Securities Law

The e-Newsletter

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CONFUSION ABOUT APPLICABILITY OF INDIAN ACCOUNTING STANDARDS

By Mandar Vasmatkar

The Ministry of Corporate Affairs vide notification dated February 16, 2015 in exercise of powers conferred by section 133 read with section 469 of the Companies Act, 2013 and sub-section (1) of Section 210A of the Companies Act, 1956 enacted the Companies (Indian Accounting Standards) Rules, 2015 (Ind AS Rules) which were made effective from April 01, 2015. Ind AS Rules laid down criteria for applicability of Indian Accounting Standards (Ind AS) in phased manner to companies and obligated such companies and their auditors to comply with Ind AS during preparation of financial statements and audit thereof.

Rule 4 (1) (i) of Ind AS Rules provides that companies may voluntarily comply with Ind AS for preparation of financial statements beginning on or before April 01, 2015. Rule 4 (1) (ii) of Ind AS Rules provides criteria for mandatory application of Ind AS in preparation of financial statements beginning on or after April 01, 2016.

Rule 4 (1) (ii) of Ind AS Rules provides that following set of companies shall comply with Ind AS in respect of financial statements beginning on or after April 01, 2016

- Listed company (whether debt or equity) or company in process of getting listed having net worth of Rs 500 crore or more.
- Company, other than above, having net worth of Rs 500 crore or more. Unlisted company having net worth of Rs 500 crore or more also has to comply Ind As Rules
- Holding, subsidiary, joint venture or associate companies of companies referred hereinabove.
- In respect of above , net worth of the company means net worth as defined under section 2(57) of the Companies Act, 2013.

According to Rule 4 (2) (a) of Ind AS Rules net worth of the company shall be calculated as per financial statement of the company as on March 31, 2014 or first audited financial statements which ends after that i.e. March 31, 2015.

According to Rule 4 (2) (b) of Ind AS in case of existing companies crossing threshold given in Rule 4 (1), net worth shall be calculated as per first audited financial statements made after meeting such threshold.

Now assume XYZ is a listed company having net worth as follows:

March 31, 2014 : Rs 400 crore ; March 31, 2015: Rs 490 crore; March 31, 2016 : Rs 550 crore

Rule 4 (2) (a) of Ind AS Rules provides that net worth of the company shall be calculated as per financial statement of the company as on March 31, 2014 or first audited financial statements which ends after that i.e. March 31, 2015. Since net worth of XYZ is below Rs 500 crore as on March 31, 2014 and March 31, 2015, XYZ is not required to comply with Ind AS in respect of financial statements beginning from April 01, 2016.

Rule 4 (2) (b) of Ind AS Rules provides that in case of existing companies crossing threshold given in Rule 4(1), net worth shall be calculated as per first audited financial statements made after meeting such threshold. XYZ has crossed Rs 500 crore net worth as on March 31, 2016 thus net worth shall be calculated as per first audited financial statements made after March 31, 2016 i.e. March 31, 2017. Since net worth has to be calculated as per audited financial statements as on March 31, 2017 for determining applicability, Ind AS wont be applicable for the financial statements beginning from April 01, 2016.

However, as per explanation to Rule 4 (2) of Ind AS Rules, company meeting threshold given in Rule 4(1) for first time at the end of accounting year, shall comply with Ind AS from immediate next accounting year. XYZ meets threshold limit of Rs 500 crore as on March 31, 2016 for the first time thus it has to comply with Ind AS for the financial year 2016-17 beginning from April 01, 2016. Further as per illustration to Rule 4 (2) of Ind AS Rules, it is very clear that Ind AS will be applicable for XYZ w.e.f. April 01, 2016.

Conclusion

Rule 4 (2) (b) of Ind AS Rules contradicts with explanation and illustration given to same Rule 4 (2) owing to poor drafting. Companies and their auditors are equally clueless on applicability of Ind AS for the financial year 2016-17 in certain cases as explained hereinabove. However, as conservative approach, companies should consider complying with Ind AS Rules in cases explained above w.e.f. April 01, 2016. Meanwhile, SEBI vide circular CIR/CFD/FAC/62/2016 dated 5 July, 2016 gave some relaxation to the companies and extended timeline for submission of financial results with stock exchanges in compliance with Ind AS Rules by 1 month for the June and September 2016 quarter.

ALGORITHMIC TRADING: AN INTRODUCTION

By Umang Thakar

"Automated Trading" is defined as meaning and including any software or facility by the use of which, upon the fulfillment of certain specified parameters, without the necessity of manual entry of orders, buy/sell orders are automatically generated and pushed into the trading system of the Exchange for the purpose of matching. SEBI has allowed Exchanges to extend Algorithmic trading facility to members involving usage of various Decision Support Tools / algorithms / strategies.

Algorithm trading is a system of trading which facilitates transaction decision making in the financial markets using advanced mathematical tools. In this type of a system, the need for a human trader's intervention is minimized and thus the decision making is very quick. This enables the system to take advantage of any profit making opportunities arising in the market much before a human trader can even spot them. As the large institutional investors deal in a large amount of shares, they are the ones who make a large use of algorithmic trading. It is also popular by the terms of algo trading, black box trading, etc. and is highly technology-driven. It has become increasingly popular over the last few years

High Frequency Trading (HFT) is a subset of algorithmic trading that comprises latency-sensitive trading strategies and deploys technology including high speed networks, colocation, etc. to connect and trade on the trading platform. The growth and success of the high frequency trading (latency sensitive version of algorithmic trading) is largely attributed to their ability to react to trading opportunities that may last only for a very small fraction of a second. Co-location (for brevity, Colo) has provided the vehicle to high frequency traders to capture such trading opportunities

Co-location is the first and most tangible manifestation of HFT. It refers to the exchanges. Practice of renting space in the facilities that house their computer servers to traders who believe they can benefit from this proximity. Co-location facilitates the practice of latency arbitrage, trading between markets based on pure speed. To succeed at latency arbitrage, a trader has to be first in line in the price-time order queues used by the exchanges. It is a zero-sum game where the order that is first in line with a bid or offer at an advantageous price wins the competition

Evolution

Over the last two decades, increased computing power, improved telecommunications infrastructure, and falling processing costs have accelerated the presence of automation in just about every human enterprise – including the securities business.

