DEVELOPMENTS IN SECURITIES LAW

IN SEPTEMBER

2018

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

This newsletter covers the updates about the developments in Indian securities law during the month of September 2018. We have summarized the key regulatory developments including informal guidance, regulatory changes brought about by the Indian capital market regulator in relation to issue of capital and disclosure requirements, delisting requirements, credit rating agencies regulations and buy-back regulation and certain important judgements of the Securities Exchange Board of India ("**SEBI**") in relation to regulation of employee benefit schemes, insider trading, fraudulent and unfair trade practices, compliance requirements for foreign institutional investors. Please see below the summary of the relevant developments and judgements.

A. Informal Guidance issued by SEBI

SBEB REGULATIONS APPLICABLE TO COMPANY RUNNING TRUST FOR EMPLOYEE BENEFIT SCHEMES

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.

SEBI on 29 June 2018 issued informal guidance in the matter of JK Paper Ltd. ("**JPL**"), whereby SEBI took a view that SEBI (Share Based Employee Benefits) Regulations, 2014 ("**SBEB Regulations**") are applicable to a trust ("**Trust**") setup by JPL, which ran welfare schemes for JPL's employees.

The Trust held 5.6% of the equity share capital of JPL and was authorized by the trust deed to receive securities of JPL or make investments in any other entity, for the purpose of generating funds and implementation of the Trust's welfare schemes.

SEBI stated that the SBEB Regulations will apply, *inter alia,* to a scheme, set up by a listed company, for direct or indirect benefit of employees of such listed company, which directly or indirectly involves dealing in or subscribing to the securities of the company. Since the trust deed authorized Trust to deal with the shares of the company, the Trust would be governed by the SBEB Regulations.

B. SEBI Orders

1. SEBI BARS FORMER MCX DIRECTOR FROM SECURITIES MARKET FOR 7 YEARS FOR INSIDER TRADING

SEBI has barred Hariharan Vaidyalingam ("**Noticee**"), former director of Multi Commodity Exchange of India ("**MCX**"), from dealing in the securities market for 7 years, for insider trading in the scrip of MCX, vide order dated 29 August 2018.

On 27 April 2012, National Spot Exchange Limited ("**NSEL**") was issued a show-cause notice ("**SCN**") by Department of Consumer Affairs ("**DCA**"), regarding non-compliance with certain conditions in a DCA Notification that partially exempted NSEL from the application of the Forward Contracts (Regulation) Act, 1952. MCX and NSEL have the same holding company, Financial Technologies India Ltd ("**FTIL**"). The Noticee was the nominee director of FTIL on the MCX board of directors and was previously key managerial person in NSEL. The Noticee sold 5,41,032 shares of MCX during 03 July 2012 to 30 August 2012.

SEBI held that, information about a company will be classified as unpublished price sensitive information ("**UPSI**") if it is likely to materially affect the price of securities of another group company. UPSI does not need to necessarily directly relate to the company at hand and may also indirectly materially affect the price of the scrip of the company. Further, it is inconsequential that, the scrip price of MCX actually went up after the SCN was issued, since only the likelihood of material effect on the share price of the company, and not actual effect, is relevant. Hence, the information regarding the SCN was UPSI, since it was likely to materially affect the share price of MCX.

The issuance of the SCN was UPSI from 27 April 2012 to 03 October 2012 ("**UPSI Term**"), since information regarding the SCN was published in a well-read newspaper on 03 October 2012. Further, the Noticee was on the board of MCX during the UPSI Term, since he did not present any evidence to refute the Ministry of Corporate Affairs record stating his resignation date from MCX to be 28 June 2012. Therefore, the Noticee was an 'insider' in terms of the SEBI (Prevention of Insider Trading) Regulations, 2015. SEBI noted that the Noticee had failed to discharge the onus of refuting the presumption that he traded while in possession of such UPSI. It was also irrelevant that the Noticee did not make any profit / loss as a result of insider trading. Therefore, the Noticee was barred from the securities market for 7 years.

2. PROMOTER NOT LIABLE UNDER TAKEOVER CODE, DUE TO AMBIGUOUS CHARGES

SEBI has refused to impose any penalty on 7 promoters ("**Promoters**") of Comfort Fincap Limited ("**CFL**") for failure to disclose change in their shareholding in CFL under the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 ("**Takeover Code**"), since the charges levelled against the promoters did not specify who the persons acting in concert ("**PAC**") were.

