funds-sifs-_98031.html

| Key stakeholders | |
|---|---|
| **Sponsor** | A sponsor can be a company /LLP / body corporate which sets up the REIT. An application for grant of certificate of registration as REIT is made by the sponsor on behalf of the trust.<br>Each sponsor has:<br>1. Unitholding - each sponsor shall hold or propose at least 5% of the number of units of the REIT on post-initial offer basis<br>2. Financial parameters and experience:<br>(a) a net worth of not less than Rs. 100 crore and each sponsor should have a networth of not less than Rs. 20 crore; and<br>(b) the sponsor or its associate(s) has not less than five years of experience in development of real estate or fund management in the real estate industry and where sponsor is a developer, at least two projects should be completed |
| **Sponsor Group** | Sponsor group – includes:<br>(i) the sponsor(s);<br>(ii) in case the sponsor is a body corporate:<br>a. entities or person(s) which are controlled by such body corporate;<br>b. entities or person(s) who control such body corporate;<br>c. entities or person(s) which are controlled by person(s) as referred at clause b.<br>(iii) in case sponsor is an individual:<br>a. an immediate relative of such individual (i.e., any spouse of that person, or any parent, brother, sister or child of the person or of the spouse); and<br>b. entities or person(s) which are controlled by such individual |
| **Manager** | Manager can be a company /LLP/ body corporate which manages assets and investments of the REIT and undertakes operational activities of the REIT<br>The Manager inter alia has:<br>2. Financial parameters:<br>• a net worth of not less than Rs 10 crore if the Manager is a body corporate or a company or<br>• net tangible assets of value not less than Rs 10 crore rupees in case the Manager is an LLP<br>2. Experience: not less than 5 years of experience in fund management or advisory services or property management in real estate industry or development of real estate.<br>3. Two or more key personnel, each having more than 5 years of experience in fund management/advisory services/ property management in the real estate industry or in development of real estate;<br><br>Board: |

| | |
|---|---|
| | 4. Not less than half of its directors/members should be independent and they should not be directors/members of a Manager of another REIT;<br>Agreement:<br>5. Entered into an investment management agreement with the Trustee which provides for the responsibilities of the Manager. |
| **Trustee** | Trustee means<br>1. a person who holds the REIT assets in trust for the benefit of the unit holders<br>2. is registered with SEBI (Debenture Trustees) Regulations, 1993 and<br>3. is not an associate of the sponsor(s) or Manager<br>4. Sufficient resources with respect to infrastructure, personnel etc. as specified by SEBI<br>The role of Trustee is supervisory in nature– overseeing the activities of the Manager, and to ensure that REIT is being operated in accordance with its constitutional documents. |

As number of parties are involved, the Regulations require them to enter into necessary agreements. The **key agreement** being Investment Management Agreement. The scope of this agreement is summed up as below:

The Investment Management Agreement, the task of entering into certain types of properties lies with the Manager. As Investment Management is entrusted with such a task, this agreement governs the relationship, the terms and conditions, the roles, responsibilities and the reporting mechanism of the Manager to the Trustee. *"Investment management agreement*" means an agreement between the trustee and the manager which lays down the roles and responsibilities of the manager towards the REIT.

### 17.2.3 Terminologies

Some of the Key terminologies are given below:

- **"Holdco" or "holding company" means a company or LLP,-**

  (iii) in which REIT holds or proposes to hold not less than 50% of the equity share capital or interest and which in turn has made investments in other SPV(s), which ultimately hold the property (ies);

  (iv) which is not engaged in any other activity other than holding of the underlying SPV(s), holding of real estate / properties and any other activities pertaining to and incidental to such holdings;"

- **"Unit**" means beneficial interest of the REIT;

- **"Unit holder"** means any person who owns units of the REIT

- **"Completed property"** means property for which occupancy certificate has been received

from the relevant authority;

- "**Related Party**"- is same as defined under the Companies Act, 2013 or under the applicable accounting standards and shall also include,

  (i) Parties to the REIT;

  (ii) Promoters, directors and partners of (i) above

"**rent generating property**" means property which has been leased or rented out in accordance with an agreement entered into for the purpose;

"**SPV**" or "**special purpose vehicle**" means any company or LLP,

(iv) in which either the REIT or the holdco holds or proposes to hold **not less than 50% of the equity share capital or interest**;

(v) which holds **not less than 80% of its assets** directly in properties and does not invest in other SPVs; and

(vi) which is **not engaged in any other activity** other than holding and developing property and any other activity incidental to such holding or development;

"**Under-Construction Property**" means a property of which construction is not complete and occupancy certificate has not been received.

"**Valuer**" means any person who is a "registered valuer" under section 247 of the Companies Act, 2013 or as specified by SEBI from time to time.

"**Value of the REIT assets**" means aggregate value of all the assets under the REIT as assessed by the valuer.

**17.2.4 Registration and Eligibility Requirements**

The following sets out the registration and eligibility requirement for REIT:

An application for grant of certificate of registration as REIT shall be made by the sponsor on behalf of the Trust in the form as specified in the Schedule I of REIT Regulations and shall be accompanied by a non-refundable application fee as specified in Schedule II of REIT Regulations.

(a) The instrument of trust is in the form of a deed duly registered in India under the provisions of the Registration Act, 1908;

(b) The Trust Deed has its main objective as undertaking activity of REIT in accordance with these regulations and includes responsibilities of the Trustee.

**Conditions for registration**

(i) The proposed activities should be clearly described

(ii) The parties to the REIT should be fit and proper persons based on the criteria as specified in Schedule II of the SEBI (Intermediaries) Regulations, 2008;

(iii) In case any previous application for grant of certificate made by the REIT or the parties to the REIT have been rejected by the SEBI, then the details of the same should be provided, else an undertaking to this effect should be provided.

(iv) In case any disciplinary action has been taken by the SEBI or any other regulatory authority against REIT or the parties to the REIT or their directors/members of governing board under any Act including SEBI the details of the same should be provided, else an undertaking to this effect should be provided.

**Granting of Registration Certificate**

SEBI on being satisfied that the trust fulfils, the requirements and after payment of the requisite fees, shall grant certificate of registration:

The registration may be granted with such conditions as may be deemed appropriate by SEBI.

**Conditions of Certificate**

The certificate granted shall, inter-alia, be subject to the following conditions-

- The REIT shall abide by the provisions of the SEBI Act and REIT Regulations;
- The REIT 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;
- The REIT and parties to the REIT shall satisfy with the eligibility conditions at all times;
- The REIT and parties to the REIT shall comply, at all times, with the Code of conduct as specified in the Schedule VI to the REIT Regulations, wherever applicable.

