DEVELOPMENTS IN SECURITIES LAW

IN OCTOBER

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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:

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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.

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INTRODUCTION

This newsletter covers key updates about the developments in Indian securities law during the month of October 2018. We have summarized the key regulatory developments including informal guidance, regulatory changes brought about or proposed by the Indian capital market regulator in relation to depositories and participants in the securities market, participation of foreign entities in the commodity market and the framework for institutional trading platform, and certain important orders of the Securities Exchange Board of India ("**SEBI**") in relation to modes of compliance with minimum public shareholding requirement and penalty for fraudulent diversion of funds. Please see below the summary of the relevant developments and orders.

A. Informal Guidance issued by SEBI

In 2003, SEBI introduced the Informal Guidance Scheme ("**Scheme**") in the interest of better regulation and development of the Indian securities market. Under the Scheme, parties may seek guidance from SEBI in case of any queries, in relation to any proposed action / inaction or interpretation of Indian securities laws. The informal guidance is not binding on SEBI.

1. LENDING AND BORROWING OF SECURITIES BY INSIDERS AMOUNTS TO INSIDER TRADING

SEBI on 05 October 2018 issued informal guidance in the matter of HDFC Securities Limited ("**HSL**"), whereby SEBI held that transactions of lending and borrowing of securities ("**SLB Transactions**") by insiders while in possession of unpublished price sensitive information ("**UPSI**"), will be prohibited as 'insider trading' under the SEBI (Prohibition of Insider Trading) Regulations, 2015 ("**PIT Regulations**").

HSL approached certain senior employees of certain companies ("**Designated Persons**"), for lending shares allotted to the Designated Persons under the securities lending and borrowing ("**SLB**") mechanism. The Designated Persons, by virtue of their employment, could be considered as 'insiders' and may be in possession of UPSI of their employer company, whose shares the Designated Persons intend to lend under the SLB mechanism. Hence, HSL sought guidance on whether the SLB Transactions would amount to 'trading' under the PIT Regulations, even though there was no sale, purchase or subscription to securities.

SEBI held that 'trading' as defined under regulation 2(L) of the PIT Regulations must be interpreted widely, to capture all activities based on UPSI which may not strictly be in the nature of buying, selling or subscribing. Consequently, SLB Transactions by the Designated Persons will amount to insider trading under the PIT Regulations, subject to contrary evidence presented by the Designated Persons.

2. REVISED ELIGIBILITY CRITERIA FOR INDEPENDENT DIRECTORS IS ALSO APPLICABLE TO EXISTING INDEPENDENT DIRECTORS

SEBI on 15 October 2018 had issued informal guidance in the matter of Sundaram Finance Limited ("**SFL**") whereby it held that the revised eligibility criteria for independent directors under the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) (Amendment) Regulations, 2018 ("**Amended Regulations**") issued *vide* notification no. SEBI/LAD/NRO/GN/2018/10 dated 09 May 2018 and effective from 01 October 2018, will be applicable to existing independent directors who were appointed before 01 October 2018.

The Amended Regulations brought about certain changes in the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 based on a report on corporate governance standards for listed companies published by the Committee on Corporate Governance headed by Mr. Uday Kotak. According to these Amended Regulations, an independent director of a listed company ("**Company A**") must not be a non-independent director of another company ("**Company B**"), if a non-independent director of Company A is also an independent director on the board of directors of Company B ("**Revised Eligibility Criterion**"). This was brought about to avoid potential situations of 'board interlock,' which could lead to a lack of independence of the company and bad corporate governance. The Revised Eligibility Criterion came into effect on 01 October 2018.

In this matter, an independent director on the board of directors of SFL, a listed company, was also a non-independent director on the board of another listed company, India Motor Parts and Accessories Limited ("**IMPAL**"). Further, an independent director on the board of directors of IMPAL was also a non-independent director on the board of SFL.

SEBI held that the Revised Eligibility Criterion is applicable to existing as well as new appointments / re-appointments of directors. Therefore, SFL must comply with the Revised Eligibility Criterion for existing as well as future independent directors.