Today, technology and automation have been brought to bear on nearly every phase of the investment process. However, the impact of this trend on market structure was first felt in the US, and it started over a decade ago.

I'd highlight four developments that drove this evolution:

- In 1999, the SEC's Regulation ATS, which enhanced competition in the US Securities markets by formalizing electronic communication networks and crossing networks as alternatives to incumbent exchanges;
- In 2001, the NYSE introduced decimalization, or the pricing of stocks in penny increments, which tightened the spreads at which stocks trade;
- In 2005, the SEC's Regulation NMS, which essentially mandated exchanges to provide fast, automated executions in order to be considered part of the "National Market System";
- And throughout this period, the de-mutualization of the exchanges, which further spurred competition and innovation in the industry.

In the wake of these changes, the size of the average trade fell dramatically, from a couple of thousand shares to a few hundred. Equities volumes doubled. Quoted spreads compressed dramatically. Along with these changes, we began to see Algorithmic and High Frequency Trading strategies deployed in noticeably greater volumes in 2005 – 2007. This transformation has been most pronounced in cash equities and listed derivatives, but it is increasingly evident in fixed income.. In 2008, India allowed the first Direct-Market-Access (DMA) and algorithmic trades to go through. Since then, algorithmic trading has taken off and now constitutes a sizeable percentage of all trading activity on the National Stock Exchange (NSE) and the BSE.

Commonly used strategy

Out of these, arbitrage, is by far the most commonly used strategy employed by traders. This gives algorithmic traders a substantial edge — speed. If there is a profitable arbitrage trading opportunity and many traders are trying to grab the same quantity at a certain price, the pre-programmed algorithmic trading engine will reach it in a matter of milliseconds. Human traders, however, can only react in a matter of seconds. Therefore, an automated algorithm tends to outperform human traders at such times. However, with opportunity comes risk. The infamous "flash crash" that occurred in the US in 2010 is the perfect example that shows how terribly wrong a situation can go with algorithmic trading.

Since algorithms generate trades based on signals, you could have a perfect storm brewing if many different algorithms generate signals, back to back, for each other. In order to prevent such situations, any algorithm must be approved by an exchange. Specifically, risk management system (RMS) checks, such as the maximum traded value, trades per second and total traded quantity have to be within certain bounds. While each stock exchange has its own RMS policies, prescribed RMS checks provide some surety that any single algorithm cannot trigger massive selling or buying. All said and done, algorithmic trading is here to stay. Any profitable trading strategy can be undertaken more profitably through an automated algorithm. The competition is so stiff that most advanced algorithms look to shave microseconds off their trades. Speed can be improved by ensuring that every step in the process from when the signal gets generated by the trading engine to how long it takes for the trade to get to the exchange is optimal. In the algo trading world, speed is referred to as latency

SEBI's Stand

The capital market regulator is planning to impose some curbs in the obscure worlds of algorithmic trading after being blamed for giving some traders a clear advantage over others.

SEBI is considering few measures that could act as speed breakers to this sophisticated system that executes trades at lighting speed. These include artificial speed bumps, restricting tick by tick data , bunching of orders and introducing order randomisation , among others ,said a senior regulatory official familiar with the development. Globally, regulators have been debating restrictions on algorithmic trading or high frequency trading (HIFT). SEBI would be the first regulator to take steps to rein in such trading

SEBI vide circulars dated March 30, 2012 and May 21, 2013 has put in place the broad guidelines for algorithmic trading in the securities market. The guidelines, inter alia, include risk management measures/ checks for Algorithmic (Algo) trading. SEBI vide circular dated May 13, 2015 has laid down guidelines to ensure fair and equitable access to the co-location facility and to ensure that the facility of co-location/ proximity hosting does not compromise integrity and security of the data and trading systems.

Editorial note: SEBI has now released a new circular with broad guidelines on September 27, marked as SEBI/HO/CDMRD/DMP/CIR/P/2016/97

MAKING REITs INVESTMENT FRIENDLY: ANALYSIS OF THE PROPOSED CHANGES BY SEBI

By Anuj Bansal

Vide its consultation paper dated 18th July 2016, Securities Exchange Board of India ("SEBI") has proposed to bring about significant amendments to the regime of Real Estate Investment Trusts ("REITs") in cognizance of several representations made to it by the interested parties as to the compliance stringency of the SEBI (REIT) Regulations, 2014. While the relaxation(s) SEBI has proposed to introduce are bound to cast an investor friendly impact upon the market; it is quintessential to analyze and determine if the amendments are synchronous to the original intendment of regulating the REITs. Part I of the present note analyses the proposals in light of the rationale behind the same while Part II commits to the market and legal impact as identified above; followed by the conclusive remarks under Part III.

Major proposals made by SEBI: Remedying the anomalies?

At the outset, SEBI has proposed to widen the ambit of a Special Purpose Vehicle ("SPV") and allow a layered investment for the same through a holding company. Presently, a SPV cannot invest the funds further and needs to hold at least eighty percent of its assets in form of real estate. The change therefore intends to harmonize the REITs regime with the provisions for investment under the Companies Act, 2013 (the "Act") and also eases out the restructuring burdens the market players are subject to. However, there is a restriction appended to it that the REIT has to have a controlling interest and not less than fifty percent of the equity share capital of the holding company so used for the purpose of investment It refers to an investment made in different layers by involvement of three or more parties.

It is further proposed that the definition of 'associates' shall be narrowed down to 'material associates' so as to effect the exclusion of parties not related to the REITs. The test of such materiality is left to the discretion of the REIT which can determine the same in its 'offer document'. SEBI also intends to include the experience of an associate within that of the REIT; relieving at the same time the regulatory requirement for the 'associates of the trustees'.

Likewise, the proposal to widen the definition of 'real estate' has been included so that the exemption presently granted is not subject to abuse. It is also proposed by SEBI to amend the definition of a 'sponsor', enabling the inclusion of 'group sponsors' within its ambit; and to consider them collectively as a single entity. Increase in the limit of sponsors from three to five is also intended.