**On line filing system**

Registration & Reporting: In order to facilitate ease of operations in terms of applying for registration, reporting and various compliances under SEBI (REIT) Regulations, SEBI has introduced an online system for filings related for REITs. The online system can be used for application for registration, reporting and filing under the provision of aforesaid Regulations.

## 17.3 Rights & Responsibilities of the parties to an REIT

**Trustees**

The Trustees shall

- hold the REIT assets in the name of the REIT for the benefit of the unit holders.
- enter into an investment management agreement with the manager on behalf of the

REIT.

- oversee activities of the manager in the interest of the unit holders,
- obtain **compliance certificate** from the manager, ***on a quarterly basis***.
- ensure that the manager complies with reporting and disclosures requirements in accordance with REIT regulations.
- review the transactions carried out between the manager and its associates and wherever the manager has advised that there may be a conflict of interest, shall obtain confirmation from a practising chartered accountant or a valuer, as applicable, that such transaction is on arm's length basis.
- periodically review the status of unit holders' complaints and their redressal undertaken by the manager.
- make distributions and ensure that manager makes timely declaration of distributions to the unit holders in accordance with the REITs regulations
- ensure that subscription amount is kept in a separate bank account in name of the REIT and is only utilized for adjustment against allotment of units or refund of money to the applicants till the time such units are listed.
- ensure that the remuneration of the valuer is not linked to or based on the value of the assets being valued.
- ensure that the manager convenes meetings of the unit holders in accordance with these regulations and oversee the voting by unit holders
- the trustee may require the manager to set up such systems and procedures and submit such reports to the trustees, as may be necessary for effective monitoring of the functioning of the REIT.
- The trustee may take up with SEBI or with the designated stock exchange, as may be applicable, any matter which has been approved in any meeting of unit holders, if the matter requires such action.
- In case of any change in manager due to removal or otherwise–
    - prior to such change, the trustee shall obtain approval from unit holders and approval from SEBI;
    - the trustee shall appoint the new manager within 3 months from the date of termination of the earlier investment management agreement;
    - the previous manager shall continue to act as such at the discretion of trustee till such time as new manager is appointed;

- the trustee shall ensure that the new manager shall stand substituted as a party in all the documents to which the earlier manager was a party;
- the trustee shall ensure that the earlier manager continues to be liable for all its acts of omissions and commissions notwithstanding such termination.

- The trustee shall obtain prior approval from the unit holders and from SEBI in case of change in control of the manager.
- The trustee of the REIT shall not invest in units of the REIT in which it is designated as the trustee.
- The trustee shall ensure that the activity of the REIT is being operated in accordance with the provisions of the trust deed, REITs Regulations and the offer documents.
- The trustee shall provide to the Board and to the designated stock exchange such information as may be sought by SEBI or by the designated stock exchange pertaining to the activity of the REIT.
- The trustee shall immediately inform the Board in case any act which is detrimental to the interest of the unit holders is noted.

**Manager**

The manager shall;

(1) make the investment decisions with respect to the underlying assets of the REIT including any further investment or divestment of the assets.

(2) manager shall ensure that the real estate assets of the REIT or holdco and/or Special Purpose Vehicle (SPV) have proper legal and marketable titles and that all the material contracts including rental or lease agreements entered into on behalf of REITs or holdco and/or SPV are legal, valid, binding and enforceable by and on behalf of the REIT or holdco and/or SPV

(3) ensure that the investments made by the InvIT are in accordance with the investment conditions specified in InviTs regulations and in accordance with the investment strategy of the REIT.

(4) undertake management of the REIT assets including lease management, maintenance of the assets, regular structural audits, regular safety audits, etc. either directly or through the appointment and supervision of appropriate agents.

(5) in consultation with Trustee, appoint the valuer(s), auditor, registrar and transfer agent, merchant banker, custodian and any other intermediary or service provider or agent for managing the assets of the REIT or for offer and listing of its units or any other activity pertaining to the REIT in a timely manner and in accordance with REIT regulations.

(6) appoint an individual or a firm as the auditor.

(7) arrange for adequate insurance coverage for the REIT assets. In case of assets held by holdco and/or SPV, the manager shall ensure that real estate assets are adequately insured.

(8) If the REIT invests in under-construction properties as per these regulations, the manager-

(a) may undertake the development of the properties, either directly or through the SPV, or appoint any other person for development of such properties; and

(b) shall oversee the progress of development, approval status and other aspects of the properties upto its completion.

(9) ensure that it has adequate infrastructure and sufficient key personnel with adequate experience and qualification to undertake management of the REIT at all times.

(10) alongwith the merchant banker(s) be responsible for all activities pertaining to issue of units and listing of units of the REIT including,–

a. filing of the offer document with SEBI and the exchanges within the prescribed time period;

b. obtaining in-principle approval and final listing and trading approvals from the designated stock exchanges;

c. dealing with all matters relating to issue and listing of the units of the REIT as specified under Chapter IV and any guidelines as may be issued by SEBI in this regard.

(11) alongwith the merchant bankers(s)], ensure that disclosures made in the offer document or other documents contains material, true, correct and adequate disclosures and are in accordance with these regulations and guidelines or circulars issued hereunder.

(12) declare distributions to the unit holders.

(13) ensure adequate and timely redressal of all unit holders' grievances pertaining to activities of the REIT.

(14) ensure that the disclosures to the unit holders, SEBI, trustees and designated stock exchanges, are in accordance with these regulations and guidelines or circulars issued hereunder.

(15) ensure that adequate controls are in place to ensure segregation of its activity as manager of the REIT from its other activities.

(16) shall not obtain any commission or rebate or any other remuneration, in connection with issue of Units.

(17) ensure that the valuation of the REIT assets is done by the valuer(s).

(18) submit to the trustee,-within 30 days of end of the quarter-

a. quarterly reports on the activities of the REIT including

i. receipts for all funds received by it and for all payments made,

ii. position on compliance with REIT regulations,

iii. performance report,

iv. status of development of under-construction properties

b. valuation reports as required under these regulations within 15 days of the receipt of the valuation report from the valuer;

c. decision to acquire or sell or develop any property or expand existing completed properties along with rationale for the same;

d. details of any action which requires approval from the unit holders as maybe required under the regulations;

e. details of any other material fact including change in its directors, change in its shareholding, any legal proceedings that may have a significant bearing on the activity of the REIT, within seven working days of such action.

(19) co-ordinate with the trustee with respect to the operations of the REIT.

(20) ensure that computation and declaration of NAV of the REIT based on the valuation done by the valuer, shall be disclosed to the stock exchange(s), not later than fifteen days from the date of valuation and such computation shall be done and declared not less than once every six months.

