



atharv

August 2021

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Basilstone Consulting is pleased to present to you the **August 2021** issue of **atharv**, covering regulatory insights as well as discussion papers. This issue covers the following areas:

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- I.1.1. Amendment to SEBI (Alternative Investment Funds) Regulations, 2012
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I. Regulatory updates & its expected impact

I.1. Securities & Exchange Board of India

I.1.1. Amendment to SEBI (Alternative Investment Funds) Regulations 2012

SEBI has amended the AIF regulations in order to permit AIFs to invest in units of other AIFs, subject to prescribed conditions. Further, Category III AIFs investing in units of other AIFs may now undertake leverage not exceeding two times of the value of portfolio (NAV) after excluding the value of investment in units of other AIFs. The definition of Key Management Personnel has been clarified for applicability of Code of Conduct.

I.1.2. Valuation of securities with multiple put options present ab-initio

SEBI has for Mutual Funds, AMC's etc., w.e.f. 01st October 2021, prescribed that if the put option is not exercised by a Mutual Fund, while exercising the put option would have been in favour of the scheme;

- (i) A justification for not exercising the put option shall be provided by the Mutual Fund to the Valuation Agencies, Board of AMC and Trustees on or before the last date of the notice period.
- (ii) The Valuation Agencies shall not take into account the remaining put options for the purpose of valuation of the security.

Put option is 'in favour of the scheme' if yield, ignoring the put option under evaluation, is more than the contractual yield/coupon rate by 30 basis points

I.1.3. Introduction of Expected Loss (EL) based Rating Scale and Standardisation of Rating Scales Used by Credit Rating Agencies

SEBI has prescribed Expected Loss based rating nomenclature for projects / instruments associated with infrastructure sector, to be complied with by 31st March 2022, as under:

Rating	Expected Credit Loss
EL 1	Lowest
EL 2	Very Low
EL 3	Low
EL 4	Moderate
EL 5	High
EL 6	Very High
EL 7	Highest



1.1.4. Intra-day Net Asset Value (NAV) for transactions in units of Exchange Traded Funds directly with Asset Management Companies

For transactions in units of Exchange Traded Funds (ETFs) by Authorized Participants / large investors directly with the AMCs, 'closing NAV of the day' may not be relevant as these transactions are based on price at which the securities representing the underlying index or underlying commodity(ies), are purchased or sold. Therefore, SEBI has permitted Intra-day NAV for such transactions, based on the executed price at which the securities representing the underlying index or underlying commodity(ies) are purchased / sold.

1.1.5. SEBI (Issue and Listing of Non-Convertible Securities) Regulations 2021

SEBI has merged Issue and Listing of Debt Securities rules (ILDS) and Non-Convertible Redeemable Preference Shares rules (NCRPS) into a single regulation to be called SEBI (Issue and Listing of Non-Convertible Securities) Regulations.

Under the new framework, issuers who are in existence for less than 3 years, have been facilitated to tap the bond market on certain conditions. This condition includes the issuance of their debt securities is made only on a private placement basis; the issue is made on the EBP (electronic book mechanism) platform irrespective of the issue size, and the issue is open for subscription only to qualified institutional buyers (QIBs).

In addition, parameters for identification of risk factors have been introduced under the new rules to assist issuers in disclosing pertinent risk factors on risks intrinsic to the issuer as well as the instrument, other risk factors, which may have an impact on the issue, among others.

The option for call and put has been introduced in case of debt securities issued on a private placement basis. Issuers who have cured the default in payment of interest/dividend/redemption amount to raise funds through non-convertible securities have been permitted to file shelf prospectus post such curing of default.

Impact: The revised regulations will enable special purpose vehicles created for specific infrastructure purposes, NBFCs, listed REITs as well as InvITs and other companies who propose to list debt securities purely on a private placement basis, but who do not have a three-year existence history, to list their debt securities issued on private placement basis, along with other minor procedural easing.



1.2. Reserve Bank of India

1.2.1. Framework for Outsourcing of Payment and Settlement-related Activities by Payment System Operators

RBI has issued a framework for outsourcing of payment and settlement related activities by Payment System Operators. Key restrictions to outsourcing are that core management functions, including risk management and internal audit; compliance and decision-making functions such as determining compliance with KYC norms, shall not be outsourced. An outsourcing policy is also required to be adopted by the Board of Directors, and the DSA / DMA agreements may require to be amended. Other aspects such as outsourcing within the Group, offshore-outsourcing etc. have also been prescribed under the framework.