Another major change introduced through the discussion paper is to relax the compliances in lieu of Related Party Transactions ("RPTs") while still stretching the compliance standard higher than that under the Act. It is proposed that procedural RPTs shall be compliant with an approval of not less than 50% unit-holders whereas the special resolution shall be consented to by at least 60% of the unit-holders. Another important development in the same respect is the stance of SEBI for pricing of RPTs and the pricing norms are fairly relaxed.

SEBI also proposes to align the minimum public holding requirement with the Securities Contracts (Regulation) Rules, 1957, thus reducing it to 10%.

Market impacts and intendment: The tale of two tests!

Having glanced through the key proposals made by SEBI, it is interesting to test their efficacy on the touchstone of market impacts upon implementation.

Not only the market is positive in response to the proposals; it is anticipated that the industry interests shall be hugely promoted by the changed regime. Allowing an investment through a holding company would not only ease the restructuring of assets but also boost the venturing between market players to come out with relatively higher number of permutations and combinations as to organizational structure of the REIT. Stamp duty obligations are also likely to decrease by such a move. However; the proposal, if culminates into an amendment shall be viewed with strict suspicion primarily because it prohibits the accruing of any special rights to the shareholders of both the SPV as well as the Holding Company and thus rules out many hedging formulae and permutations for restructuring.

Likewise, whereas the market sentiment is highly supportive of replacing associates with 'material associates'; vesting the discretion of cherry picking the materiality in the hands of REIT is potent to lead to an indeterminate state for the investor. At the same time, compliance check becomes tougher for SEBI since the test prescribed for materiality of associates is bound to differ for every REIT, thus supplementing the chaos. Repercussions of introducing the concept of group sponsors to REITs are also skeptical since it would promote collusion of sponsor with its associates to qualify as a singular entity; for that it is ultimately the REIT which shall be in control as to who would be the associates. Similarly, the exclusion of associates of trustees from the regulatory realm is tantamount to become another instance of discretionary abuse by the REIT.

It is unclear as to why SEBI deemed it unfit to extend the compliance requirements under the Act to REITs in relation to RPTs; when the proposal effectively stands at a pedestal lower to it and there exists no plausible reason for it. Furthermore, the proposal to introduce the respective limits of 110% and 90% in relation to buying and selling in RPTs seems to be an unwarranted relaxation.

Conclusion

Considering the market impact tilted in favour of REITs amendments; but the legislative intendment slightly hampered; it is concluded that SEBI shall look forward towards resolving the two in the pursuit of not compromising with the investor interests; while promoting the REITs securities at the same time.

JURISDICTION OF SEBI

By Jitesh Maheshwari & Vivek Chhipa

The Companies and investors are dependent on each other as the fund required for the working of the companies are provided by the investors for which they receive gains from the companies. However their give-and-take relationship can be harmed because of the greed of some people hiding under the cloak of the company. Many investors are not experts of the capital market and it makes them prone to be the victim of malpractices like corporate frauds. Securities and Exchange Board of India (hereinafter SEBI) is an expert body which is established for the same reason. It makes the regulations, it implements them and in case of a breach it takes upon a quasi-judicial function.

SEBI has power to prohibit fraudulent and unfair trade practices relating to securities market and is entitled to pass appropriate orders to restraint persons from accessing the securities market or can give appropriate directions to any person in the interest of investors. Companies whose securities are traded on a public market, it is trite law that the disclosure of information about the company is crucial for the correct and accurate pricing of the company's securities.

While functioning in its judicial capacity, it has wide discretion. It can initiate criminal proceedings in terms of Section 24 of the Act or can issue directions in terms of Section 11B read with Section 11(4) of the Act or can do both. As Section 24 of the SEBI Act deals with the criminal offences under the Act and its punishment, it requires higher degree of proofs and evidences to establish the guilt beyond all reasonable doubts.

In *Sterlite Industries (India) Ltd. v. Securities and Exchange Board of India* SEBI prohibited a public limited company through its directors from accessing the capital market for a period of two years and also ordered to initiate prosecution proceedings under Section 24 read with Section 27 of SEBI Act for violation of Regulation 4(a) and 4(d) of the FUTP regulations. By judicial activism the jurisdiction of SEBI has been expanded and evolved in such a way that the interest of investor is protected. The purpose of this Article is to throw light on the present position regarding jurisdiction of SEBI.

Jurisdiction

The jurisdiction of SEBI has been continuously evolved and expanded by the courts so as to cover the fraudulent conducts in the securities market within its ambit. For instance, SEBI has been given jurisdiction to probe into the issuance of Global Depository Receipts if it has an adverse affect on the Indian Securities market. The expression 'interests of investors' occur in sub-section 1 of Section 11 and Section 11B of Securities and Exchange Board of India, 1992 (hereinafter SEBI Act). The Supreme Court of India in its landmark judgment of *Sahara India Real Estate Corporation Limited v. Securities and Exchange Board of India* in which it was advanced by the Appellant that SEBI does not has jurisdiction on the issue of Optionally Fully Convertible Debenture has they were hybrid security.

The Supreme Court interpreted Section 11 of SEBI Act and observed that '*sub- s. (2) does not curtail the powers and functions vested with the SEBI under sub-s. (1) of s. 11 of the SEBI Act as sub-s. (2) aforementioned commences with the words "Without prejudice to the generality of the foregoing provisions"*.' This judgment shows that the SEBI has no limitations and can do anything and everything to protect the interests, whether the act included in sub-section 2 or not. The expressions like 'without prejudice' and 'may' employed in sub-section 2 expresses that the activities referred to in this provision are just some of the powers of SEBI and not all the powers. In case the provisions of Section 11 of SEBI Act are construed in a restrictive manner, the interests of the investors in securities will suffer.

It cannot be said that sub-section (2) provides an exhaustive list of measures which the Board can take and it cannot take other measures which are in consonance with the main purpose of the statute and consistent with the duty cast on it.

Further under Section 11B the expression 'persons associated with the securities market' would include all and sundry who have something to do with the securities market. 'Persons associated with' denotes a person having connection or having intercourse with the other; in the present case that 'other' with whom a person is to have connection or intercourse is the securities market.

The Supreme Court of India has observed that '*when we interpret the provisions of the SEBI Act and the Regulations relating to a company registered under the Companies Act, the provisions of the Companies Act have also to be borne in mind*.' By this it seems that the provisions of the Companies Act are the limitation on the provision of SEBI Act.