3. TRADING BY AIF EMPLOYEES IN UNITS OF AIF SCHEMES WILL AMOUNT TO INSIDER TRADING

SEBI on 09 October 2018 had issued informal guidance in the matter of SBI Funds Management Private Limited ("**SBIFM**"), stating that employees of alternative investment funds ("**AIF**") investing in AIF schemes that invest in securities that are listed or proposed to be listed, must comply with the PIT Regulations.

SBIFM is the manager of SBI Alternate Equity Fund, a category III AIF and the asset management company ("**AMC**") of SBI Mutual Funds. SBIFM had adopted a 'code of conduct' ("**Code**") and 'employee dealing policy' as required under SEBI circular no. MFD/CIR./No.4/216/2001 dated 08 May 2001 ("**Circular**") and the PIT Regulations. However, the Circular and Code do not specifically mention whether investment in AIF schemes will fall under the ambit of the Circular and Code.

Some employees of SBIFM proposed to invest in units of the AIF schemes, who, by nature of their employment, might have access to UPSI. SBIFM enquired whether the Code will be applicable to SBIFM employees for investment in units of AIF schemes.

SEBI held that the Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012 ("**AIF Regulations**") permit investment in listed securities, which are amenable to insider trading. The purpose of regulation 9 of the PIT Regulations is to lay out minimum standards for compliance with the PIT Regulations for market intermediaries, especially with respect to dealing / trading in securities by employees / connected persons. Additionally, SEBI circular dated 17 November 2016 makes it mandatory for AMCs, trustees of mutual funds, their employees and directors to comply with the PIT Regulations. Therefore, the Code will apply to trading / investment by employees of AIFs / AMCs in units of AIF schemes that invest in securities that are listed or proposed to be listed.

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B. SEBI Orders

1. NO PENALTY IMPOSED FOR RECLASSIFICATION OF PROMOTERS TO COMPLY WITH MINIMUM PUBLIC SHAREHOLDING REQUIREMENT

SEBI has held that reclassification of promoters as public shareholders in order to meet the minimum public shareholding ("**MPS**") requirement of listed companies does not attract penalty under the Securities Contracts (Regulation) Rules, 1957 ("**SCRR**"), Securities Contracts (Regulation) Act ("**SCRA**") and Listing Agreement ("**LA**"), in the matter of Gokaldas Exports Limited ("**GEL**") on 03 October 2018.

In 2007, Blackstone FP Capital Partners Mauritius V B SU acquired 68.7% shares of GEL through share purchase agreement ("**SPA**") with the erstwhile promoters ("**Erstwhile Promoters**") of GEL and through a subsequent open offer. Consequently, the Erstwhile Promoters held 20% shares and the public shareholding of GEL was brought down to 11.73% of the total shareholding of GEL. Subsequently, on 04 June 2010, an amendment to the SCRR mandated all listed companies to achieve MPS at 25% by 03 June 2013, through any of the prescribed methods under the LA, SCRR, SCRA or relevant SEBI circulars ("**Prescribed Methods**").

In February 2013, the SPA was terminated, and articles of GEL were amended to remove the special rights available to the Erstwhile Promoters. Further, relevant disclosures were made to the stock exchanges for reclassification of the Promoters as 'public shareholders,' thus bringing the public shareholding to 31.73%. However, reclassification of promoters as public shareholders, was not one of the Prescribed Methods to achieve MPS. Therefore, SEBI issued a show-cause notice dated 28 April 2016 to the Erstwhile Promoters for complying with MPS requirement by a method other than the Prescribed Methods.

SEBI observed that the relevant provision for liability for non-disclosure with listing requirements is section 23E of the SCRA, which imposes an obligation to comply with the listing conditions or delisting conditions. There is no penalty for compliance with listing conditions using a method other than any of the Prescribed Methods. Therefore, SEBI refused to impose penalty on the Erstwhile Promoters.