On 10 June 2013, Luharuka Commotrade Pvt. Ltd issued a letter of offer ("**Letter of Offer**") with respect to the shares of CFL, in which details of shareholding of the promoters was provided. The Letter of Offer provided that there were inter-se transfers of shares amongst the Promoters during 1997-98, 1998-99, 2004-05 and 2005-06. However, there was no public announcement, as required under the Takeover Code. SEBI issued an SCN against the promoters for violation of the Takeover Code, due to non-disclosure of acquisition of shares by promoter and PAC.

SEBI held that the charge levied in the SCN against the Promoters is ambiguous and unclear, since the SCN does not specify who from amongst the promoters was the acquirer and who were the PAC.

3. FRESH OPEN OFFER NOT REQUIRED, ON CONSOLIDATION OF CONTROL

SEBI exempted Diageo Plc. and Relay B.V ("**Diageo Group**"), promoters of United Spirits Limited (" **USL** / **Target**"), from making a fresh open offer to the shareholders of the Target under the Takeover Code in its order dated 06 September 2018 in the matter of United Spirits Ltd.

The Diageo Group had entered into a share purchase agreement ("**SPA**") and shareholding agreement ("**SHA**") dated November 09, 2012 with United Breweries Holding Ltd. and KF Invest ("**UB Group**"). Pursuant to this, the Diageo Group made 2 open offers in accordance with the Takeover Code ("**First** and **Second Open Offer**"), after which the Diageo Group held 54.78% and UB Group held 4% of the Target's shareholding.

The SHA provided UB Group with certain protective veto rights ("**Veto Rights**") and the right to appoint nominee certain directors to the board of the Target ("**Voting Rights**"). Further, the Voting Rights and Veto Rights were rescindable if the UB Group breached the SHA. On 24 November 2015, the UB Group breached certain provisions of the SHA and consequently, ceased to have Veto Rights and Voting Rights. Thereafter, SEBI issued an SCN on 12 May 2017 stating that the Target was no longer jointly controlled by the UB Group and the Diageo group, but was solely controlled by the Diageo group and consequently, the Diageo Group failed to make an open for change of control.

However, post completion of investigation in the matter, SEBI held that the Diageo Group was not required to make an open offer to the shareholders of the Target, since ceasing of Veto Rights and Voting Rights by UB Group, did not lead to a change of control of the Target. The Diageo Group had already acquired control over the Target after the Second Open Offer, that is far before the UB Group ceasing to hold Veto Rights and Voting Rights. Further, the Voting Rights were not significant enough to give UB Group 'control' over the Target and the Veto Rights were limited and protective in nature, which did not constitute 'control' of the Target.

Further, SEBI stated, "where one of the two promoters renounces his control over the target company such that the entire control of the company vests in the hand of the lone promoter who continues, it cannot be said that there is a 'change in control' as the public shareholders are familiar with both the promoters being in control of the company and have accepted the same."

4. SEBI IMPOSES FINE ON FII FOR FAILURE OF SUB-ACCOUNT TO COMPLY WITH BROAD-BASED FUND CRITERIA

SEBI has imposed a fine of INR 200,000 on foreign institutional investor ("**FII**") European American Bank AG ("**EABA**"), for failure to ensure that their sub-account India Focus Cardinal Fund ("**IFCF**") complies with conditions for broad-based funds under the SEBI (Foreign Institutional investors) Regulations, 1995 ("**FII Regulations**") in the matter of European American Bank AG on 21 August 2018.

On 27 July 2010, EABA submitted an undertaking on behalf of IFCF, stating that IFCF has complied with the broad-based fund criteria under the FII Regulations, as required by SEBI. SEBI, on several occasions, requested for additional information regarding the break-up of the institutional investors of IFCF. After initially refusing to provide such information due to confidentiality reasons, EABA provided information regarding only some of the investors.

Further, SEBI also held that IFCF had not complied with the requirements under the FII Regulations. Under the FII Regulations, institutional investors that hold more than 49% in a class of shares of the sub-account, must themselves satisfy the criteria of being a broad-based fund. However, this condition was not met by IFCF's institutional investors, including EABA itself, which held 75% shares in one share class of IFCF. Therefore, IFCF did not satisfy the criteria of broad-based fund. Finally, EABA failed to provide SEBI with material information, that is, that IFCF had not met the conditions of broad-based fund criteria. Therefore, EABA was held liable for violation of FII Regulations by EABA and by IFCF, since under FII Regulations, an FII shall be responsible for the acts / omissions of their sub-accounts.

