

Mutual Fund Policy

SEBI has recently issued a paper on the Long Term Policy for Mutual Funds discussing wide ranging issues surrounding the mutual fund sector and has recommended various measures to improve penetration of mutual funds in India.

Tax incentives: SEBI has recommended tax exemptions of upto Rs. 50,000 under Section 80C of the Income Tax Act for investments in long term mutual fund products like the Mutual Fund Linked Retirement Plan or, in the alternative, increase of the tax exemption limit under Section 80C to Rs. 2,00,000 and include investments in ELSS, MFLRP within that limit in order to channelize investments into long term mutual fund products.

Employee Provident Fund Organizations: SEBI has recommended that the Labour Ministry permit all Employee Provident Fund Organizations to invest upto 15% of their corpus in long term mutual fund schemes. In what could be a game changer in the EPF space, it has been recommended that employees/contributors now be offered an option for investing a part of their corpus in a long term mutual fund product of their choice for 10 or 15 years. This is along the lines of the 401(k) benefit plans available for the workforce in the US. However, given the ultra cautious approach taken by the government in the past, it is unlikely for such a recommendation to be implemented.

Central Public Sector Enterprises: Further, SEBI has recommended that all Central Public Sector Enterprises be allowed to invest their surplus funds, which run into trillions of rupees, in SEBI registered mutual funds, as opposed to just public sector mutual funds under existing laws.

These measures would provide incentives for the public to invest in mutual funds, as well as improve liquidity in the capital markets.

Capital Adequacy: SEBI has also increased the minimum net worth for AMCs from Rs. 10 crores (Rs. 100 million) to Rs. 50 crores (except Infrastructure Debt Funds) within the next three years.

This appears to be a move without any purpose and appears to be an anti-competitive move against smaller players, many of whom have performed better than their larger peers. SEBI has also mandated that AMCs invest atleast 1% of their funds as seed fund in schemes promoted by them, which would also be counted towards computing their net worth. The AMCs will be required to maintain its seed capital in all schemes, except close-ended schemes and have been given a year to comply. This also does not appear to have been well thought as it rewards bigger players rather than smarter players.

Disclosures: SEBI has also sought to improve quality of disclosures made by mutual funds by asking them to disclose their voting pattern on a quarterly basis, as well as provide other information pertaining to the AUM regularly on their websites. This would be a good move towards improved corporate governance in India.

Distribution through PSU banks: In a bid to improve distribution channels, SEBI has also recommended that PSU banks be allowed to distribute all mutual fund products, as well as tap the internet to distribute products online.

New Corporate Governance Norms

SEBI, in its February 2014 board meeting, approved several alterations to the listing agreement in an attempt to revamp the corporate governance norms in the country. These changes, a preview to which is available in the agenda paper of the board meeting, were brought in after relying heavily on "Consultative Paper on Corporate Governance norms in India" (4 January, 2013) and the various comments that were received in response to it. While a number of the changes have already been incorporated within the Companies Act, 2013, the relevant sections have not been notified as of today. In certain circumstances, SEBI has chosen to lay down norms that are more stringent than what is present in the Companies Act.

SEBI has proposed the creation of *General Principles of Corporate Listing*

Governance which will aid in understanding how specific rules in the Listing Agreement are to be interpreted.

Independent Directors: One of the major focuses of the new norms is in relation to independent directors. With the primary concern being ensuring independence and effectiveness of such directors, limits on tenure, limits on number of directorships, provisions for separate meetings of such directors, etc. have been brought in. *Succession planning* and *performance evaluation* of directors are some other requirements imposed on boards.

Related Party Transactions: The proposed new norms deal heavily with related party transactions. They further expand the definition of RPTs and include the requirement to obtain prior approval from the audit committee and also from non-interested shareholders, in cases of major RPTs.

Policies: Additionally, companies will be required to come out with policies for whistle-blowers, remuneration, risk management, divestment of material subsidiaries, etc.

With these new norms set to come into force on 1 October, 2014, all listed companies will soon be required to pay greater attention to adequate corporate governance. It would not only increase the cost of running business for listed companies, but may also have several adverse effects, for instance, disqualification of independent directors who have overstayed their tenure.

SEBI Notification on Certification for Investment Advisers

SEBI, through a notification dated 27 January, 2014 has recognized Certified Financial Planner certification from the Financial Planning and Standards Board India, as being an eligible certification for registration under SEBI (Investment Advisers) Regulations, 2013. However the proviso to paragraph 3 of the Notification exempts only those associated persons, who have already obtained CFP certification or who would obtain it within 30 days from the date of the Notification from obtaining certification by passing the NISM certification examinations.

