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## SEBI's New Initiative: SEBI augments governance in Credit Rating Agencies & Mutual Funds



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### Introduction

In its last board meeting of the calendar year 2017, the SEBI Board deliberated on 10 important issues directly affecting the securities market and the securities market intermediaries. The SEBI Board has approved amendments to Regulations relating to Credit Rating Agencies, Listing Obligations and Disclosure Requirements ('LODR Regulations'), Issue of Capital and Disclosure Requirements Regulations ('ICDR Regulations'). The SEBI Board has also approved the additional methods for listed entities to achieve minimum public shareholding requirements. The Board has approved the proposal of floating Consultation Paper for amending SEBI (Investment Advisers) Regulations, 2013. The decisions taken by the SEBI Board<sup>1</sup> will require subsequent amendments to the related Regulations. This article is an analysis and compilation of the decisions taken by the SEBI Board at its meeting and its impact on the securities market.

### Amendments to SEBI (Credit Rating Agencies) Regulations, 1999:

The SEBI Board approved the following amendments to the Regulations of CRAs:

- (i) Increase in the minimum net worth requirement to Rs. 25 Crores (from Rs. 5 Crores). It mandated the requirement of maintaining minimum shareholding of 26% in the CRA for a minimum period of 3 years from the date of grant of registration by the Board. With respect to the foreign CRA, SEBI Board has mandated that the company should be incorporated in Financial Action Task Force ('FATF') member jurisdiction and registered under their law only shall be eligible to promote a CRA in India;
- (ii) SEBI Board has imposed restriction on crossholdings amongst CRAs, whereby no CRA shall: (a) directly or indirectly, hold 10% or more of shareholding and/ or voting rights in any other CRA and (b) Have representation on the Board of any other CRA. However, Pension Funds, Insurance Schemes and Mutual Fund Schemes are not bound by the restriction on such holding. SEBI Board has restricted the acquisition of shares / voting rights in a CRA by another CRA. Acquisition of shares and/or voting rights in a CRA by another CRA beyond 10% shall be permitted only if such acquisition results in change in control with prior approval of SEBI;
- (iii) CRAs shall be permitted to withdraw the ratings subject to the CRA having rated the instrument continuously for a stipulated period and in the manner as may be specified by SEBI from time to

time;

- (iv) On the issue relating to conflict of interest, SEBI Board stated that the CRAs shall segregate their activities other than the rating of financial instruments and economic/ financial research to a separate legal entity.

SEBI Board has stated that a shareholder holding 10% or more shares and/ or voting rights in a CRA shall not hold 10% or more shares and/ or voting rights, directly or indirectly, in any other CRA. Interestingly, restriction is also imposed on having a representation on the Board of peer rating agency. This decision taken by the SEBI Board is with an objective to augment the governance and mitigate the issues of conflict of interest. The proposal sanctioned for higher net worth requirement will encourage CRAs to invest in intellectual capital and build quality infrastructure, thereby paving the way for a world-class industry. The decision taken by the SEBI Board for mandating the requirement of maintaining minimum shareholding of 26% in the CRA for a minimum period of 3 years will ensure greater commitment from promoters in setting-up CRAs. Withdrawal of credit rating by CRAs has been a contentious issue for a very long time. SEBI Board, in its meeting, has addressed the same. SEBI Board has clarified that CRAs shall be permitted to withdraw the ratings subject to the CRA having rated the instrument continuously for a stipulated period. The decision of the SEBI Board intends to avoid abrupt suspension of the rating by the CRAs.

The SEBI circular comes in the wake of abrupt rating downgrades of Amtek Auto, JSPL and Bhushan Steel and Ballarpur Industries in the last few years in which credit ratings agencies had either suspended or downgraded ratings abruptly<sup>2</sup>.

The above decisions taken by the SEBI Board relating to CRAs will be effective only after the SEBI (Credit Rating Agencies) Regulations, 1999 are amended.

### **Amendments to SEBI (Listing Obligations and Disclosure Requirements), 2015:**

The SEBI Board approved the following amendments to SEBI (Listing Obligations and Disclosure Requirements), 2015:

- (i) Disclosure of financial results on the Exchange(s) by issuers of listed debt in line with the corresponding requirements for issuers of listed equity i.e. Statement of Profit and Loss on a quarterly and year-to-date basis and Statement of Assets and Liabilities/ Balance Sheet on a half-yearly basis;
- (ii) Disclosure of annual consolidated financial results to the Exchange(s) in case of issuers having only listed debt – Issuers of listed debt shall disclose their audited annual consolidated financial results on the Exchange(s) within sixty days from the end of the financial year.

