DEVELOPMENTS IN SECURITIES LAW

IN DECEMBER 2018

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ACUITY LAW

ABOUT ACUITY LAW

Acuity Law was founded in November 2011. Acuity Law comprises of a team of young and energetic lawyers led by Souvik Ganguly and Gautam Narayan, who have deep and diverse experiences in their chosen areas of practice. We have advised Indian and multinational companies, funds, banks and financial institutions, founders of companies, management teams, international law firms, domestic and international investment banks, financial advisors and government agencies in various transactions in and outside India.

Acuity Law takes pride in rendering incisive legal advice taking into consideration commercial realities. Our areas of practice are divided into two departments.

The Corporate practice is led by Souvik Ganguly and the Disputes practice is led by Gautam Narayan.

As part of the Corporate practice, Acuity Law advises on:

- Mergers and acquisitions;
- Distressed mergers and acquisitions;
- Insolvency Law;
- Private Equity and Venture Funding;
- Employment and labour laws
- Commercial and trading arrangements; and
- Corporate Advisory

As part of the Disputes practice, Acuity Law under the leadership of Gautam Narayan advises and represents clients on domestic and cross - border:

- Civil disputes;
- Criminal law matters; and
- Arbitration matters

Acuity Law actively follows legislative and policy developments in its chosen areas of practice and shares such developments with clients and friends on a regular basis.

If you want to know more about Acuity Law, please visit our website www.acuitylaw.co.in or write to us at al@acuitylaw.co.in.

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INTRODUCTION

This newsletter covers key updates about the developments in Indian securities law during the month of December 2018. We have summarized the key regulatory developments including regulatory changes brought about or proposed by the Indian capital market regulator in relation to settlement of proceedings, timeline for compliance with transfer of securities in dematerialized form, clubbing of investment limits for foreign portfolio investors, listing of equity shares of Indian companies on foreign stock exchanges and vice versa, and certain important orders of the Securities Exchange Board of India ("**SEBI**") in relation to failure to make adequate disclosures regarding (a) listing of securities on foreign stock exchanges and (b) change of shareholding required under insider trading and takeover regulations. Please see below the summary of the relevant developments and orders.

A. SEBI Orders

1. PENALTY OF INR 500,000 FOR FAILURE TO MAKE DISCLOSURE REGARDING ISSUE OF GDRS AND LISTING OF SHARES ON FOREIGN STOCK EXCHANGE

SEBI *vide* its order dated 18 December 2018, has imposed a penalty of INR 500,000 on M/s. Silverline Technologies Limited ("**STL**") for failure to make adequate disclosures regarding the issuance of Global Depository Receipts ("**GDRs**"), listing and delisting of the GDRs on Luxembourg Stock Exchange ("**LUX**"), acquisition of M/s. Envoy Technologies Inc ("**Envoy**") and submission of incorrect shareholding details to the Bombay Stock Exchange ("**BSE**").

On 06 March 2009, STIL issued 200,000 GDRs which were listed on LUX. From February 2009 to March 2009 ("**Investigation Period**"), SEBI conducted investigations into the activities of STL for failure to make adequate disclosures required under the Securities Contract (Regulation) Act, 1956 ("**SCRA**") and Listing Agreement ("**LA**").

STL contended that since the GDRs were listed by LUX only on 21 April 2009, there had been no violation of securities law during the Investigation Period. Further, STL had accurately informed the BSE of a change in its shareholding pattern due to listing of the GDRs for the quarter ending in June 2009, and not for March 2009, since the GDRs were listed by LUX in April 2009. Additionally, STL contended that it had clearly intimated BSE of the acquisition of Envoy, through, *inter alia*, disclosure of its balance sheet.

SEBI held that STL had failed to provide any proof of 'corporate announcement' regarding its board resolution approving of the issue of GDR and their consequent listing on LUX (for example, by way of an acknowledgement of receipt of disclosure by BSE). Similarly, STL had failed to provide any corporate announcement expressly informing BSE of the acquisition of Envoy and disclosure of the balance sheet was insufficient. Further, the change in the shareholding pattern was required to be included in the quarter ending in March 2009, since the local custodian of the GDR issuance in India had received physical share certificates of shares on 06 March 2009 for the issuance of GDRs. Thus, the date of receipt of physical share certificates is relevant, and not the date on which the GDRs were actually listed on the foreign stock exchange. Therefore, SEBI held that STL had violated the relevant provisions of the SCRA and the LA and imposed a penalty of INR 500,000 on STL.