(21) ensure that the audit of accounts of the REIT by the auditor is done not less once in a year and such report is submitted to the stock exchange [s] within sixty days of end of financial year ending March 31st

(22) appoint a custodian in order to provide such custodial services as may be authorised by the trustees.

(23) place before its board of directors in case of company or the governing board in case of an LLP a report on activity and performance of the REIT at least once every three months.

(24) designate an employee or director as the compliance officer for monitoring of compliance with REIT regulations and guidelines or circulars issued hereunder and intimating SEBI in case of any non-compliance.

(25) convene meetings of the unit holders in accordance with regulation 22 and maintain records pertaining to the meetings in accordance with regulation 26.

(26) ensure that all activities of the compliance with laws, as may be applicable, of the State or the local body with respect to the activity of the REIT including local building laws.

(27) ensure that all activities of management of assets of the REIT and activities of the intermediaries or agents or service providers appointed by the manager are in accordance with REIT regulations and circulars issued thereunder.

**Sponsors**

The sponsor and sponsor group shall

(1) (a) set up the REIT; (b) appoint the trustees of the REIT

(2) transfer or undertake to transfer to the REIT, its entire shareholding or interest and rights in the holdco and/ or SPV or ownership of the real estate assets to the REIT prior to allotment of units of the REIT to the applicants,

(3) The sponsor(s) and sponsor group(s) shall collectively hold not less than –

(i) fifteen percent of the total units of the REIT, for three years from the date of listing of units in the initial offer:
Provided that any holding by the sponsor(s) and sponsor group(s) exceeding fifteen percent shall be held for a period of not less than one year from the date of listing of units issued in the initial offer;

(ii) five percent of the total units of the REIT, from the beginning of fourth year and till the end of fifth year from the date of listing of the units issued in the initial offer;

(iii) three percent of the total units of the REIT, from the beginning of sixth year and till the end of tenth year from the date of listing of the units issued in the initial offer;

(iv) two percent of the total units of the REIT, from the beginning of eleventh year and till the end of twentieth year from the date of listing of the units issued in the initial offer;

(v) one percent of the total units of the REIT, after completion of the twentieth year from the date of listing of units issued in the initial offer:
Provided that the maximum value of the units to be held by the sponsor(s) and sponsor group(s) for compliance with clauses (ii) to (v) of this sub-regulation shall not exceed five hundred crore rupees or such other value as may be decided by the Board from time to time and such valuation shall be based on the latest available net asset value of the REIT:

(4) The units required to be held as per point (3) above shall be locked in and shall not be encumbered.

(5) The sponsor(s) and sponsor group(s) would be responsible for all acts, omissions and representations/covenants of the REIT and the sale or transfer of assets or holdco or SPV to the REIT.

**Valuer**

(1) The valuers shall at all times,–

a. ensure that the valuation of the REIT assets is impartial, true and fair and is in accordance with REIT Regulations;

b. ensure that adequate and robust internal controls to ensure the integrity of its valuation reports;

c. ensure that it has sufficient key personnel with adequate experience and qualification to perform valuations;

d. ensure that it has sufficient financial resources to enable it to conduct its business effectively and meet its liabilities;

e. the valuer and any of its employees involved in valuing of the assets of the REIT, shall not,–

   i. invest in units of the REIT or in the assets being valued; and

   ii. sell the assets or units of REITs held prior to being appointed as the valuer, till the time such person is designated as valuer of such REIT and not less than six months after ceasing to be valuer of the REIT;

f. the valuer shall conduct valuation of the REIT assets with transparency and fairness and shall render, at all times, high standards of service, exercise due diligence;

g. ensure proper care and exercise independent professional judgment;

h. act with independence, objectivity and impartiality in performing the valuation;

i. discharge its duties towards the REIT in an efficient and competent manner,

j. not accept remuneration, in any form, for performing a valuation of the REIT assets from any person other than the REIT or its authorized representative;

k. shall before accepting any assignment, from any related party to the REIT, shall disclose to the REIT any direct or indirect consideration which the valuer may have in respect of such assignment;

l. disclose to the REIT any pending business transactions, contracts under negotiation and other arrangements with the manager or any other party whom the REIT is contracting with and any other factors that may interfere with the valuer's ability to give an independent and professional valuation of the property;

m. not make false, misleading or exaggerated claims in order to secure assignments;

n. not provide misleading valuation, either by providing incorrect information or by withholding relevant information;

o. not accept an assignment which interferes with its ability to do fair valuation;

**Auditor**

The auditor has the following rights and responsibilities:

(a) conduct audit of the accounts of the REIT and draft the audit report

(b) ensure that the accounts and financial statements give a true and fair view of the state of the affairs of the REIT,

(c) have a right of access at all times to the books of accounts and vouchers pertaining to activities of the REIT;

(d) have a right to require such information and explanation pertaining to activities of the

REIT as he may consider necessary for the performance of his duties as auditor

(e) undertake a limited review of the audit of all the entities or companies whose accounts are to be consolidated with the accounts of the REIT as per the applicable Indian Accounting Standards (Ind AS)

## 17.4 Fund raising by REIT

REITs can raise funds only through an Initial Public offer ( IPO).

### 17.4.1 The REIT can raise funds by public issue–

(a) it shall be by way of Initial Public Offer (IPO);

(b) any subsequent issue of units after initial public offer shall be through (i) follow-on offer, (ii) preferential allotment, (iii) qualified institutional placement, (iv) rights issue, (v) bonus issue, (vi) offer for sale or any other mechanism as may be specified by SEBI;

**(A) IPO**

For an REIT to make an initial offer of units, it should fulfil the following criteria–

- The REIT shall be registered with SEBI;
- The value of REIT assets shall not be less than Rs. 500 crore;

  *(Such value shall mean the value of the specific portion of the holding of REIT in the underlying assets or SPVs;);*
- the minimum number of unit holders other than sponsor(s), its related parties and its associates forming part of public shall be not less than two hundred;
- maximum subscription from any investor other than sponsor(s), its related parties and its associates shall not be more than 25 percent of the total unit capital
- The offer size shall not be less than Rs. 250 crore.

**Note:** The requirement of value is to be fulfilled before filing the offer document with SEBI with an undertaking to this effect and adequate disclosures in offer document or placement memorandum.

***Minimum public unitholding***

The minimum offer and allotment to public through an offer document/placement memorandum shall be,–

(a) atleast 25% of the total outstanding units of the REIT, if the post issue capital of the REIT calculated at offer price is less than Rs. 1,600 crore;

(b) of the value of atleast Rs. 400 crore, if the post issue capital of the REIT calculated at offer price is to or more than Rs. 1,600 crore and less than Rs. 4,000 crore;

(c) atleast 10% of the total outstanding units of the REIT, if the post issue capital of the REIT calculated at offer price is equal to or more than Rs. 4,000 crore.