Impact: This framework lays down responsibilities on the Payment System Operators to ensure minimum safety net on outsourced activities from both Business Continuity Planning perspective, as well as responsibility defining perspective.

1.2.2. Extending scope of Tokenisation

RBI has extended the scope of tokenisation to include consumer devices – laptops, desktops, wearables (wrist watches, bands, etc.), Internet of Things (IoT) devices, etc., instead of the earlier availability of tokenisation only on mobile phones and tablets of interested card holders.

Impact: This long-awaited circular opens up a myriad of electronic devices to become payment mechanisms, making the payment process more seamless for individuals. It also provides a massive opportunity for Fintechs and Payment processing platforms to venture into this new space, alongwith opportunities for OEM manufacturers to enter the payment processing space.

1.2.3. Factoring Regulation (Amendment) Act, 2021

The expert committee under chairmanship of Mr. U. K. Sinha had recommended that, (i) non-banking finance companies, other than those non-banking finance companies whose principal business is factoring, should also be permitted to discount invoices on Trade Receivables Discounting System in order to widen the scope of financiers; (ii) the Trade Receivables Discounting System concerned should be permitted to act as agents of financiers for filing registration of charges with the Central Registry as it would bring operational efficiency; and (iii) the time period for registration of invoice and satisfaction of charge upon it should be reduced in order to check possibility of dual financing. This amendment is to incorporate these recommendations under the Factoring law.



Impact: The amendments are expected to help micro, small and medium enterprises significantly, by providing added avenues for getting credit facility, especially through Trade Receivables Discounting System. Increase in the availability of working capital may lead to growth in the business of the micro, small and medium enterprises sector and also boost employment in the country.

1.2.4. Others

RBI has issued various regulations / guidelines as under:

- (i) Master Direction on Prepaid Payment Instruments
- (ii) DRAFT Foreign Exchange Management (Non-debt Instruments - Overseas Investment) Rules, 2021
- (iii) DRAFT Foreign Exchange Management (Overseas Investment) Regulations, 2021

1.3. Ministry of Corporate Affairs

1.3.1. Insolvency and Bankruptcy Code (Amendment) Act 2021

This amendment lays down the legal provisions for Pre-Packaged Insolvency Resolution Process. The same has been extensively discussed in Para 1.3.1 of *atharv* for the month of April 2021.

1.3.2. Amendment to 'Electronic Records' rules for IFSC entities

Vide two separate notifications, MCA has amended the (i) Companies (Specification of definitions details) Rules, 2014 and (ii) Companies (Registration of Foreign Companies) Rules, 2014 to add the following explanation to the definition of 'Electronic Records'.

Explanation.- For the purposes of this clause, electronic based offering of securities, subscription thereof or listing of securities in the International Financial Services Centres set up under section 18 of the Special Economic Zones Act, 2005 (28 of 2005) shall not be construed as 'electronic mode' for the purpose of clause (42) of section 2 of the Act.

Accordingly, provisions being attracted to 'electronic records' under the Companies law would therefore not be attracted to electronic based offering of securities, subscription thereof or listing of securities in the International Financial Services Centres.



1.4. International Financial Services Authority

1.4.1. Accounting Standard to be followed by IFSC Banking Units (IBUs) for the purpose of IFSCA regulatory reporting and compliance

IFSCA has prescribed that IBUs shall follow the IFRS accounting standards issued by the IASB, including any new amendments thereto, for preparing and maintaining its financial statements on standalone basis and for the purpose of reporting and compliance under the relevant IFSCA regulations, rules, directions, circulars and guidelines applicable for IBUs. The financial year to be adopted shall be from 01 April to 31 March

Impact: The circular provides a headway into the expected accounting policies under IFRS to possibly be prevalent in the IFSC.