2. PENALTY FOR FAILURE TO MAKE RELEVANT DISCLOSURES REGARDING TRANSFER OF SHAREHOLDING UNDER THE PIT REGULATIONS 1992 AND THE TAKEOVER CODE

SEBI *vide* order dated 26 December 2018, has imposed a combined penalty of INR 1,000,000 on the promoters of Timbor Home Limited ("**THL**") for failure to make relevant disclosures under the provisions of SEBI (Prohibition of Insider Trading) Regulations, 1992 ("**PIT Regulations 1992**") and the SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 2011 ("**Takeover Code**").

SEBI observed that the shareholding of the promoters of the Company ("**Promoters**") had decreased from 29.9% to 0.29% during the period 01 April 2014 to 30 May 2015, due to 10 separate off-market and on-market transactions without any consideration, which resulted in the sale of more than 25,000 shares of THL ("**Transactions**"). However, the Promoters had failed to make the relevant disclosures required under the PIT Regulations 1992 and the Takeover Code to the stock exchanges.

Under the PIT Regulations 1992, any change in shareholding which exceeds 25,000 shares was required to be disclosed to the stock exchange. Further, the Promoters, being persons acting in concert, had failed to make relevant disclosure of change in shareholding under the Takeover Code.

The Promoters, while admitting that the disclosure requirements had not been met due to ignorance, contended that SEBI should take a lenient view since the Transactions had been made by them without any considerations and were in the interest of THL.

SEBI held that where there is any change in the combined shareholding of the PAC on account of acquisition/sale of shares by any one of them, such persons alone would be responsible to make the necessary disclosures, since requiring every individual to make disclosures with regards to transactions of others would lead to absurd consequences. SEBI imposed a collective penalty of INR 1,000,000 on the Promoters, ranging from INR 100,000 to INR 300,000 on each of the Promoters respectively.

Therefore, SEBI has taken the view that good faith and the intent behind a transaction will not justify failure to comply with disclosure requirements under securities law.

B. Circulars and Regulations

1. SEBI EXTENDS TIMELINE FOR COMPLIANCE WITH REQUIREMENT FOR TRANSFER OF SECURITIES IN DEMAT FORM

On 28 March 2018, SEBI had amended the SEBI (Listing Obligations and Disclosure Requirements) Regulations 2015 ("**LODR Regulations**"), as a result of which, requests for effecting transfer of securities would not be processed unless the securities are held in the dematerialized form (that is, electronic form) with a depository, except in case of transmission or transposition of securities. This measure was to come into effect from 05 December 2018 ("**Deadline**").

However, due to representations received from market stakeholders, SEBI has extended the Deadline to 01 April 2019, *via* a press release on 03 December 2018.

2. SEBI NOTIFIES SEBI (SETTLEMENT PROCEEDINGS) REGULATIONS, 2018

On 30 November 2018, SEBI notified the Securities and Exchange Board of India (Settlement Proceedings) Regulations, 2018 ("**2018 Regulations**"), which came into force on 01 January 2019 and have substituted the SEBI (Settlement of Administrative and Civil Proceedings) Regulations, 2014 ("**2014 Regulations**") for settlement of violations of securities law, between SEBI and the offender.