Further SEBI has been given power to administer some of the provision under the Companies Act, 2013 as Section 24 of the Companies Act, 2013 deals with the powers of SEBI which it can administer on Prospectus and Allotment of Securities, Share Capital and Debentures, Dividend to be paid by the company, Forward Dealing and Insider Trading. Although no power has been given to SEBI on Chapter X and XII of Companies Act, 2013 which deals with the conduct of Auditors and Directors of the Company under Section 24 but still they can be held liable by SEBI whenever the fraud is committed by the Company irrespective of the fact that the fraud was not deliberately committed by them.

In *N. Narayanan v. Adjudicating Officer, SEBI*, the directors of the Company were also held liable for the fraud committed by the Company as they had the duty to check for the fraud. Even the auditor firm was held liable for fraud which was committed in the famous *Satyam scam* by Ramalinga Raju. It was observed by the Bombay High Court in *Price Waterhouse Co. v. Securities and Exchange Board of India* the words employed in the sub-s. (2) of S. 11 are of wide amplitude and would therefore take within its sweep a Chartered Accountant if his activities are detrimental to the interest of the investors or the securities market.

The audit is intended for the protection of the shareholders and the auditor is expected to examine the accounts maintained by the Directors with a view to inform the shareholders of the true financial position of the Company. Auditors are mandatorily required to be engaged by a company under the parameters statutorily prescribed by SEBI itself and in case of default, they are amenable to the jurisdiction of SEBI for action since the primary responsibility for true and adequate disclosure lies with them.

Conclusion

Hence with this evolution of jurisdiction of SEBI, which covers not only the actual perpetrators but also the auditors and directors of the Company who fails in their duty and report the suspicion of fraud, is in the betterment of investors as it will bound them to check the fraud before it is committed.

SUPREME COURT'S DIRECTIVE ON COLLECTIVE INVESTMENT SCHEME

By Aishwarya Jain

The Securities Law (Amendment) Act 1995 made it mandatory to register CIS as per the regulations. But the regulations came into effect from 15.10.1999 whereas the amendment was made in 25.1.1995. While the amendment provided for existing CIS to register when the regulations come into effect, it was silent on issue of CIS after the amendment but before regulations. Thus, Supreme Court was faced with an issue in the matter of *SEBI v. Gaurav Varshney and Anr* regarding the applicability of activities of Collective Investment Scheme made after the amendment but before the regulations.

Issue

The main issue decided by the court was whether section 12(1B) of SEBI Act which had forbidden the sponsoring or carrying on of a collective investment initiative without obtaining registration from the 'Board' was violated by the respondents and is a criminal action against the respondents maintainable? The appeal was filed by the 'Board' against the decision of High court which quashed criminal proceedings against the respondents.

Held

The Supreme Court while looking into the legal issue explained Section 12(1B) which is extracted hereunder

"12 Registration of stock-brokers, sub-brokers and share transfer agents, etc –

(1B) No person shall sponsor or cause to be sponsored or carry on or cause to be carried on any venture capital funds or collective investment scheme including mutual funds, unless he obtains a certificate of registration from the Board in accordance with the regulations

Provided that any person sponsoring or cause to be sponsored, carrying or causing to be carried on any venture capital funds or collective investment scheme operating in the securities market immediately before the commencement of the Securities Laws (Amendment) Act, 1995 for which no certificate of registration was required prior to such commencement, may continue to operate till such time regulations are made under clause (d) of sub-section (2) of section 30."

In the opinion of Supreme Court, effective interpretation of Section 12(1B) would be to divide persons into two classes. First class would include persons who have commenced the activity of sponsoring or carrying collective investment scheme prior to 25.1.1995 and second class would be persons who have not commenced activity of sponsoring and carrying collective investment scheme prior to 25.1.1995. The court was not hesitant in holding that existing collective investment scheme which was allowed to continue till the regulations come into effect would include only proviso category. And therefore it was impermissible for a person who has not commenced collective investment scheme prior to 25.1.1995 to do so thereafter, till the regulations are framed. The bar therefore to commence CIS only after registration was held by the court to be 'absolute and unconditional'. In view of the above, the court held in favor of SEBI and found respondents to be in breach of bar created by section 12(1B) from commencing activity till they have obtained certificate of registration in consonance with collective investment regulations.

While in substance the decision was in favor of the 'Board', on certain grounds it upheld the decision of high court in quashing criminal proceeding against the *Varshneys*. Looking into the technicality, the complaint was filed by the prosecution against the respondents on two grounds. Firstly, that the accused did not apply for registration under the collective investment regulations. And secondly, the accused did not take any step in winding up the scheme and refunding deposits as per the regulations. The court was of the view that the above assertions were made on assumption that the respondents were "existing" operators i.e. those belonging to proviso category. Moreover, the chargesheet revels that the respondents were being treated as belonging to proviso category while the counsel of the 'Board' wants it to be later treated in their contentions as non- proviso category. This was not allowed by the court. It observed:

"34. There can be no doubt whatsoever, that the particulars of the offence, of which an accused is charged, have to be clearly stated to him. In case the accused in the present case were to be charged for having violated Section 12(1B) as new operators under the non-proviso category, it was imperative to inform them of all the relevant particulars, namely, that they had unauthorisedly commenced a collective investment scheme, during the period when there was a complete bar, against commencing to sponsor or carry on a collective investment scheme. In the absence of the above particulars of the offence, they could not have been tried or punished for the same. No amount of evidence can be looked into, for an accusation not levelled or made out, in a complaint. This is one of the basic tenets of the criminal jurisprudence."

Implications

Statue by conferring power has created bar on certain persons from commencing a defined activity with regard to collective investment scheme. The ruling of Supreme Court implied that the bar is mandatory and is not restricted to framing of rules. This bar would work as a restriction on commercial activities of companies falling under the purview of the regulations and have clarified ambiguity as to effective date of statue which is subject to rules thereof. The activity commenced after the law came into force is 'wholly impermissible' without registration even though the requirement for CIS regulations regarding the procedure for registration of the collective investment scheme has not been effectuated. The explicit order of Supreme Court respecting the fulfillment of section 12(1B) in favor of the 'Board' has put onerous burden on the companies for fulfilling the provision as has been created by the statue and cannot take the blanket of non-existence of rules to excuse themselves of the bar created.