1.4.2. Guidelines on Corporate Governance and Disclosure Requirements for a Finance Company

IFSCA has prescribed extensive guidelines on Corporate Governance and Disclosure requirements to Finance Company. Key highlights are:

- Fit and Proper Criteria
- Deed of Covenants
- Appointment of Compliance Officer
- Setting up of Committees
- Policy on Related Party transactions
- Disclosures

Impact: The guidelines seem to be similar to those applicable to NBFC-ND-SI. These guidelines lay the foundation stone of best practices in the Corporate Governance and Disclosure requirements

1.4.3. Guidelines on Factoring and Forfeiting of Receivables

IFSCA has issued guidelines on Factoring and Forfeiting of Receivables, applicable to Finance Companies, IBUs and ITFS Platform. The guidelines cover major aspects of receivable financing, including:

- Assignment
- Notice
- Discharge of Liability
- Assignor Prohibition
- Liability of Debtor
- Set-off



The framework lays down a new class of intermediary which permits its participants to undertake or participate in International Trade Finance related activities which includes Export Invoice Trade Financing, Reverse Trade Financing, Bill discounting under Letter of Credit, Supply Chain Finance for Exporters, Export Credit (Packing Credit), Insurance / Credit Guarantee, Factoring system and any other trade product. The framework additionally lays down the eligibility requirements for the platform and participants, On-Boarding and KYC & AML requirements, Minimum agreement standards, and illustrative process flows, etc.

Impact: The framework permits entities to setup a trade financing platform, which in turn is akin to TREDs platform issued by RBI, albeit, with operations in foreign currency. It opens a vast avenue for domestic financiers and fintech platforms to provide a solution to provide international finance related services on-shore in freely convertible foreign currency.

1.4.4. Participation in financial products linked to Indian Rupee (INR) by branches of Indian banks and branches of other Indian financial institutions

The regulator has issued a clarification that branches of Indian banks and branches of other Indian financial institutions operating in IFSC may, subject to the directions issued by IFSCA, offer financial products linked to Indian Rupee.



2. Discussion Papers

2.1. Prohibition of Insider Trading

Introduction

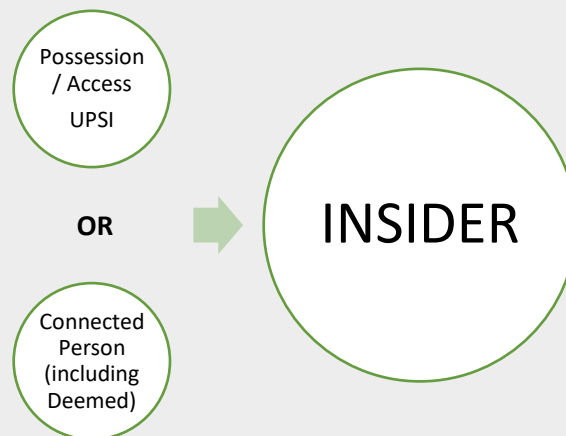
Insider trading is the trading of a corporation's stock or other securities (such as bonds or stock options) by individuals with access to non-public information about the company. In most countries, trading by corporate insiders such as officers, key employees, directors, and large shareholders may be legal, if this trading is done in a way that does not take advantage of non-public information.

However, the term is frequently used to refer to a practice in which an insider or a related party trades based on material non-public information obtained during the performance of the insider's duties at the corporation, or otherwise in breach of a fiduciary or other relationship of trust and confidence or where the non-public information was misappropriated from the company.

Insider trading denotes dealing in a company's securities on the basis of confidential information relating to the company which is not published or not known to the public used to make profit or loss. It is fairly a breach of fiduciary duties of officers of a company or connected persons towards the shareholders.

The prevention of insider trading is widely treated as an important function of securities regulation.

Who is an Insider?



UPSI means any information, relating to a company or its securities, directly or indirectly, that is not generally available which upon becoming generally available, is likely to materially affect the price of the securities and shall, ordinarily including but not restricted to, information relating to (i) financial results; (ii) dividends; (iii) change in capital structure; (iv) mergers, demergers, acquisitions, de-listings, disposals and expansion of business and such other transactions; (v) changes in key managerial personnel.