**Exclusion**: However, any units offered to sponsor or the manager or their elated parties or their associates shall not be counted towards units offered to the public.

**If Minimum public shareholding is less than 25%:** any listed REIT which has public holding below 25% shall increase its public holding to at least 25%, within a period of 3 years from the date of listing pursuant to initial offer.

***Subscription***

- **minimum subscription** amount from any investor in initial and follow-on offer shall be within the range of Rs. 10,000 to Rs. 15,000.
- **maximum subscription** from any investor should not be more than 25% total unit capital, (other than sponsor(s), its related parties and its associates).

***Steps prior to initial public offer and follow-on offer,***

The appointment of a Merchant Banker is the first step. Thereafter the offer document is filed.

- The merchant banker is required to file the draft offer document along with prescribed fees with the designated stock exchange(s) and SEBI, not less than 30 working days before filing the offer document with designated stock exchange and the SEBI. The offer document shall be filed with the designated stock exchanges and the SEBI not less than 5 working days before opening of the offer.
- The draft offer document filed with SEBI shall be made public, for comments, if any, by hosting it on the websites of SEBI, designated stock exchanges, REIT and merchant bankers associated with the issue for a period of not less than 21 days;
- The comments of SEBI, if any has to be incorporated before filing the offer document with the designated stock exchanges;
- The draft offer document and offer document shall be accompanied by a due diligence certificate signed by the lead merchant banker;

**Validity of SEBI approval**: REIT can open the issue within a period of not more than one year from the date of issuance of observations by SEBI;

The REIT may invite for subscriptions and allot units to any person, whether resident or foreign. In case of foreign investors, such investment shall be subject to guidelines as may be specified by the RBI and the government from time to time.

***Strategic investors:*** Similar to an IPO of equity shares where Anchor Investor invest prior to the opening of the Issue to the public, in REITs, Strategic investors play such a role. The key features being:

- The strategic investor(s) shall, either jointly or severally, invest not less than 5% and not more than 25% of the total offer size and shall enter into binding unit subscription agreement with the Manager
- The price at which the strategic investor(s) has/have agreed to buy units of the REIT shall not be less than the issue price determined in the public issue.
- Broad details of the unit subscription agreement shall be disclosed in the draft offer document or offer document, as applicable.

**Minimum number of unit holders in an REIT** (other than the sponsor(s), its related parties and its associates) shall be 200.

**Lock in of the Units**: The units subscribed by strategic investors, pursuant to the unit subscription agreement, will be locked-in for a period of 180 days from the date of listing in the public issue.

**The application** for subscription shall be accompanied by a statement containing the abridged version of Offer document.

**Abridged offer document** will contain the risk factors and summary of the terms of issue;

**Offer period**: initial public offer and follow-on offer shall be open for subscription for a minimum period of 3 working days and maximum period of 30 days;

**Allotment** (In case of oversubscription): The REIT shall allot units to the applicants (other than anchor investors) on a proportionate basis rounded off to the nearest integer subject to minimum subscription amount per subscriber;

**Mode of allotment**: Units shall be allotted only in dematerialized form;

**Pricing**: The pricing shall be determined through Book building process or any method prescribed by SEBI.

**Listing**: The units should mandatorily be listed on the stock exchange within 6 working days of the close of the Issue in case of publicly offered units.

**Refunding the money to the applicants**:

- **In case of Under subscription**: Subscription money is to be refunded to all the applicants if at least 90% of the fresh issue size is not received as specified in the offer document.
- **If the number of applicants is less than 200**: Subscription money to be refunded to all the applicants, in case the number of subscribers to the initial public offer forming part of the public is less than 200.

**Over subscription**:

- **Retention by the REIT**: The money to be retained in case of over subscription (maximum allowed is 25% of the issue size) shall be mentioned in the offer document.

- Money shall be refunded to applicants to the extent of the oversubscription.
- Adequate disclosures for utilisation of the excess money is to be made in the Offer document. The same cannot be used for General purposes.
- **Payment of Interest**: REITs shall pay interest at 15% per annum from the closure of the issue in case the Units are not listed or the money refunded within the specified time.

**Offer for sale:** Units may be offered for sale to public.

The amount earmarked for general purposes, as mentioned in objects of the issue in the draft offer document filed with SEBI, shall not exceed 10% of the amount raised by the REIT by issuance of units.

**Surrender of registration certificate:**

Failure to do an IPO within 3 years (which can be extended for another year by SEBI) of registration shall entail surrender of Registration certificate.

**Contents of Offer document or Follow on Offer document – IPO/FPO**

The offer document shall include all information as specified under Schedule III- of SEBI REITs Regulations.

**Broadly, the offer document shall inter-alia include the following**:

- Basic details of the REIT- Registered office, Registration number etc.,
- Details of the Sponsor, Manager, Trustee and other parties.
- Background of REIT, including the structure, details of any arrangements pertaining to underlying REIT assets entered into with various parties prior to the issue and credit ratings, if any.
- Terms of issue including number of units, price, distribution policy, listing of units, commitment from strategic investors, if any.
- Description of assets under REIT
- Business details including investment strategy, use of proceeds, Leverage
- Related party transactions
- Valuation methodology
- Audited Financial statements of the REIT, Manager and sponsor for previous 3 years
- Sector or sub-sector specific information relevant to invest in the REITs
- Rights of Unit Holders

- Title and approval disclosures, litigations and regulatory actions
- Risk factors
- Brief details on taxation and regulatory aspects

However, the offer document shall not be misleading or contain any untrue statements or mis-statements. Further, it should not provide for any guaranteed returns to the investors.

***IPO Advertisements***

The IPO advertisements shall not (a) be misleading; (b) contain anything extraneous to the contents of the offer document. Any positive highlights, shall also contain risk factors with equal importance.