While reviewing the other aspect of the judgment, the court accentuated that the complainant will have to be clear and cautious before approaching the court regarding the provision for breach of law for which a complaint has been filed. The stand of the complainant in their chargesheet and contentions with regard to the category under which the accuse fall should not vary. Moreover, the court said that this defect and deficiency could not be remedied later under CrPC.

Conclusion

The Supreme Court in *SEBI v. Gaurav Varshney* has accelerated action against those CIS that are in violation of the regulatory norms and said that a law under section 12(1B) cannot be taken as a conditional legislation subject to framing of rules. Further, it created a warning for the complainant to be careful before filing their allegations and cannot change their stand in their contentions.

Nevertheless, the decision of the Supreme Court is significant as much as it reiterates the applicability of amendment under section 12(1B) which once declared a bar on certain activity is made mandatory and limits the circumstances when an excuse to divert from the statute is allowed on the ground of non-existence of rules. It has provided precision and certainty in the matter. The registration requirements were introduced to work as a protective shield in the interest of the investors in the collective investment scheme. Though an irregularity on the part of the *Varshneys* cannot be ignored, the board's stand on treating the scheme under the proviso category has made all the difference in favor of whom the judgment is delivered.

SECURITIES UPDATE

MARCH

09.03.2016 SEBI/HO/MRD/DP/CIR/P/2016/0000000038
SEBI permits recognized stock exchanges to introduce cross-currency F&O contracts on EUR-USD, GBP-USD and USD-JPY in view of RBI permitting the same.
Further, currency options on EUR-INR, GBP-INR and JPY-INR currency pairs have also been permitted.

15.03.2016 CIR/IMD/FPIC/39/2016
SEBI permits FPIs to invest in units of REITs, InvITs, AIFs in terms of Reg. 21 (1) (n) of the FPI Regulations.
Further, they are also allowed to acquire corporate bonds under default (fully or partially). The FPIs are to disclose the term of such offer to the Debenture Trustee.

17.03.2016 CIR/MRD/DSA/41/2016
SEBI specified that the "Commodity Derivatives" shall be eligible as securities for trading and the stock exchanges operating in International Financial Services Centres (IFSCs) may permit dealing in Commodity Derivatives under cl 7 of the IFSC Guidelines, 2015.

18.03.2016 SEBI/HO/IMD/DF2/CIR/P/2016/42
SEBI issued circular on Mutual Funds specifying requirements in relation to Consolidated Account Statement, Enhancing scheme related disclosures, disclosure of executive remuneration, internal credit risk assessment, deployment of New Fund Offer (NFO) proceedings in CBLO. This changes are for further transparency and protection of mutual fund investors.

29.03.2016
SEBI/HO/CDMRD/DEICE/CIR/P/2016/0000000044
SEBI decided to apply the Cyber Security and Cyber Resilience Framework to National Commodity Derivative Exchanges.

31.03.2016 SEBI/HO/CFD/DIL/CIR/P/2016/47
SEBI has specified disclosure of financial information in offer documents in accordance with Ind AS for the purposes of compliance with SEBI (ICDR) Regulations, 2009.

APRIL

21.04.2016 CIR/IMD/DF1/48/2016
SEBI issued a circular in furtherance of Regulation 31(2) of SEBI (Issue and Listing of Debt Securities) Regulations, 2008 to mandate Electronic Book Mechanism for all private placements of debt securities in primary market with an issue size of Rs.500 crores and above. It provides eligibility conditions and functions for Electronic Book Provider and also procedures for Electronic Book Mechanism.

25.04.2016 SEBI/HO/CDMRD/DMP/CIR/P/2016/49
SEBI issued a circular to mandate the disclosure of proprietary trading by derivatives stock brokers to their respective clients and the compliance of commodity derivatives exchanges to the provisions on "Pro – account" trading terminals issued by SEBI vide its circular no. SEBI/MRD/SE/Cir32/2003/27/08 dated August 27, 2003.

MAY

02.05.2016 SEBI/HO/CFD/DCR1/CIR/P/2016 /52
SEBI issued a circular regarding Revised Formats under SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011. The revised format includes specific time period in the formats of reporting compliance under Chapter V of the regulations, in order to bring it in line with the requirement under regulation 10(1)(a) which requires the compliance to be reported for a period of 3 years.

04.05. 2016 SEBI/HO/MRD/DRMNP/CIR/P/2016/54
SEBI issued a circular on Investment Policy, Liquid Assets for the purpose of Calculation of Net Worth of a Clearing Corporation and Transfer of Profits. It outlines the manner in which the Cleaning Corporations must frame and align the investment policy. Further, for the purpose of calculation of Net worth of a Clearing Corporation, the eligible instruments for investment will be considered as 'Liquid Assets'. A few provisions to be implemented by the cleaning corporation for contribution to Core SGF have also been described.

11.05.2016 **CIR/IMD/DF/55/2016**

SEBI issued circular describing guidelines for public issue of units of InvITs (Infrastructure Investment Trusts). The guidelines consists of provisions for (i) Appointment and obligations of merchant banker and others, (ii)Filing of offer document, (iii) Allocation in public issue, (iv) Application and Abridged version of the offer document,(v) Security Deposit,(vi) Opening of an issue and subscription period, (vii) Underwriting, (viii) Price and price band, (ix)Bidding process, (x)Allotment procedure and basis of allotment, (xi)Maintenance of books and records, (xii)Post- issue reports, (xiii)Public communications, publicity materials, advertisements and research reports, (xiv) Other Obligations of Post-issue lead merchant banker, (xv)General conditions, (xvi)Power to relax strict enforcement of these guidelines etc.

27.05.2016 **CIR/CFD/CMD/56/2016**

SEBI issued a circular regarding Disclosure of the Impact of Audit Qualifications by the Listed Entities to streamline the existing process as follows: to make the listed entities disseminate the cumulative impact of all the audit qualifications in a separate format, simultaneously, while submitting the annual audited financial results to the stock exchanges; to dispense with the existing requirement of filing Form A or Form B for audit report with unmodified or modified opinion respectively; to dispense with the existing requirement of making adjustment in the books of accounts of the subsequent year. The circular further specifies the operational details for implementing the aforesaid amendments.