Legal Requirements

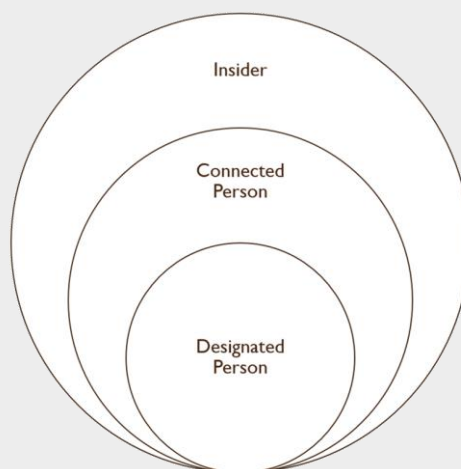
The Companies Act of 2013 had a provision to restrict Insider Trading U/s 195, which prohibited any communication of sensitive information by the key managerial persons. Later, this section was omitted as section 458 of the Companies Act delegates the power to SEBI to conduct trials against the accused persons and therefore there was a confusion that the accused should be held under the Companies Act or the SEBI regulations and therefore in 2017 the section 195 was omitted by a notification. Hence, the current regulations regarding Insider Trading in India are the SEBI (Prohibition of Insider Trading) Regulations, 2015 and Section 12A (Prohibition of Insider trading) and 15G (Penalty for Insider Trading) of the SEBI Act.

Applicability of Code of Conduct & Code of Fair Disclosure

Code of Fair Disclosure	Code of Conduct	
For Listed Companies	For Listed Companies & SEBI Intermediaries	For Other Persons
Responsibility of Board	Responsibility of Board / Head of Organization	Responsibility of Board / Head of Organization
Publishing on Website required	Not Required	Not Required
Schedule 'A'	Schedule 'B' Schedule 'C'	Schedule 'C'
Filing with exchange required	Not Required	Not Required

Proof of responsibility

Proving that someone has been responsible for a trade can be difficult because traders may try to hide behind nominees, offshore companies, and other proxies. Nevertheless, the Prohibition of Insider Trading regulations have laid down the onus as under:



In the case of connected persons, the onus of establishing, that they were not in possession of unpublished price sensitive information, shall be on such connected persons and in other cases, the onus would be on SEBI. (Regulation 4(2) of SEBI PIT Regulations)

Recent Case Laws

A landmark judgement was passed in one of the many cases involving use of WhatsApp platform by the Securities Appellate Tribunal. The principle being derived in that case being that the information can be branded as an unpublished price sensitive information only when the person getting the information had a knowledge that it was unpublished price sensitive information. Though knowledge is a state of mind of a person, the same can be proved on preponderance of probabilities on attendant circumstances.

Conclusion

The Prohibition of Insider Trading law, is ever evolving, and more so on account of complex transactions and advancing information communication environment. Regulations, by themselves, may not be sufficient a tool to address the issues of intentional insider trading. The PIT laws, while issued to safeguard the interest of investors, does not rely on 'Guilty state of mind', as evident from multiple deeming provisions laid down. Such deeming provisions act as a double-edged sword, since on one side, obtaining sufficient evidence to prove insider trading may be difficult, on the other lies the unintentional or inadvertent lapses. Therefore, it is essential for stakeholders / compliance officers to continually monitor these ever-evolving regulations by correlating them to the transactions, since the deeming provisions under the regulations may lead to attraction of penal provisions, albeit on account of inadvertent lapses.

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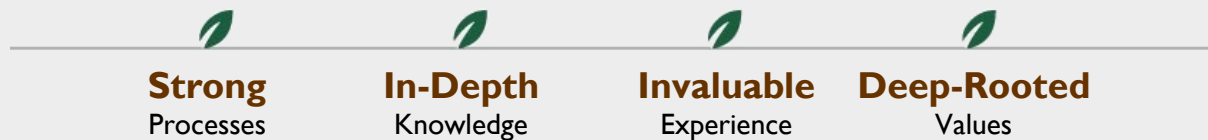


About Basilstone

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We, at Basilstone aim to position ourselves as the ‘Go to Consultants’ for **Simple Solutions & Value Creation** recognised by our clients for delivering ultimate desired results.

The Purpose of Basilstone is to provide simple solutions and create value backed by:



We clearly resonate ourselves with the ever-growing Basil, inspiring us to imbibe the quality of being natural and pure while we adapt to changing conditions and innovation. The rock-solid Stone is representative of our endurance, stability, permanence and our determination, paving the path of value creation for our clients and our firm allegiance to our principles.

Basilstone is the quintessential blend of traditional values and modern thoughts which are echoed in the experience, enthusiasm and energy of its people and translated in the services rendered to its clients.

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