1. SEBI ISSUES MASTER CIRCULAR FOR COMMODITY DERIVATES MARKET

C. Circulars and Regulations

SEBI has compiled all the circulars relating to the domestic commodity derivatives segment issued by Commodity Derivatives Market Regulation Department till 07 September 2018, into a single master circular, *vide* Circular No. CDMRD/DMP/CIR/P/2018/126 dated 07 September 2018 ("**Master Circular**"). In case of inconsistency between the Master Circular and the original applicable circular, the content of the original circular shall prevail.

2. SEBI ISSUES CIRCULARS ON REVISED ELIGIBILITY CONDITIONS AND KYC REQUIREMENTS FOR FPIs

On 26 March 2018, a working group under the chairmanship of Shri H.R. Khan ("**Khan Committee**"), was constituted to look into all issues related to the working of Foreign Portfolio Investors ("**FPIs**") in India. On 08 September 2018, the Khan Committee released an interim report ("**Interim Report**"). All stakeholders were invited to provide their comments on the Interim Report by 17 September 2018.

Based on the recommendations in the Interim Report, SEBI issued revised eligibility conditions for FPIs to invest in India, *vide* its circular CIR/IMD/FPIC/CIR/P/2018/132 ("**Eligibility Circular**") and know-your-customer ("**KYC**") requirements for these FPIs *vide* its circular CIR/IMD/FPIC/CIR/P/2018/131 ("**KYC Circular**"), both dated 21 September 2018. Both Circulars broadly follow the recommendations made in the Interim Report. The amendments in SEBI (Foreign Portfolio Investors) Regulations, 2014, wherever necessary, are to be notified separately.

Some key changes brought about by the Eligibility Circular are:

1. Non-Resident Indian ("**NRI**") / Overseas Citizen of India ("**OCI**") / Resident Indian ("**RI**") shall be allowed to be constituents of FPIs subject to the following conditions:
   i. Contributions by the NRI/ OCI/ RI, including those of NRI/ OCI/ RI controlled investment managers ("**IM**") of FPIs, should be below 25% from a single NRI / OCI / RI, and in aggregate should be below 50% of the corpus of the FPI.
   ii. NRI / OCI / RI should not be in 'control' of FPI. However, this restriction will not apply to FPIs which are 'offshore funds,' for which no-objection certificate has been provided by SEBI under SEBI (Mutual Funds) Regulations, 1996.
2. FPIs, other than FPIs investing only in mutual funds in India, can be controlled by IMs which are in turn controlled and / or owned by NRI / OCI / RI, if:
   i. IM is appropriately regulated in its home jurisdiction and registers itself with SEBI as non-investing FPI; or
   ii. IM is incorporated or setup under Indian laws and appropriately registered with SEBI.

Existing FPIs and new applicants shall be given a time period of 2 years from the date of coming into force of the amended regulations or from the date of registration, whichever is later in order to satisfy the above eligibility conditions.

Some key changes brought about by the KYC Circular are:

1. Beneficial owners defined in accordance with PMLA Rules: A beneficial owner ("**BO**") is the natural person who ultimately owns or controls an FPI and should be identified in accordance with Rule 9 of the Prevention of Money Laundering (Maintenance of Records) Rules, 2005 ("**PMLA Rules**"). FPIs must maintain a list of their BOs in the form provided in the KYC Circular. In case of FPIs having general partner / limited partnership structure, the BO will be identified on ownership or entitlement basis and control basis.
2. Materiality thresholds to determine BO: FPIs have different 'materiality thresholds' to identify their BOs. In order to identify the BOs of the FPIs, the materiality threshold should be applied to the owner entity of the FPI itself, at the first instance. Subsequently, the materiality threshold should be applied on a 'look through' basis, to identify the BO of the FPI's intermediate shareholder / owner entity. In case the intermediate shareholder / owner entity is eligible for registration as Category I FPI, there is no need for identification and verification of beneficial ownership of that entity.
3. Foreign companies not entitled to exemption under rule 9(3)(f) of PMLA Rules: Under rule 9(3)(f) of the PMLA Rules, if the client or the owner of the controlling interest is a company listed on a stock exchange, or is a subsidiary of such a company, it is not necessary to identify and verify the identity of any shareholder or beneficial owner of such companies. Under the KYC Circular, foreign companies cannot claim this exemption from requirement to identify and verify the shareholders / BO.
4. Periodical KYC review: FPIs are subject to review of KYC information, on a periodical basis. The frequency of the KYC review will depend upon the risk categorization of FPIs in the following manner:
   - Category III and Category II FPIs from 'high risk jurisdictions,' KYC review should be done on an annual basis.
   - In case of all other FPIs, the KYC review should be conducted at the time of continuance of FPI registration.
5. Time period for compliance with KYC Circular: Existing FPIs registered prior to the KYC Circular are required to provide the list of BOs and applicable KYC documentation within 6 months from the date of the KYC Circular ("**Deadline**"), failing which the concerned custodian of the securities shall not allow such FPI to make fresh purchases till the time KYC documentary requirements are complied with. However, the FPI will be allowed to continue to sell the securities already purchased by it and disinvest its holdings within a period of 180 days from the expiry of the Deadline. In case the FPI remains non-compliant with this requirement even after 180 days from the Deadline, its FPI registration will no longer be valid and it would need to disinvest its holdings immediately.

3. SEBI AMENDS THE TAKEOVER CODE

On 11 September 2018, SEBI notified certain amendments to the Takeover Code *vide* Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) (Second Amendment) Regulations, 2018 ("**Amendment**"). SEBI had published a consultative paper on 28 March 2018 ("**Consultative Paper**") for reviewing provisions of the Takeover Code, to bring about changes such as simplification of language, removal of redundant provisions and inconsistencies, updating the references to the Companies Act, 2013, other new SEBI Regulations and incorporating relevant circulars, FAQs, informal guidance. The Amendment has incorporated changes in line with the recommendations arising out of the Consultative Paper.

Some key points of the Amendment are:

1. Introduction of concept of 'fugitive economic offenders' ("**FEO**"): The Amendment has introduced the concept of FEO i.e. an individual who is declared a fugitive economic offender under the Fugitive Economic Offenders Act, 2018. FEOs are barred from making a public announcement of an open offer or making a competing offer for acquiring shares or entering into any transaction for direct or indirect acquisition of any shares / voting rights / control of a target company.
2. Voluntary open offer connected to 'voting rights': Under the Amendment, such an acquirer is now required to offer to acquire 10% of the 'voting rights,' and not merely shares, of the target company.
3. Increase of time to revise open offer: After the Amendment, the acquirer can make such revisions till 1 working day before the commencement of the tendering period. Previously it was 3 working day before the commencement of the tendering period.
4. Removal of SEBI's duty to give prior hearing in certain cases: Under the previous law, SEBI could issue directions in a specific case relating to interpretation or application of any provision of the Takeover Code, only after affording a reasonable opportunity of being heard to the concerned persons and after recording reasons for the direction. This provision has been removed by the Amendment.
5. Disclosure in case of disposal of shares: In case any disposal of shares by an acquirer holding 5% or more shares of the target company, exceeds 2% shareholding of the target company, then the acquirer must also disclose this disposal of shares the target company within 2 days of the disposal of shares in addition to the stock exchange(s).

4. SEBI NOTIFIES ICDR REGULATIONS, 2018; REPEALS ICDR REGULATIONS, 2009

On 11 September 2018, SEBI notified SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 ("**2018 Regulations**"), which shall repeal the SEBI (Issue of Capital and Disclosure Requirements), Regulations 2009 ("**2009 Regulations**"). The 2018 Regulations are based on the recommendations of SEBI-constituted Primary Market Advisory Committee and public comments on a consultation paper for introducing amendments to the 2009 Regulations, dated 04 May 2018.