31.05.2016 **SEBI/HO/IMD/DF2/CIR/P/2016/57**

SEBI issued a circular with respect to restriction on redemption in mutual funds. The circular prescribes the various requirements to be observed before imposing restriction on redemptions. Restriction may be imposed when there are circumstances leading to a systemic crisis or event that severely constricts market liquidity or the efficient functioning of markets such as liquidity issues, market failures, operational issues etc. Any imposition of restriction would require specific approval of Board of AMCs and Trustees and the same should be informed to SEBI immediately.

JUNE

07.06.2016 **SEBI/HO/MRD/DP/CIR/P/2016/58**

SEBI issued a circular today in relation to the regulation of Investor Protection Fund of depositories. The contributions which will form part of the aforesaid fund are stated. The fund will be utilized for creating awareness among the investors and to assist and promote development of securities market. Further, the various investments which can be made through the proceeds of the fund has been stated. Lastly, the constitution and management of fund has been stated.

10.06.2016 **CIR/IMD/FPI&C/59/2016**

SEBI issued a circular with respect to Know Your Client (KYC) norms for Offshore Derivative Instruments (ODI) subscribers, transferability of ODIs, reporting of suspicious transactions, periodic review of systems and modified ODI reporting format. It laid down common KYC norms to identify the beneficial owners. The criteria laid down is any person holding 25% or more shareholding in a Co. was said to be the Beneficial owner of the Co. Further, the ODI Issuers are also required to file suspicious transaction reports with the Indian Financial Intelligence Unit. Also, the ODI Issuers are now required to submit the intermediate reports with respect to transfer of ODI on monthly basis.

22.06.2016 **SEBI/HO/MRD/DP/CIR/P/2016/60**

SEBI issued a circular today to review of the framework of position limits for currency derivatives contract. The purpose of the circular is to ease trading requirements in the currency derivatives segment by clarifying that the position limit linked to open interest shall be applicable at the time of opening a position. It suggested the implementation measures to be undertaken by various intermediaries like stock exchange, clearing corporation and depositories. The measures included the relevant amendment in bye-laws, communication of the changes to the stakeholders etc.

JULY

12.07.2016 **CIR/MIRSD/64/2016**

Circular on simplification of Account Opening Kit. Presently a stock broker or depository participant is required to provide particular documents as per the SWBI circular as part of account opening kit. To simplify the account opening kit, the stock broker shall make available the standard documents to the clients either in electronic or physical form, as preference of client. In case of electronic form logs are to me maintained, and stock exchanges are to monitor in half yearly audits.

15.07.2016 **CIR/MRD/DRMNP/65/2016**

The circular is on the acceptance of Fixed Deposit Receipts by Clearing Corporations. Currently FDR of banks are accepted by Clearing Corporation as eligible collateral from participants. Clearing corporations are directed to put in place systems for implementation of circulars, rules and regulations. They also have to put notice and report the status of implementation to SEBI. The circular also advises against accepting FDRs from trading/clearing members as collateral, which are issued by the member themselves or banks who are associate of trading/ clearing member.

21.07.2016 **CIR/MIRSD/ 66 /2016**

Circular relates to the operationalization of Central Know Your Client (KYC) Registry. The Central Registry of Securitization and Reconstruction and Security Interest of India (CERSAI) will perform the functions of the Central KYC Record Registry. KYC information for sharing with the Central KYC Records Registry will be as per the Rules. CKYCR has started with effect from July 15,2016.

AUGUST

10.07.2016 SEBI/HO/IMD/DF2/CIR/P/2016/68
SEBI released a circular establishing the following details regarding mutual funds: Prudential limits in sector exposure for Housing Finance Companies (HFCs), disclosure of votes cast by mutual fund, submitting of final copy of SID prior to launch of the scheme.

19.07.2016 SEBI/HO/CDMRD/DMP/CIR/P/2016/71
In lieu of the merger of the Forwards Markets Commission with SEBI, in order to facilitate larger participation by genuine hedgers by providing them with necessary incentives with a view to deepen the commodity derivatives market, the exchanges shall hence forth stipulate a Hedge Policy for granting hedge limits to their members and clients.

30.07.2016 SEBI/HO/CDMRD/DMP/CIR/P/2016/76
The circular was issued for the purpose of making Exchanges work for registration of subscribers of Price Dissemination services and disseminate derivatives prices to them on a daily basis. Such direct price dissemination service would provide information to subscribers instantly in an efficient and transparent manner and is expected to be of great benefit to market participants.

SEPTEMBER

1.09.2016 SEBI/HO/CDMRD/DRMP/CIR/P/2016/77
In order to streamline and strengthen the risk management framework across national commodity derivatives exchanges SEBI has prescribed additional risk management norms for National Commodity Derivatives Exchanges. These norms are in addition to the already existing norms that SEBI vide circular CIR/CDMRD/DRMP/01/2015 dated October 01, 2015, had prescribed.

2.09.2016 SEBI/HO/CDMRD/DMP/CIR/P/2016/78
In order to maintain the transparency of spot price polling process and dissemination of spot prices arrived at through spot price polling process, SEBI has issued a circular which consolidates and updates such norms prescribed by erstwhile FMC. This circular has laid down certain directions the commodity derivatives exchanges have to follow.

07.09.2016 SEBI/HO/CDMRD/DRMP/CIR/P/2016/79
SEBI has re-issued certain guidelines for Regional Commodity Derivatives Exchanges that were prescribed by erstwhile FMC for fixation of Due Date Rate for Commodity Specific (Regional) Exchanges.

SEBI/HO/CDMRD/DRMP/CIR/P/2016/80
SEBI has issued a circular to consolidate and update such norms that were prescribed by erstwhile FMC for regular monitoring of and levy of penalty for short-collection/non-collection of margins from clients.

SEBI/HO/CDMRD/DMP/CIR/P/2016/82
In order to promote competition in the market and bring in greater efficiencies and lower transaction costs to market participants, SEBI has issued a circular regarding the collection of transaction charges. It has laid down certain norms that shall be applicable to the Commodity Derivatives Exchanges while levying transaction charges.