The following documents need to be provided alongwith the draft offer document and offer document/placement memorandum:

- Declarations --to be signed by the board of directors of the manager and sponsor
- Full valuation report
- Due diligence certificate
- In principle approval from the exchange(s)

**(B) Further Issues**

**Rights issue through Fast track methods**:

In case the REITs fulfil certain parameters, it can file offer document under the Fast track Issue with Stock Exchanges and a copy needs to be filed with SEBI. Such parameters inter-alia include the following:

- the units of the REIT should have been listed on any stock exchange for a period of at least 3 years immediately preceding the record date;
- all the units of the REIT are held in demat form on the record date;
- the average market capitalisation of public unitholding of the REIT shall be atleast Rs 250 crores;
- the REIT is compliant with the listing and disclosure requirements of the REIT Regulations;
- the REIT has redressed at least ninety-five per cent of the complaints received from the investors till the end of the quarter immediately preceding the month of the record date;
- no show-cause notices issued by SEBI is pending against the REIT, parties to the REIT or their respective promoters or partners or directors as on the record date;
- the REIT, parties to the REIT or their respective promoters or partners or directors has not

settled any alleged violation of securities laws with SEBI during 3 years immediately preceding the record date;

- units of the REIT have not been suspended from trading as a disciplinary measure during last 3 years immediately preceding the record date.
- no regulatory action has been imposed on the REIT in the three years preceding the year in which rights issue is proposed
- there shall be no conflict of interest between the lead merchant banker(s) and the REIT or parties to the REIT in accordance with the applicable regulations;
- The sponsor(s) and sponsor group shall mandatorily subscribe to their rights entitlement and shall not renounce their rights, except to the extent of renunciation within the respective sponsor group or for the purpose of complying with minimum public shareholding norms prescribed under the REIT Regulations
- there are no audit qualifications on the audited accounts of the REIT in respect of those financial years for which such accounts are disclosed in the letter of offer;

**(C) Preferential Offer /Institutional Placement**: A listed REIT can make a preferential offer only to Institutional Investors, as defined under REIT Regulations.

**Trading lot** shall be of ONE unit.

## 17.5 Listing - Conditions

**Listing of Units:**

It shall **be mandatory** for units of all REITs to be listed on a recognized stock exchange having nationwide trading terminals.

All the Units issued by REITs shall only be in demat form.

**Conditions post listing of Units:**

- The REIT shall redeem units only by way of a buyback or at the time of delisting of units.
- The units shall remain listed on the designated Stock Exchanges unless delisted.
- The REIT shall maintain the minimum public holding limit, failing which the units may be delisted by SEBI.

## 17.6 Delisting of Units:

***By the manager***

The manager shall apply for delisting of units of the REIT to the SEBI and the Stock Exchanges, if the:

- public holding falls below the specified limit.

- no projects or assets are remaining under the REIT for a period exceeding six months and REIT does not propose to invest in any project in future.
- trustee and manager requests such delisting and such request has been approved by unit holders.
- unit holders apply for such delisting.

***By the SEBI or Stock Exchanges:*** The Exchanges or SEBI may initiate delisting of units of REITs for violation of the listing agreement or these regulations or the Act. Delisting also may be initiated if it is in the interest of the unit holders.

**17.6.1 Procedure for delisting**

The procedure for delisting of units of REIT including provision of exit option to the unit holders shall be in accordance with the listing agreement and in accordance with procedure as may be specified by SEBI and by the designated stock exchanges from time to time.

**17.6.2 Effect of delisting**

- The REIT has to surrender its certificate of registration to SEBI;
- The REIT shall no longer undertake activity of an REIT;
- The REIT and parties to the REIT shall continue to be liable for all their acts of omissions and commissions with respect to activities of the REIT

**17.7 Issuance of Debt Securities by REITs**

**17.7.1 Applicable Regulations**

REITs shall follow provisions of SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021 ("NCS Regulations") for issue of debt securities. The provisions of the Companies Act, 2013 shall not be applicable to REITs for issuance of debt securities

**Debenture Trustees**: For the issuance of debt securities REITs shall appoint one or more debenture trustee registered under SEBI (Debenture Trustees) Regulations, 1993. However, a Trustee to the REIT shall not be eligible to be appointed as debenture trustee to such issue of debt securities.

**17.7.2 Security creation**

Any secured debt securities issued by REITs shall be secured by the creation of a charge on the assets of the REIT or holdco or SPV, having a value which is sufficient for the repayment of the amount of such debt securities and interest thereon.

**17.8 Borrowings**

- The aggregate consolidated borrowings cannot exceed 49% of the value of the REIT Assets;
- If the borrowings are between 25% to 49% of the value of the REIT Assets, then the following

is required

- Credit rating
- Approval of the Unit holders

- Commercial Paper: REIT having net worth of INR 100 Crore or higher are eligible to issue Commercial Papers (CPs), in terms of Reserve Bank Commercial Paper Directions, 2017 dated August 10, 2017 and SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021.
- The issuance of listed CPs shall be within the overall debt limit permitted under SEBI (Real Estate Investment Trusts) Regulations 2014.

**17.9 Valuation of Assets**

**Condition for a Valuer:**

- The valuer shall not be an associate of the sponsor(s) or manager or trustee and
- Valuer shall have more than five years of experience in valuation of real estate.

**Valuation Report & submission:**

- Full valuation includes a detailed valuation of all assets of the REIT by the valuer including physical inspection of every property by the valuer.
- Full valuation report shall include the mandatory minimum disclosures as specified in Schedule V to the Regulations.

**Frequency of valuation:**

- A full valuation shall be conducted by the valuer once in every financial year
- Valuation should be done within 3 months from the end of the Financial year
- A half yearly valuation of the REIT assets shall be conducted by the valuer for the half-year ending on September 30 for incorporating any key changes in the previous six months and such half yearly valuation report shall be prepared within 45 days from the end of such half year.

**Filing timeline**:

Valuation Reports have to be filed by the Manager to designated stock exchange and unit holders within 15 days from the receipt of the Reports

**17.10 Investment conditions**

- The investment by an REIT shall only be in Holding company and/ or SPVs or properties or securities or TDR in India.
- The REIT shall not invest in vacant land or agricultural land or mortgages other than mortgage

backed securities: Provided that this shall not apply to any land which is contiguous and extension of an existing project being implemented in stages.

- The REIT may invest in properties through SPVs subject to the following-

    - No other shareholder or partner of the SPV shall exercise any rights that prevents the REIT from complying with the provisions of these regulations and an agreement has been entered into with such shareholders or partners to that effect prior to investment in the SPV.

    - in case the SPV is a company/ LLP, the manager, in consultation with the trustee, shall appoint atleast such number of nominees on the board of directors or the governing board of such SPVs, as applicable, which are in proportion to the shareholding or holding interest of the REIT in the SPV;

    - the manager shall ensure that in every meeting including annual general meeting of the SPV, the voting of the REIT is exercised.

**In case of dispute:**

- The shareholders' agreement or partnership agreement shall provide for an appropriate mechanism for resolution of disputes between the REIT and the other shareholders or partners in the holdco and/or the SPV:

  Provided further that the provisions of these regulations shall prevail in case of inconsistencies between such agreement(s) and the obligations cast upon an REIT under REIT regulations.