Some key changes brought about by the 2018 Regulations are:

1. Scope: The 2014 Regulations were limited to settlement proceedings or violations of securities laws under the (a) Securities Contract (Regulation) Act, 1956 and (b) the Depositories Act, 1996 or related securities rules and regulations. The 2018 Regulations include the violations to any other laws to the extent that they are administered by SEBI, such as the provisions of the Companies Act, 2013 and the rules framed thereunder.
2. Restrictions on settlement: Under the 2018 Regulations, settlement will not be allowed if the default has a market wide impact, causes losses to a large number of investors or affects the integrity of the market. Certain categories of offenders, such as willful defaulters and fugitive economic offenders, have also been barred from instituting settlement proceedings.
3. Confidential settlements: The 2018 Regulations give SEBI the power to maintain the confidentiality of the identity of the applicants, while publishing other details of the settlement on its website. Confidential settlements are allowed if the applicants are willing to provide substantial assistance in investigation, inspection, inquiry or audit against any other person in respect of a violation of securities laws.
4. Application after expiry of limitation period: Under the 2018 Regulations, if the application is filed after 60 days after the expiry of the initial limitation period, then the settlement sum will be increased by 25%. Under the 2014 Regulations, applications filed after 60 days of expiry of the limitation period would lead to an increase in the settlement amount by only 6% simple interest, from the date expiry of the limitation period.
5. Application will not prohibit the initiation of new proceedings: Under the 2018 Regulations, any settlement application made will not prohibit the institution of new proceedings, if the initiation is deemed necessary for the purpose of issuance of interim civil and administrative directions to protect the interests of the investors and the integrity of the markets. No such provision existed in the 2014 Regulations.

3. SEBI RELEASES CLARIFICATIONS ON CLUBBING OF INVESTMENT LIMITS OF FPIS

On 10 April 2018, SEBI had released clarifications on know your customer ("**KYC**") norms and clubbing of investment limits of foreign government / government related entities, *vide* its circulars no. CIR/IMD/FPIC/CIR/P/2018/64 ("**KYC Circular**") and SEBI/HO/IMD/FPIC/CIR/P/2018/66 ("**Investment Limit Circular**").

On 13 December 2018, in supersession of the KYC Circular and Investment Limit Circular, SEBI issued certain clarifications regarding clubbing of investment limits for foreign portfolio investors ("**FPIs**"), *vide* its circular no. SEBI/HO/IMD/FPIC/CIR/P/2018/150 ("**Circular**").

The key points of the Circular are:

1. Basis of clubbing of limits: Clubbing of investment limit for FPIs will be on the basis of:
   i. common ownership of more than 50%, or
   ii. common control. However, clubbing of investment limit of FPIs having common control shall not be done in case of (a) FPIs which are appropriately regulated public retail funds; or (b) FPIs which are public retail funds majority owned by appropriately regulated public retail funds on 'look through' basis; or (c) FPIs which are public retail funds and investment managers of such FPIs are appropriately regulated.
2. Clubbing of investment limits: In case, 2 or more FPIs including foreign governments / their related entities have direct or indirect common ownership of more than 50% or control, all such FPIs will be treated as forming part of an investor group and the investment limits of all such entities shall be clubbed at the investment limit as applicable to a single FPI.
3. Consequences of breach: In case of breach of the investment limit mentioned in point 2 above, the FPI will have to perform either of the following options:
   i. The FPI must divest its holding within 5 trading days from the date of settlement of the trades to bring its shareholding below 10% of the paid-up capital of the company; or
   ii. The said investments shall be treated as Foreign Direct Investment from the date of breach.

C. Reports

1. REPORT ON LISTING OF EQUITY SHARES OF COMPANIES INCORPORATED IN INDIA ON FOREIGN EXCHANGES AND OF COMPANIES INCORPORATED OUTSIDE INDIA ON INDIAN EXCHANGES

On 04 December 2018, the Expert Committee for Listing of Equity Shares of Companies incorporated in India on Foreign Stock Exchanges and of Companies incorporated outside India on Indian Stock Exchanges ("**Committee**") submitted its report ("**Report**") to SEBI, recommending certain changes to be made to various legislations to allow and facilitate the listing of equity shares of Indian companies on foreign stock exchanges and of foreign companies on Indian stock exchanges, in view of the ongoing evolution and internationalization of capital markets across the globe.

The recommendations of the Committee are divided into 2 major heads: (**A**) Proposals for listing of Indian companies on foreign stock exchanges; and (**B**) Proposals for the listing of foreign companies on Indian stock exchanges.