SEBI/HO/CDMRD/DMP/CIR/P/2016/83
SEBI has issued a circular in continuation of its previous circular dated January 15, 2016 regarding Daily Price Limits (DPL) of non-agricultural commodity derivatives. It also prescribes norms for DPL determination on first trading day of the derivatives contract on agricultural as well as non-agricultural commodities.

SEBI/HO/CFD/DCR/CIR/P/2016/81
In order to ensure effective enforcement of exit option to the public shareholders in case of compulsory delisting of companies SEBI has issued a circular directing such companies to comply with certain requirements provided under this circular. These requirements are in addition to the restrictions imposed under Regulation 24 of the Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2009

15.09.2016 SEBI/HO/MIRSD3/CIR/P/2016/0000000085
SEBI has issued a circular addressing the issues raised by the investors regarding the clarification of certain points mentioned in clause 2 of Annexure-A of circular no. CIR/MIRSD/10/2013 dated October 28, 2013.

16.09.2016 SEBI/HO/CDMRD/DRMP/CIR/P/2016/86
SEBI has issued a circular notifying the continuation of all the circulars that were issued by erstwhile FMC regarding Settlement Guarantee Fund (SGF), Stress Test to determine adequacy of SGF and Base Minimum Capital

SEBI/HO/CDMRD/DMP/CIR/P/2016/87
SEBI has now made it mandatory for the members of the commodity derivatives exchanges to use Unique Client Code for all clients transacting on the commodity derivatives exchanges. Moreover, PAN would be the sole identification number and mandatory for all entities/persons that are desirous of transacting on the commodity derivatives exchanges except for the investors residing in the State of Sikkim and Central & State government and officials appointed by the courts e.g. Official liquidator etc.

20.09.2016 SEBI/HO/CDMRD/DRMP/CIR /2016/88
SEBI has issued a circular that consolidates and updates such norms prescribed for National Commodity Derivatives Exchanges by the erstwhile FMC relating to permission for trading in futures contracts and modification in contract specifications at exchange level.

21.09. 2016 SEBI/HO/CDMRD/DRMP/CIR/P/2016/90
This circular was issued to consolidate and update such norms prescribed for National Commodity Derivatives Exchanges by the erstwhile FMC. The norms updated include staggered delivery, early delivery systems, the early pay in facility, the penalties, the fixation of the Final Settlement Price (FSP), as well as the expiry date of running contracts.

23.09.2016 SEBI/HO/MIRSD/MIRSD2/CIR/P/2016/92
The circular relates to the erstwhile FMC. It had issued various circulars/letters/ directions to exchanges dealing in commodity derivatives for compliance by their members from time to time. Consequent to merger of FMC with SEBI, this circular seeks to harmonize the equity and commodities market. Accordingly, regulatory provisions have been divided into three parts as described below.
Part A contains details of FMC circulars which shall stand repealed and relevant SEBI circulars which shall be applicable.
Part B contains details of FMC circulars contents/norms of which shall continue as they are specific to commodity derivative markets.
Part C contains details of FMC circulars which shall stand repealed.

26.09.2016 SEBI/HO/CDMRD/DEICE/CIR/P/2016/94
The erstwhile FMC, from time to time, had prescribed various norms and guidelines for National Commodity Derivatives Exchanges with respect to Investor Protection Fund (IPF) through various circulars. This circular deals with the consolidation and updation of the norms and guidelines which will be applicable to all National Commodity Derivatives Exchanges (Exchanges).
The Circular includes provisions for the constitution and management of IPF, contributions to the IPF, the manner of filing claims and determining the eligibility of claims, the determination of legitimate claims, threshold limit for claims and disbursement of claims from the IPF

SEBI/HO/MIRSD/MIRSD2/CIR/P/2016/95
The committee constituted by SEBI on "Enhanced Supervision of Stock Brokers", has recommended guidelines, which covers such broad areas such an uniform nomenclature for naming/tagging of bank and accounts and reporting of such accounts, monitoring of clients funds through an alerting and reconciliation mechanism so as to detect mutualisation, changing the current system of internal audit, monitoring of stock brokers by stock exchanges so as to take pre-emptive steps, uniform penal action, as well as other requirements.

27.09.2016 SEBI/HO/CDMRD/DMP/CIR/P/2016/97
In the past the erstwhile FMC from time to time had issued norms on Algorithmic Trading in consultation with the Exchanges. This circular consolidates such norms, and includes the definition of algorithmic trading, and various regulations.

SEBI/HO/ CDMRD/DMP/P/CIR/2016/100
According to this circular Portfolio Management Services (PMS) will continue as per the earlier FMC directives, thus PMS currently would not be permissible in the Commodity Derivative Market.

SEBI/HO/CDMRD/DMP/2016/101
Regarding disclosures required by the Commodities Derivatives Exchanges, the circular puts out a detailed, consolidated set of regulations that will be the current norm. This is in the interest of increased transparency and accessibility of information, as was the trend set by the erstwhile FMC.

SEBI/HO/CDMRD/DMP/CIR/P/2016/103
This circular aims to prescribe norms which are the minimum requirements/standards for compliance by the exchange accredited Warehousing Service Providers, warehouses and assayers and are to be complied with in addition to those laid down by Warehousing Development and Regulatory Authority (WDRA), any other government authority from time to time. This circular was issued in the light of the fact that Warehousing infrastructure and its ancillary services play a critical role in the delivery mechanism of the Commodity Derivatives Market since a robust & credible warehousing infrastructure is sine qua non for an effective Commodity Derivatives Market that can inspire confidence amongst the market participants and other stake holders

28.09.2016 SEBI/HO/CDMRD/DMP/CIR/P/104
At present the only instrument available in the Commodity Derivatives market is futures on individual commodities. On the recommendation of a committee of experts known as Commodity Derivatives Advisory Committee (CDAC) SEBI decided that Commodity Derivatives Exchanges shall be permitted to introduce trading in 'options', as opposed to futures alone. .

OCTOBER

03.10.2016 IMD/FPIC/CIR/P/2016/107
The limits for Foreign Portfolio Investments (FPIs) in Central Government, Long term FPIs and FPIs in State Development Loans were all revised for October 2016 and January 2017.