**17.11 Other significant matters**

**(A) Related party Transactions**

All related party transactions shall be on an arms-length basis in accordance with relevant accounting standards and shall be ***disclosed*** -

- in the offer document
- to the designated stock exchanges and unit holders periodically

**(B) Post listing- prior approval of Unit holders**

Prior approval of Unit holders is necessary if,

- the total value of all the related party transactions, in a financial year, pertaining to acquisition or sale of properties, whether directly or through Holdco and/or SPVs, or

investments into securities exceeds 10% of the value of REIT; or

- the value of the funds borrowed from related parties, in a financial year, exceeds 10% of the total consolidated borrowings of the REIT, holdco and/or the SPV(s).

**(C) Rotation of Valuers**

No Valuer shall undertake valuation for the same property for more than 4 years consecutively. In case of any material development having an impact on the valuation of assets, the following shall be considered:

- full valuation of the property under consideration within 2 months from the date of such event.
- disclosure of the valuation report to the trustee, investors and the designated stock exchanges within 15 days of such valuation.

The valuer shall not value any assets in which it has either been involved with the acquisition or disposal within the last twelve months other than such cases where valuer was engaged by the REIT for such acquisition or disposal.

**(D) Dispute Resolution**

Disputes between the investors and the Manager is subject to a resolution mechanism that includes mediation and/or conciliation and/or arbitration, in accordance with the procedure specified SEBI.

No loss or damage or expenses incurred by the manager or officers of the manager, including those in relation to resolution of claims or disputes of investors, shall be met out of the trust property.

**17.12 Continual Disclosures to Stock Exchange**

**( A** ) The manager of all REITs shall submit-

c) an annual report to all unit holders electronically or by physical copies and to the designated stock exchanges within 3 months from the end of the financial year.

d) half-yearly report to all unit holders of the REIT with respect to activities of the REIT within forty five days from the end of the half year ending on September 30th

**( B) Unit holding pattern** needs to be disclosed for each class of unitholders as under:

- one day prior to listing of units on the stock exchanges
- within 21 days from the end of each quarter and
- within 10 days of any capital restructuring of REIT resulting in a change exceeding 2% of the total outstanding units of REIT.

**( C ) Financial Information**

- An REIT shall submit its-
    - Half yearly (audited/unaudited) results within 45 days from the end of the half year, (the unaudited results should be accompanied by a Limited Review Report of the Auditors
    - Audited annual financial information within 60 days of the end of the Financial year, to the Stock Exchanges
- The Financial Information is to be disclosed both on Standalone and Consolidated basis.
- Financial Information of the Manager to be disclosed alongwith that of REITS in case the Networth of the Manager is materially eroded.

**Approval & authentication of Financial Information**:

The Board of Directors/ Governing Board of the Manager shall approve the financial statements. The financial information is required to be signed by two designated personnel of the Manager and the Chairperson or Managing Director/partner or Wholetime Director/ Partner. In the absence of all of them, it may be signed by any other director/partner of the Manager.

**Additional Information:**

- REITS shall disclose statements of the Net Distributable Cash flows (NDCF) s of the REIT, its HoldCo and SPVs.
- Disclosure of the fees paid to the Manager
- The Statement of deviations /variations is to be submitted to Stock Exchanges on a quarterly basis, if the Units are listed
- REITs should get itself registered on SCORES platform of SEBI. Investors Grievances if any, to be addressed within 21 days of the receipt of the complaints.

**(D ) Event based disclosure**

Some disclosures which are event based are listed below:

- acquisition or disposal of any properties, exceeding 5% of the value of the REIT assets
- additional borrowing at level of holco or SPV or REIT, exceeding 5% of the value of the REIT assets;
- additional issue of units by the REIT;
- details of any credit rating obtained by the REIT and any change in such rating;
- any issue which requires approval of the unit holders;

- any legal proceedings which may have significant bearing on the functioning of the REIT;
- notices and results of meetings of unit holders,
- any instance of non-compliance with these regulations
- any material issue that in the opinion of the manager or trustee needs to be disclosed to the unit holders.

**(E) Maintenance of records**

The manager shall maintain the following records in physical or electronic form for a period of not less than seven years:

- decisions of the manager with respect to investments or divestments and documents supporting the same
- all investments or divestments of the REIT and documents supporting the same including rationale for such investments or divestments;
- agreements entered into by the REIT or on behalf of the REIT;
- documents relating to appointment of Trustee, Registrar etc.;
- insurance policies for real estate assets;
- investment management agreement;
- all the related documents pertaining to issue and listing of units;
- distributions declared and made to the unit holders;
- disclosures and periodical reporting made to the trustee, SEBI, unit holders and the designated stock exchanges;
- valuation reports including methodology of valuation;
- books of accounts and financial statements;
- audit reports;
- unit holders' grievances and actions taken thereon including copies of correspondences made with the unit holder and SEBI;
- any other material documents
- Documents pertaining to Registration
- Notices and agenda sent to the Unit holders

**(F) Investor Charter** and Disclosure of Investor Complaints by Merchant Bankers for public by REITs

All the registered Merchant Bankers are advised to disclose on their websites,

- the Investor Charter for Public Offer by REITs,
- Investor complaints and redressal of the same on their websites, latest by 7th of succeeding month.

**(G) Disclosures to the Investors**

The Manager shall:

- submit annual report, half yearly report and valuation report to the Unit holders
- acquisition or disposal of any projects, directly or through holdco or SPV, value of which exceeds 5 percent of value of the REIT assets;
- additional borrowing, at level of holdco or SPV or the REIT, resulting in such borrowing exceeding 5 per cent. of the value of the REIT assets during the year
- additional issue of units by the REIT;
- details of any credit rating obtained by the REIT and any change in such rating;
- any issue which requires approval of the unit holders;
- any legal proceedings which may have significant bearing on the functioning of the REIT;
- notices and results of meetings of unit holders,
- any instance of non-compliance with these regulations including any breach of limits specified under the regulations;
- any material issue that in the opinion of the manager or Trustee needs to be disclosed to the unit holders.

**(H) Post listing compliance:**

**The Manager of REITs** have to comply with the provisions of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (LODR)

**17.13 Board composition and role**

( A )The REIT Board should have minimum 6 Directors with one woman Independent Director.

**Quorum** for the board meeting shall be one-third of its total strength or three directors, whichever is higher, including at least one independent director.

**The minimum information** to be placed before the Board of Directors shall include the items specified in Part A of Schedule VIII to the REITs Regulations.

The Board shall review compliance reports every quarter pertaining to all laws applicable to the REIT as well as steps taken to rectify instances of non-compliances.

The chief executive officer, the chief financial officer and the compliance officer shall provide the compliance certificate, including the items specified in Part B of Schedule VIII.