Some key recommendations in the Report are:

A. Listing of equity shares of Indian Companies on Foreign Stock Exchanges

1. Permissible foreign stock exchanges: Indian companies may only list equity shares on stock exchanges in certain permissible jurisdictions ("**Permissible Jurisdiction**") which fulfill the qualifications specified in the Report. For example, jurisdiction must be a member of the board of the International Organization of Securities Commissions ("**IOSCO**") and the securities market regulator of such jurisdiction

must have signed a memorandum of understanding, either with IOSCO or with SEBI. Further, the jurisdiction must be a member of the Financial Action Task Force.

2. Listing of unlisted and listed Indian companies: Listing of unlisted companies will be governed by the relevant Indian laws and the listing framework of the Permissible Jurisdiction in which the company may be listed. Listed companies shall have to comply with the laws in effect in India and any additional compliances as may be required by the Permissible Jurisdiction.
3. Amendment of Indian laws: The following Indian laws should be amended, to execute the suggestions of the Report:
   i. Foreign exchange law: Introduction of Part B to Schedule I of the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2017 ("**FEMA 20R**"), to set out the regulatory framework for purchase by a person resident outside India of equity shares of a company incorporated in India listed on a foreign stock exchange, such as prohibited activities, entry routes and sectoral caps.
   ii. Companies law: The Ministry of Corporate Affairs ("**MCA**") may issue a notification clarifying that Chapter III of the Companies Act 2013, relating to prospectus and allotment of shares, and related rules, will not apply to listing of equity shares of companies incorporated in India on foreign stock exchanges.
   iii. Securities law: Listing of equity shares of unlisted companies incorporated in India on foreign stock exchanges would be governed by the listing framework of the concerned Permissible Jurisdiction. The relevant Indian laws, such as the Companies Act, 2013, would also continue to apply to such companies. Companies whose securities are listed in India, must comply with all laws applicable in India.
4. KYC and AML framework and the beneficial ownership requirement: The KYC and anti-money laundering ("**AML**") framework of the Permissible Jurisdictions shall suffice as acceptable standards for compliance. Beneficial ownership requirements may also be met by submitting information as prescribed in the Permissible Jurisdictions.
5. Accounting Standards: Accounting standards of the country of listing shall be applicable which may include preparation of consolidated statements in accordance with either the comparable global standards or standards applicable to domestic companies in such jurisdictions. The companies may also be required to prepare other such consolidated financial statements as per Indian Accounting Standards for statutory reporting purposes.

B. Listing of equity shares of foreign companies on Indian Stock Exchanges

1. Permissible Jurisdictions: The criteria to determine the Permissible Jurisdiction is similar to that of Indian companies to be listed on foreign stock exchanges.
2. Amendment of Indian laws: The Report recommends the amendment of the following Indian laws, to execute the suggestions of the Report:
   i. Foreign exchange law:
      a) The Report recommends that FEMA 20R should be amended to specifically permit investments by resident Indians in securities of companies incorporated outside India listed on Indian stock exchanges, and to enable

resident Indians to transfer securities of companies incorporated outside India listed on Indian stock exchanges. Currently, only companies incorporated in India and listed on an Indian exchange may have the ability to invest in the securities of a listed company incorporated outside India.

b) the Foreign Exchange Management (Deposit) Regulations 2016 should be amended to enable foreign companies to open bank accounts in India for listing purposes and related transactions.

ii. Companies law: A suitable provision should be introduced in the Companies Act, 2013, enabling SEBI to make regulations to permit listing of equity shares of companies incorporated outside India on India stock exchanges. This provision may be similar to section 390 of the Companies Act 2013, relating to regulation of Indian depository receipts.

iii. Securities law: Provisions of the SEBI (issue of Capital and Disclosure Requirements) Regulations 2018, LODR Regulations, PIT Regulations, Takeover Code, SEBI (Buy Back of Securities) Regulations 2018 and SEBI (Delisting of Equity Shares) Regulations 2009, should be amended to incorporate the recommendations in the Report.

3. Investor KYC: To subscribe to securities of companies incorporated outside India but listed in India, the investor will have to comply with the prevalent Indian KYC and beneficial ownership norms.