The IA Regulations prescribes minimum qualification and certification requirements for a registered investment adviser for protecting investors by ensuring that only a duly competent and suitably licensed person provides investment advice. The 30-days period is unreasonable and does not have any connection with this objective. It would adversely affect an additional route of certification and reduce the number of certified advisers. It effectively implies that a person who gets CFP certification from FPSB India post 30 days from the date of the Notification is less proficient than one who gets the same certification within 30 days from that date. Further, persons who are currently registered with FPSB India for obtaining their certification will still need to obtain certification from NISM by passing the NISM examinations. Under Article 14 of the Constitution of India, classification is permissible if: (i) it is based on intelligible differentia, and (ii) the differentia has a rational nexus to the object sought to be achieved by the rule in question. Persons obtaining certification by passing CFP certification from FPSB India form one class, irrespective of the date on which they attain the certification. Therefore they should be treated equally, and the impugned proviso may be held violative of Article 14.

Annual Information Memorandum

With an aim to bridge the information asymmetry between the primary and the secondary market investors, SEBI has recently released a discussion paper on "Annual Information Memorandum". SEBI, in line with an IOSCO principle, has emphasised that reliable, timely and readily accessible information is fundamental for investors.

At present, listed companies in India are required to comply with several disclosure norms arising out of a fragmented set of legal regulations viz. SEBI regulations, listing agreement, stock exchange byelaws, company law legislations, etc. The only comprehensive disclosure that is available for investors is an offer document during public issuance or annual reports published annually by companies.

SEBI has felt the need for consolidation of disclosures in one place to facilitate investors in making informed

decision in relation to their investments. SEBI has proposed that listed companies be required to file an Annual Information Memorandum with up-to-date information about their financial and operating performance. According to SEBI, this will bring down compliance costs and aid in any future capital raisings. In addition, the disclosure requirements under the annual report would be restricted only to disclosures required under the Companies Act, 1956/2013. In the United States, similar disclosures are already in place such as Form 10K, 10Q, 20F etc.

This move towards consolidation of information is welcome and would go a long way in aiding secondary market investors to make informed investment decisions. However, from the perspective of a company, SEBI should provide further clarity regarding whether the AIM may be used as a shelf prospectus at a subsequent date as a tool to raise capital from public.

Think twice before delaying disclosures

SEBI recently imposed a penalty of Rs 50 lakh on seven promoter entities of Hindustan Unilever Limited for their delayed filing of continual disclosures required under the takeover regulations of 1997 and 2011. The delays ranged from 4 to 31 days. While the promoters contended that the delays were inadvertent and without any intention to conceal any information or gain any advantage, the Adjudicating Officer of SEBI observed that once violation of statutory obligations is established, the intention of the violator becomes irrelevant and imposition of penalty becomes essential. While this order reiterates the importance of timely disclosure and indicates SEBI's stand of placing interests of investors at the core of securities market regulation, the amount of penalty appears disproportionate.

Applicability of exemption under Takeover Regs

A German holding company, in order to undertake some internal restructuring of business units, decided to transfer its substantial shareholding in an Indian listed company Styrolution ABS (India) Ltd., held through one of its ce

subsidiaries based in the UK, to another subsidiary in Singapore. They sought informal guidance from SEBI regarding whether such inter se transfers would be exempt from open offer obligations under the takeover regulations.

The takeover regulations provides that *inter se transfers* amongst a company, its subsidiaries, its holding company and other subsidiaries of such holding company are exempted. SEBI in its informal guidance, provided some clarity on whether a foreign company and its foreign subsidiaries can also avail of this benefit. While the definition of 'company' does not include a body corporate incorporated outside India, SEBI observed that, the definitions of 'Holding Company' and 'Subsidiary' under Section 4 of the Companies Act, 1956, includes such body corporates. Hence, SEBI found that such transfers will fall within the ambit of the general exemptions provided within the takeover regulations.

CSR Notified

The Ministry of Corporate Affairs came out with notifications on 27 February, 2014, bringing into effect rules in relation to corporate social responsibility. They are set to come into force on 1 April, 2014. The following are some of the major changes:

- The list of permissible CSR activities provided under Schedule VII of the Companies Act is expanded.
- Contributions to political parties, whether direct or indirect, would not be considered as a CSR expenditure.
- Companies are required to continue undertaking CSR activities for 3 years even after they fall below the specified financial threshold in a particular year. Companies are permitted to allocate upto 5% of the CSR expenditure on building and developing CSR capacities.
- Certain issues that existed for public unlisted, private, and foreign companies in complying with the membership requirements of their CSR committees have been clarified.

About Us

Finsec Law Advisors is a financial sector law firm which provides regulatory advice and assistance focusing on the securities, investments and banking industry.

www.finseclaw.com

Disclaimer : The newsletter is not in the nature of a legal opinion or advice. Copyright reserved.