10.10.2016 SEBI/HO/MRD/DSA/CIR/P/2016/110
All Exclusively listed companies of De-recognized/Non-operational/exited Stock Exchanges have been placed in the Dissemination Board (DB). SEBI also issued clarifications, on the matters of raising capital for listing on national stock exchanges, as well as on the procedure to provide exit to investors. It also contemplates action against any promoter or director whose company is on the DB and has failed to demonstrate adequacy of efforts for providing exit to their shareholders

14.10.2016 SEBI/HO/CDMRD/DRMP/CIR/P/2016/112
Established the maximum percentage of commodities collateral for clearing members and further directed exchanges to necessary arrangements for timely liquidation of collaterals accepted by them.

19.10.2016 SEBI/HO/MRD/DSA/CIR/P/2016/113
SEBI has allowed mutual fund distributors to use recognised stock exchanges' infrastructure to purchase and redeem mutual fund units directly from Mutual Fund/Asset Management Companies and further guidelines laid to increase its outreach.

20.10.2016 CIR/IMD/DF/114/2016
Regulations have been laid down to make sure that relevant financial information in offer document has been disclosed.

24.10.2016 CIR/CFD/DIL/115/2016
Disclosure requirements were laid down for recently listed insurance companies in Indian stock exchanges.

26.10.2016 SEBI/HO/CFD/CMD/CIR/P/2016/116
In order to ensure effective enforcement, it has been decided in consultation with recognized stock exchanges to freeze the holdings of their promoters of companies who have been non compliant of listing agreement.

BEST ARTICLE OF THE 2ND EDITION OF THE SECURITIES LAW E-NEWSLETTER:

ESOP'S FOIBLES: THE CASE OF PHANTOM STOCKS AND SAR'S

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Introduction

Employee stock option plans commonly called ESOP's are schemes strategically devised by employers of various types of companies to simultaneously realize diverse key short term and long term business goals. These schemes are given to employees in addition to or instead of a part of their salary in various combinations as payment in kind in order to remunerate, reward, rally and retain employees.The main advantages of issuing ESOP's are:

There is no cash outflow for the company, and helps in retaining and attracting talented employees.

Section 2(37) of the new Companies Act defines employees' stock option (ESOP) as-

"The option given to the directors, officers or employees of a company or of its holding company or subsidiary company or companies, if any, which gives such directors, officers or employees, the benefit or right to purchase, or to subscribe for, the shares of the company at a future date at a pre-determined price."

Though traditional ESOP's have been used successfully by several companies especially start ups, they do have certain inherent drawbacks. The main drawback of ESOP's is the problem of dilution of equity. If ESOP's are not well organized, a company may face difficulties when it comes to making important decisions. This is because, most employees who become shareholders may not be prudent decision makers and this may prevent a company from passing important resolutions in statutory meetings.

To combat the inherent limitations posed by ESOP's., companies worldwide have been using other instruments such as phantom stocks and stock appreciation rights (SAR's). A phantom stock is simply a promise to pay a bonus in the form of the equivalent of either the value of company shares or the increase in that value over a period of time.

A stock appreciation right (SAR) is much like phantom stock, except it provides the right to the monetary equivalent of the increase in the value of a specified number of shares over a specified period of time. As with phantom stock, this is normally paid out in cash, but it could be paid in shares. Both phantom stocks and SAR's help companies avoid the risk of equity dilution and also protect employees from risks of owning volatile stocks.

The trend of using phantom stocks and SAR's has recently caught up in India as more and more start-ups are emerging and founders and owners are exploring cost efficient ways to retain talented personnel and mitigate risks associated with dilution of ownership. However, unlike many other developing countries, phantom stocks and SAR's lack adequate statutory recognition and regulation.

SEBI's regulatory muddle

Recently, SEBI issued two informal guidance letters in response to certain specific queries raised by Mindtree Limited and Saregama India Limited. The queries pertained to the question of applicability of The SEBI (Share Based Employee Benefits) Regulations, 2014 (the "Regulations") in the context of phantom stocks and stock appreciation rights. SEBI answered in the negative by clarifying that phantom stock option and stock appreciation rights did not fall within the ambit of the Regulations and therefore companies issuing such stock options would not be required to comply with the Regulations.

The apparent confusion in interpreting the Regulations was created due to Regulation 1(3)(iii) of the Regulations which provides that the Regulations apply to stock appreciation rights schemes in addition to other types of employee share benefit schemes. In addition, stock appreciation rights have been specifically stipulated in the Regulations. However, in the subsequent proviso of the Regulations, i.e. Regulation 1(4) it is stated that the applicability of the Regulations is restricted to companies whose shares are listed on a recognized stock exchange in India and which *inter alia* involve dealing in or subscribing to or purchasing securities for the company, directly or indirectly.

SEBI seems to have relied on this proviso while issuing its guidance as it indicates the necessity for actual subscription or purchase of shares by employees, which obviously is impossible under phantom stock schemes. From a review of the Regulations and SEBI's interpretation, either of the two possibilities emerges. Either SEBI has erroneously interpreted the Regulations; or there is a serious lacunae in the Regulations which has the effect of contradicting itself and rendering it infructuous. On a bare reading of the Regulations, it seems the case of the latter as the two conflicting provisos, i.e. 1(3) and 1(4) nullify each other and ultimately leave the issue of stock appreciation rights in a state of legislative limbo!

Conclusion

In fact, it is confusing why the Regulations would expressly deal with phantom stock and stock appreciation rights if the legislative intention was to exclude them from the purview of the Regulations. While intricate tools of statutory interpretation may be used to untangle this piece of contorted legislation in order to give recognition to phantom stocks and SAR's, such a recourse should not be resorted to as it will leave open future risks associated with alternate interpretations of the ambiguous Regulations.

What is actually needed is a separate set of rules governing phantom stocks and SAR's in India. While it is important to allow companies flexibility in designing their own employee stock option schemes and allowing them exemption from compliances in cases of phantom stocks or stock appreciation rights, there must be definitive rule regarding phantom stocks and stock appreciation rights. SEBI should clearly define phantom stocks and stock appreciation rights and should provide an unambiguous regulatory framework which adequately addresses the challenges and issues which may arise from the use of such emerging stock options.