The Board of directors of the Manager shall specify the recommendation of the Manager in the notice to the unitholders.

**(B) Nomination Rights**

Unitholder(s) holding 10% or more of the total outstanding units of the REIT, either individually or collectively have a right but not the obligation to appoint a Nominee Director" (a non-independent director) on the Board of Directors of the Manager.

If the unitholding of more than one unitholder is aggregated for this purpose, then Notice to the Investment Manger shall also identify up to two unitholders as authorized representative of the group of Eligible Unitholder(s).

**Exception**: A shareholder or a lender of the manager or the REIT (or its HoldCo(s) or SPVs), who is an entity will not have the right to nominate one or more directors on the Board of Directors of the Manager even if the Units held are more than 10%.

**(C) Policy for appointment:**

The Board of Directors of the Manager shall formulate and adopt a policy for selection of Nominee Director, which shall inter-alia contain

- qualifications
- criteria for appointment
- evaluation parameters of individuals
- shall specify remuneration / sitting fees,
- process of removal or resignation of Unitholder Nominee Directors
- role of the Nomination and Remuneration Committee

Such policy shall be made available on the website of the REIT.

**(D) Process of appointment**:

The eligibility of a Unitholder Nominee Director shall be confirmed by the Manager, based on the evaluation done by the Nomination and Remuneration Committee and/or the Board of Directors of the Manager in line with the policy formulated.

The appointment shall be made within 30 days of confirmation by the NRC or the Board.

**(E) Conflict of interest:**

Unitholder Nominee Directors shall recuse themselves from voting on any transaction where either such director, such director's associates or the Eligible Unitholder(s) who nominated him / her or associate of such Eligible Unitholder(s) is a party

**(F) Checking the eligibility annually**:

The Manager shall send a written intimation to all unitholders on their email address(es) registered either with the Manager or with any depository, within 10 days from the end September 30,2023, requesting them to inform the Manager if any Eligible Unitholder(s) wish to exercise the right to nominate a Unitholder Nominee Director.

Eligible Unitholder(s) who wish to exercise this right shall inform the Manager through a written notice within ten days of receipt of the intimation from the Manager.

The Eligible Unitholder(s) shall be reckoned based on the unitholding pattern of the REIT as on September 30, 2023.

**(G) Monthly review on the eligibility:**

The Manager of the REIT shall, within 10 days from the end of each calendar month, review whether the Eligible Unitholder(s) who have exercised the board nomination right, continue to have/hold the required number of units of REIT and shall submit such report to the Trustee of the REIT.

**(H) Trust Deed:**

The trust deed and the investment management agreement of the REIT should provide for nomination and appointment of Unitholder Nominee Directors on the Board of Directors by Eligible Unitholder(s)

**17.14 Other Reporting & Compliances**

**(A) Vigil Mechanism**

The manager shall formulate a vigil mechanism, including a whistle blower policy for directors and employees to report genuine concerns.

**(B) Secretarial Compliance Report**

A secretarial compliance report given by a practicing company secretary is required to be filed with the stock exchanges, within 60 days from end of each financial year and annexed to the Annual Report.

**Quarterly compliance Report on Corporate Governance** is to be filed with Exchanges within 21 days from the end of the Quarter.

**( C ) Annual meeting of the Unit holders**

An annual meeting of all unit holders shall be held not less than once a year within one hundred twenty days from the end of financial year and the time between two meetings shall not exceed fifteen months.

The same can be held through audio video visual means.

The notice to the unit holders may be given through emails registered with the REIT or with depositories.

**( D ) Website:**

REITS should maintain a functional website. It should contain the following:

- Details of business
- Financial information
- Email id for Investor grievances
- Contact details of designated officials
- Notices, Calls letters, Circulars
- All Reports including Compliance Reports filed with the Stock Exchanges
- All intimations made by REiTS to Stock Exchanges

### 17.15 Inspection by SEBI

SEBI has powers to conduct inspection on the activities of REITs. The outcome/ final decision of the inspection may envisage requiring the REITs to:

- delist its units from the stock exchanges and surrender its certificate of registration;
- REIT to wind up;
- to sell its assets;
- to take appropriate action against the parties to REIT
- prohibiting the REIT or parties to the REIT from operating in the capital market or from accessing the capital market for a specified period.

**Investor Charter Real Estate Investment Trusts (REITs):**

In a move to enhance financial consumer protection alongside enhanced financial inclusion and financial literacy and in view of the recent developments in the securities market including introduction of Online Dispute Resolution (ODR) platform and SCORES 2.0, it has been decided to introduce the investor charter for REITs.[41]

[41] https://www.sebi.gov.in/legal/circulars/jun-2025/investor-charter-real-estate-investment-trusts-reits-_94555.html

**Review Questions**

1. Which of the following medium is a notice to the unit holders of a REIT **not permitted** to be given?

(a) **Whatsapp message on the number registered with REIT**
(b) emails registered with REIT
(c) registered post at the address registered with REIT
(d) speed post at the address registered with REIT

2. Unit holding pattern of REIT is required to be disclosed for each class of unitholders _____ prior to the listing of such units on Stock Exchanges.

**(a) 1 day**
(b) 2 days
(c) 5 days
(d) 10 days

3. REIT having net worth of Rs. _____ are eligible to issue Commercial Papers (CPs).

(a) 200 crores or more
(b) 300 crores or more
(c) 250 crores or more
**(d) 100 crores or more**

4. In case the sponsor of REIT is an individual, which amongst the following are not included in the sponsor group?

(a) entities controlled by this individual
**(b) brother-in-law's wife**
(c) parent of the individual
(d) child of the spouse