2. SEBI DIRECTS PROMOTERS OF FHL AND RELATED ENTITIES TO REPAY INR 4.03 BILLION, DUE TO FRAUDULENT DIVERSION OF FUNDS

SEBI has directed listed company Fortis Healthcare Ltd. ('**FHL**') to recover INR 4,030,000,000 from its promoters Mr. Malvinder Mohan Singh and Mr. Shivinder Mohan Singh ("**FHL Promoters**") and 8 related entities (collectively, "**Noticees**") *vide* its order dated 17 October 2018, in the matter of Fortis Healthcare Limited.

On 12 February 2018, SEBI conducted a meeting with the auditors of FHL, to investigate allegations claiming that the Noticees had siphoned off an amount of at least INR 5,000,000,000 from FHL, based on information reported in a news article dated 09 February 2018. Subsequent to this meeting, SEBI conducted a preliminary examination into the affairs of FHL.

SEBI found that FHL, through its wholly owned subsidiary, had extended an amount of INR 5,760,000,000 through inter corporate deposits ("**ICDs**") ("**Transactions**") to 3 unrelated entities (i) Best Healthcare Private Limited; (ii) Fern Healthcare Private Limited; and (iii) Modland Wears Private Limited (collectively, "**Borrowing Companies**"), during December 2011. However, the ultimate beneficiaries of these funds were FHL Promoters / promoter entities of FHL and the ICDs were routed through the Borrowing Companies for the sole purpose of circumventing the disclosures to be made for related party transactions under clause 32 of the LA.

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Further, FHL had entered into circular transactions, to fraudulently represent that the debts of the FHL Promoters / promoter entities of FHL had been paid off. Additionally, FHL and its promoters / promoter entities had defrauded investors, by failing to make relevant disclosures relating to loss-making short-term loan transactions and had fraudulently diverted funds for the personal benefit of the FHL Promoters / promoter entities. As a result of these fraudulent activities, the outstanding principal amount of the ICDs with the Borrower Companies on 31 May 2018, was determined to be INR 4,030,000,000.

SEBI held that it would continue to investigate the roles of the Borrowing Companies as well as other companies involved in the Transactions. However, in order to protect the interest of the investors and the integrity of the securities market, SEBI issued an interim order ("**Interim Order**") directing the Noticees to repay the outstanding debt of INR 4,030,000,000 with due interest to FHL by 17 January 2019, and pending investigation, the Noticees are restricted from alienating any of the assets / property / funds of FHL, except to meet day to day operations, without the prior permission of SEBI.

C. Circulars and Regulations

1. SEBI ISSUES REGULATIONS FOR DEPOSITORIES AND PARTICIPANTS IN THE SECURITIES MARKET

SEBI has issued SEBI (Depositories and Participants) Regulations, 2018 ("**2018 Regulations**"), *vide* its circular dated 03 October 2018. The 2018 Regulations seek to harmonize and align norms relating to depositories and participants registered with SEBI (respectively, "**Depository**" and "**Participant**"), with other existing laws such as the Companies Act 2013. The 2018 Regulations are effective from 03 October 2018 and have replaced the SEBI (Depositories and Participants) Regulations, 1996.

Some key aspects of the 2018 Regulations are:

1. Shareholding limit in a Depository: Depending upon its residential status and nature, an entity may hold up to either 15% or 5% of the paid-up equity share capital of a Depository, either directly or through persons acting in concert ("**PAC**").
   i. Person resident in India:
      a. Stock exchanges, other depositories, banking companies, insurance companies and public financial institutions can hold up to 15%;
      b. All other persons resident in India may hold up to 5%.
   ii. Person resident outside India: The combined holding of all persons resident outside India in the paid up equity share capital of a Depository must not exceed 49% of its total paid up equity share capital.
      a. Foreign stock exchange, foreign depository, foreign banking company, foreign insurance company, foreign commodity derivatives exchange and bilateral or multilateral financial institution approved by the Central Government may hold up to 15%;
      b. All other persons resident outside India may hold up to 5%.
2. Eligibility for holding shares in the Depository: All persons holding 2% or more of the paid-up equity share capital of the Depository must be 'fit and proper' as per criteria laid down in the 2018 Regulations.