Some key aspects of the 2018 Regulations are:

1. <u>Increase of time period to announce price band</u>: Under the 2009 Regulations, where the issuer did not disclose the floor price / price band in the red herring prospectus, the issuer was required to announce the floor price / the price band at least 5 working days before the opening of the issue. Under the 2018 Regulations, the price band can be announced 2 working days before opening of the issue.
2. <u>Reduction in span of financial disclosure to be made for public / rights issue</u>: In case of financial disclosure for public / rights issue, the audited consolidated financial statements of the past 5 years were required to be submitted. Under the 2018 Regulations, audited consolidated financial statements of the past 3 years must be submitted.
3. <u>Increased threshold for submission of draft letter of offer for right issue to SEBI</u>: The 2018 Regulations shall apply to rights issue by a listed issuer, where the aggregate value of the issue is INR 100 million or more. Previously the threshold for application was INR 5 million.
4. <u>Promoter shareholding shortfall</u>: Under the 2018 Regulations, promoters of the issuer must hold at least 20% of the post-issue capital of the issuer. In case of shortfall in promoter shareholding, up to 10% of minimum promoter's contribution can now be met by institutional investors (Foreign Venture Capital Investor, Scheduled Commercial Banks, Public Financial Institution, Alternate Investment Funds and Registered Insurance Companies) without being identified as promoters.
5. <u>Wide definition of 'group companies</u>': The 2018 Regulations has widened the definition of 'group companies;' and shall include such companies (other than promoter and subsidiaries) with which there were related party transactions in past 3 years.

5. SEBI AMENDS CREDIT RATING AGENCIES REGULATIONS

SEBI *vide* circular no. D/DOS3/CIR/P/2018/130 dated September 19, 2018 has allowed Credit Rating Agencies ("**CRA**") to undertake research activities, incidental to rating, such as research for Economy, Industries and Companies. Also, in cases of requests by an issuer for review of the rating(s) provided to its instrument(s) shall be reviewed by a rating committee of the CRA that shall consist of majority of members that are different from those in the Rating Committee of the CRA that assigned the earlier rating, and at least one-third of members are independent.

6. SEBI NOTIFIES NEW BUY-BACK OF SECURITIES REGULATIONS, 2018

SEBI has notified the SEBI (Buy-Back of Securities) Regulations, 2018 ("**Buy-Back Regulations 2018**"). These regulations shall be applicable to buy-back of shares or other specified securities of a company in accordance with the applicable provisions of the Companies Act, 2013.

Following are the key provisions of Buy-Back Regulations 2018:

1. A company may buy-back its shares or other specified securities by any one of the following methods:
   i. from the existing shareholders on a proportionate basis through the tender offer;
   ii. from the open market through
      a. book-building process,
      b. stock exchange;
   iii. from odd-lot holders.

Provided that no offer of buy-back for 15% or more of the paid up capital and free reserves of the company shall be made from the open market.

3. A company shall not make any offer of buy-back within a period of 1 year reckoned from the date of expiry of buyback period of the preceding offer of buy-back.
4. A company may undertake a buy-back of its own shares or other specified securities out of-
   i. its free reserves;
   ii. the securities premium account; or
   iii. the proceeds of the issue of any shares or other specified securities. Provided that no such buy-back shall be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities.
5. No company shall directly or indirectly purchase its own shares or other specified securities:
   i. through any subsidiary company including its own subsidiary companies;
   ii. through any investment company or group of investment companies; or
   iii. if a default is made by the company in the repayment of deposits, interest payment thereon, redemption of debentures or preference shares or payment of dividend to any shareholder, or repayment of any term loan or interest payable thereon to any financial institution or banking company.
6. Separate provisions have been framed explaining the disclosures, filing requirements and timelines for public announcement for buy-back through tender offer, buy-back through stock exchange and buy-back through book building. Further, clarity has been provided with respect to timelines under the Buy-Back Regulations 2018.

7. SEBI AMENDS SEBI (DELISTING OF EQUITY SHARES) REGULATIONS, 2009

On 11 September 2018, SEBI has approved the following amendments to the SEBI (Delisting of Equity Shares) Regulations, 2009 ("**Delisting Regulations**").

Some key features of the Delisting Regulations are:

1. Counter offer to reverse book building price: In case of voluntary delisting, if the price discovered through the reverse book building process is not accepted by the promoters, a counter offer can be given by the promoters. However, the price through the counter offer should not be less than the book value and delisting will be successful only if such counter offer is accepted by such number of public shareholders that the post offer promoter shareholding reaches at least 90%.
2. Introduction of timeline for exit to public shareholders in case of compulsory delisting: As per the unamended Delisting Regulations, promoters of compulsorily delisted companies had to provide exit to the public shareholders. However, the unamended Delisting Regulations did not provide for any timeline for providing this exit option. SEBI decided to amend the Delisting Regulations to provide that promoters will have to give the exit to public shareholders within 3 months of delisting from recognized stock exchange.