## ANNEXURE 1: LIST OF SEBI MANDATED NISM CERTIFICATIONS UNDER SEBI (CAPSM) REGULATIONS, 2007

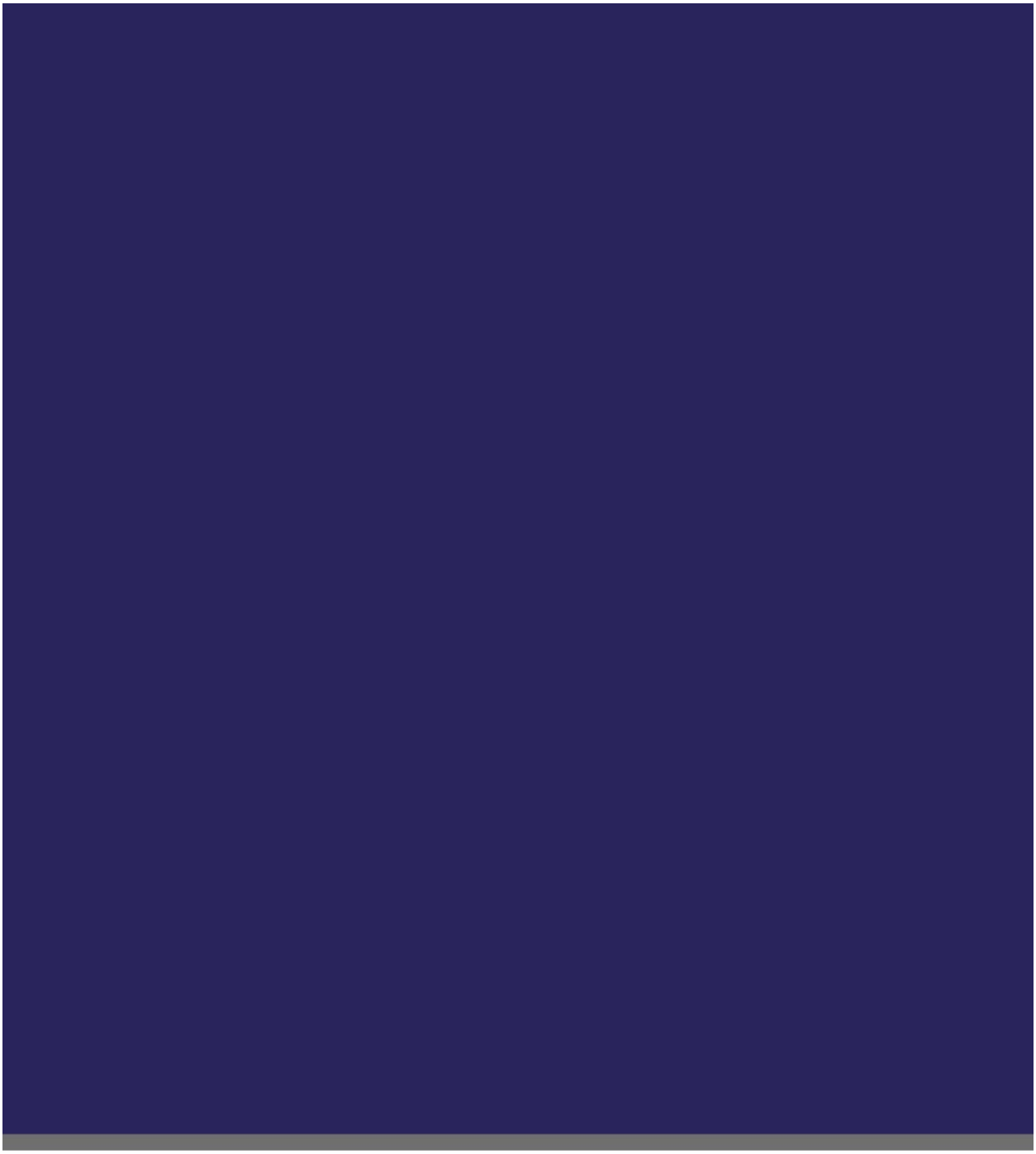
| **MANDATED EXAMINATIONS** | | |
|---|---|---|
| **Sr. No.** | **Name of the examination** | **Mandated for whom** |
| 1 | NISM Series I: Currency Derivatives Certification Examination | Approved users and sales personnel of trading members of currency derivatives segments of recognized stock exchanges. |
| 2 | NISM Series II-A: Registrars and Transfer Agents (Corporate) Certification Examination<br><br>AND<br><br>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-III-C: Securities Intermediaries Compliance (Fund) | For persons engaged in compliance functions with any intermediary registered with SEBI as Mutual Funds, Alternative Investment Funds, Real Estate Investment Trusts, and Infrastructure Investment Trusts. 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 that govern the Securities Market. |
| 5 | 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. |
| 6 | 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. |
| 7 | 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". |
| 8 | NISM Series VI: Depository Operations Certification Examination | Associated persons engaged or employed by a registered depository participant in:<br>(a) dealing or interacting with clients;<br>(b) dealing with securities of clients;<br>(c) handling redressal of investor grievances;<br>(d) internal control or risk management;<br>(e) activities having a bearing on operational risk; or |

| | | |
|---|---|---|
| | | (f) maintenance of books and records pertaining to the above activities |
| 9 | 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. |
| 10 | 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. |
| 11 | NISM Series IX: Merchant Banking Certification Examination | Associated persons designated as Key Management Personnel, who, -<br>a. perform SEBI regulated activities such as initial public offer, further public offer, Open Offer, Buy-back, Delisting;<br>b. deal with the issuers in connection with activities mentioned in (a) above;<br>c. deal with intermediaries associated with activities mentioned in (a) above;<br>d. act as designated Compliance Officer dealing with the activities mentioned in (a) above;<br>e. submit Due Diligence Certificates to SEBI in connection with the activities mentioned in (a) above; |
| 12 | NISM-Series X-A: Investment Adviser (Level 1) Certification Examination<br><br>NISM Series X-B: Investment Adviser (Level 2) Certification Examination<br><br>NISM Series-X-C: Investment Adviser Certification (Renewal) 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. |

| | | |
|---|---|---|
| 13 | 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.<br>(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.<br>(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. |
| 14 | NISM Series-XV: Research Analyst Certification Examination<br><br>AND<br><br>NISM Series-XV-B: Research Analyst Certification (Renewal) 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. |
| 15 | 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. |
| 16 | NISM-Series-XIX-C: Alternative Investment Fund Managers Certification Examination | AIF Manager exam is mandated for at least one key personnel, amongst the associated persons functioning in the key investment team of the Manager of an Alternative Investment Fund. |
| 17 | NISM Series-XIX-D: Category I and II Alternative Investment | For the role of managers of AIFs and their key management team in performing fund management duties, governance of funds, |

| | | |
|---|---|---|
| | Fund Managers Certification Examination | managing conflict of interests etc. The examination focuses on fund management aspects relating to Category I and II AIFs, and also it enhances the quality of fund management activities in the AIF space. |
| 18 | NISM Series-XIX-E: Category III Alternative Investment Fund Managers Certification Examination | For Category III AIF Managers and its key investment team. It is based on fund management aspects relating to Category III AIFs. The examination focuses to enhance the quality of fund management activities in the Category III AIF space and enables a better understanding of features of AIF products, investment valuation norms, fund governance processes, fund performance measurements, taxation aspects and related regulations. |
| 19 | NISM Series XXI-A: Portfolio Management Services (PMS) Distributors Certification Examination | The associated persons are engaged by a Portfolio Manager as a distributor of the Portfolio Management Services. |
| 20 | NISM Series XXI-B: Portfolio 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. |

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