3. Acquisition of voting rights or equity shares in the Depository: Persons who acquire 2% to 5% of the equity shares or voting rights in a Depository, directly or indirectly, either individually or through PAC, must seek the approval of SEBI within 15 days of the acquisition. Further, a person must obtain the prior approval of SEBI in order to acquire or hold more than 5% of the paid-up equity share capital of a Depository.
4. Disclosure requirements: All disclosure requirements and corporate governance norms applicable for listed companies shall *mutatis mutandis* apply to a Depository.

2. SEBI ALLOWS ELIGIBLE FOREIGN ENTITIES TO PARTICIPATE IN THE COMMODITIES DERIVATIVES MARKET

SEBI has allowed foreign entities having actual exposure to Indian commodity markets, or eligible foreign entities ("**EFE**"), to participate in the commodities derivatives market, *vide* its circular dated 09 October 2018 ("**EFE Circular**"). SEBI had published a consultative paper on 18 May 2018 ("**EFE Consultative Paper**") to discuss a suitable framework for allowing foreign participants to hedge their commodity exposure. The Circular has incorporated changes in line with the recommendations arising out of the EFE Consultative Paper.

Prior to the EFE Circular, foreign entities were not permitted to directly participate in the Indian commodity derivatives market, even if they imported / exported various commodities from / to India, that is, had actual exposure to the various commodities in the Indian market. By virtue of their actual exposure to the various commodities in the Indian market, these entities were exposed to price uncertainty of Indian commodity markets.

Some key points of the EFE Circular are:

1. Eligible Commodities: EFEs can trade in all commodity derivatives traded on Indian stock exchanges except for those contracts where the underlying commodity is a 'sensitive commodity,' as determined by SEBI under circular no. SEBI/HO/CDMRD/DMP/CIR/P/2017/84.
2. Definition of EFE: An EFE is a person resident outside India as defined under the Foreign Exchange Management Act, 1999, having actual exposure to Indian physical commodity markets.
3. Eligibility Conditions: An EFE shall be permitted to participate in the Indian commodities derivatives market on the following conditions:
   i. Minimum net worth: The EFE must have minimum net worth of USD 500,000;
   ii. Actual exposure: The EFE has actual exposure to Indian physical commodity markets;
   iii. Jurisdiction of EFE: The EFE is a resident of a jurisdiction that has signed a memorandum of understanding ("**MOU**"), either with SEBI, or with International Organization of Securities Commissions ("**IOSC**"). The EFE further must not be from a jurisdiction that has been categorized by the Financial Action Task Force as a jurisdiction unable to sufficiently counter problems such as money laundering or financing of terrorism; and
   iv. FPIs and FVCIs: EFEs who are also registered with SEBI as Foreign Portfolio Investors ("**FPIs**") or Foreign Venture Capital Investors ("**FVCIs**") must ensure that there is clear segregation of funds / securities / commodities.

4. Registration: The EFE must open an account with an authorized stock broker ("**ASB**") having minimum net worth of INR 250,000,000/- registered with SEBI. The EFE will participate in the commodities derivatives market through this ASB only.
5. KYC Requirements: The EFEs must meet all Know Your Customer requirements prescribed for the equivalent category of FPIs. The EFE must also provide its valid Legal Entity Identifier issued by organizations accredited by the Global Legal Entity Identifier Foundation, wherever available.
6. Tenor: The tenor of the hedge shall not be greater than the tenor of underlying exposure. The hedging positions taken in all derivatives contracts by the EFE, across multiple stock exchanges, shall not exceed its actual exposure in the physical market.
7. Hedge Limit: An EFE shall apply for the hedge limits corresponding to its own physical exposure to the commodity and cannot apply for a hedge limit in respect of any stock it holds on behalf of another entity, including stock positions it holds on behalf of a group-entity. The limits sanctioned to the EFE shall be utilized only by it and not by anyone else, including any subsidiary / associate company.

1. CONSULTATION PAPER FOR THE REVIEW OF FRAMEWORK FOR INSTITUTIONAL TRADE PLATFORM

D. Consultation Paper

On 20 October 2018, Primary Market Advisory Committee of SEBI ("**PMAC**") and a group of various industry stakeholders published a consultation paper ("**Consultation Paper**") to review and suggest changes in the existing framework for institutional trade platform ("**ITP**"), which had previously failed to gain a positive reaction from the market. An ITP is a platform specially designed for listing of new age start-ups in sectors like e-commerce, data analytics, bio-technology and other start-ups. All stakeholders have been invited to provide their comments on the Consultation Paper by 16 November 2018.

Some key recommendations of the Consultation Paper are:

1. Rename ITP: The term 'ITP' is proposed to be renamed to 'Innovators Growth Platform' ("**IGP**")
2. New eligibility criteria for investment on IGP: In order to be eligible to be listed on the IGP, at least 25% of the pre-issue capital of the entity, for at least a period of 2 years, should have been held by Qualified Institutional Buyers / other regulated entities ("**ORE**"), and / or Accredited Investors ("**AI**"), out of which not more than 10% should be by AIs.
   An ORE is an entity which is :
   i. Category III FPI, or
   ii. a pooled investment fund with (a) minimum assets under management of USD 150,000,000; and (b) is registered with a financial sector regulator in the jurisdiction of which it is a resident; and (c) is a resident of a jurisdiction that has signed an MOU, either with SEBI or with the IOSC.
   iii. The ORE further must not be from a jurisdiction that has been categorized by the Financial Action Task Force, as a jurisdiction unable to sufficiently counter problems such as money laundering or financing of terrorism.

An AI is an entity which is accredited by stock exchanges / depositories, which meets the following criteria:

i. in case of an individual, he / she must have total gross income of INR 5,000,000 annually and have minimum liquid net worth of INR 50,000,000; or
ii. in case of a body corporate, it has a net worth of at least INR 250,000,000.

3. No separate cap on post-IPO shareholding: As per the current SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 (“**ICDR Regulations**”), which restricts a person from holding 25% or more of the post-issue capital of the entity, either individually or through persons acting in concert, has been proposed to be removed. This will remove any cap on post- initial public offer (“**IPO**”) shareholding.
4. Minimum application size and trading lot reduced: The minimum application size in secondary market, and trading lot, has been reduced to INR 200,000 and in multiples thereof, from the existing size and lot of INR 1,000,000.
5. Remove caps for allocation to investors: The existing requirement for allocation of 75% of the net public offer to institutional investors, and allocation of the remaining 25% to non-institutional investors, has been proposed to be removed. This will remove any minimum reservation of allocation to any specific category of investors, and allocation will be done on a proportionate basis. Further, the existing provision providing a cap of 10% of the issue size for discretionary allotment to institutional investors, has been done away with.
6. Number of allottees: The maximum limit of 200 allottees has been proposed to be removed, and a minimum number of allottees has been proposed to be set at 50 allottees.
7. No lock-in of pre-issue capital: As per the current ICDR Regulations, shares held by venture capital funds / AIFs / FVCIs have been exempted from the requirement for the entire pre-issue capital of the entity to be subject to a lock-in period of 6 months from the date of allotment. This exemption has been revoked, and the 6-month lock-in requirement will apply to all categories of pre-IPO public shareholders. However, shares arising out of employee stock ownership plans, will be exempt from this lock in requirement.
8. IGP as the main board: IGP would be designated as a main board platform for start-ups with an option to trade under regular category after completion of 1 year of listing. Under the current ICDR Regulations, an entity listed on ITP can migrate to the main board after expiry of 3 years from the date of listing.
9. Minimum offer to the public: Under regulation 31 of ICDR Regulations, the minimum offer to the public is subject to the requirements of the SCRR. The Consultation Paper proposes that the minimum net offer to public should be in compliance with minimum public shareholding norms and minimum offer size should be INR 100,000,000.