The SEBI Board has sanctioned a proposal whereby the disclosures of financial results on the Exchange(s) by issuers of listed debt are in alignment with the corresponding requirements for issuers of listed equity. SEBI Board has also provided for the disclosure requirements for issuers having listed only debt.

### **Additional methods for listed entities to achieve Minimum Public Shareholding requirements:**

The SEBI Board decided to introduce the following two additional methods for achieving Minimum Public Shareholding ('MPS') requirements:

- (i) Qualified Institutions Placement (QIP) and
- (ii) Sale of shares up to 2% held by promoters/promoter group in open market subject to certain conditions for listed companies to comply with the MPS requirement.

With an objective to give effect to the sanctioned proposal, the SEBI Board has approved corresponding amendments to SEBI (ICDR) Regulations, 2009.

Pursuant to the extant provisions – Rule [19A](#) of Securities Contracts (Regulation) Rules, 1957), every listed company shall maintain a public shareholding of at least 25%. Listed companies are permitted to adopt any of the methods to comply with MPS requirements, which includes: (i) Issuance of shares to public through prospectus, (ii) Offer for sale to public through prospectus, (iii) Sale of shares held by promoters through secondary market<sup>3</sup>, (iv) Institutional Placement Programme, (v) Rights issue to public shareholders, (vi) Bonus shares to public shareholders, and (vii) Any other method as may be approved by SEBI under case to case basis.

In addition to the above, SEBI Board has approved two additional methods for achieving MPS requirements i.e. QIP and sale of shares up to 2% held by promoter/promoter group in open market. QIP offers a quick solution to listed entities enabling them to meet MPS requirements apart from meeting their funding requirements. Also, sale of a certain small percentage of shares through open market will facilitate quicker and cheaper compliance for listed entities where promoters hold shares marginally above the threshold limit.

With an aim to increase liquidity in the stock market and reduce share price manipulation, capital markets regulator SEBI is considering another increase in minimum public shareholding requirement from the current 25% to 30% or even 35%<sup>4</sup>. However, as per the SEBI Press Release, this proposal was not discussed and sanctioned by the SEBI Board in its recent meeting.

### **Issuance of refund orders/allotment letters/share certificates through electronic mode:**

As per extant provisions of SEBI (Issue of Capital and Disclosure Requirements Regulations), 2009, refund orders, allotment letters and share certificates are dispatched by way of registered post or certificate of posting, as may be applicable. As a green initiative, SEBI Board approved the proposal of inclusion of electronic mode as a valid method of communicating the allotment advice/credit of shares/unblocking of funds in addition to the present methods.

This decision approved by the SEBI Board is in addition to the decision of mandating the ASBA application for Initial Public Offer. Both these decisions will help the regulator in reducing the time between allotment of shares and listing of shares on the stock exchange. In addition to this, the SEBI Board's decision is in line with the digital initiatives of the Government and would reduce printing costs for the issuer company leading to faster communication and ease of doing business.

### **Norms for Shareholding and Governance in Mutual Funds:**

SEBI Board deliberated on the norms for shareholding and governance in Mutual Funds. SEBI Board discussed on the issue of potential conflict in case of sponsor and its associates or any shareholder of a Mutual Fund having stake or Board representation in Asset Management Company ('AMC') and Trustee Companies of another Mutual Fund. SEBI Board resolved that:

- (i) Sponsor of a Mutual Fund, its associate and/or its group company, and its AMC through the schemes, or otherwise collectively, may not be allowed to: (a) have 10% or more stake in AMCs / Trustee Companies of any other Mutual Funds, (b) have representation on the board of the AMC / Trustee Company of any other Mutual Funds;
- (ii) Any shareholder holding 10% or more stake in an AMC / Trustee Company of a Mutual Fund, may not be allowed to: (a) have 10% or more stake in AMCs / Trustee Companies of any other Mutual Funds, (b) have representation on the board of the AMC / Trustee Company of any other Mutual Funds;

SEBI Board recommended that any existing non-conformity with the said requirements may be aligned within a reasonable time. The restriction on shareholding and representation on the board of the AMC / Trustee Company of any other Mutual Funds is similar to restriction imposed on Credit Rating Agencies (as discussed earlier in this article). The SEBI Board has approved a proposal whereby sponsor of a Mutual

Fund, its associate company and/or its group company, and its AMC through the schemes, or otherwise collectively, may not be allowed to have 10% or more stake in AMCs / Trustee Companies of any other Mutual Funds. The restriction further extends to any shareholder holding 10% or more stake in an AMC / Trustee Company of a Mutual Fund. The decision taken by the SEBI Board is aimed at avoiding any conflict of interest and help in strengthening the governance structure for mutual funds.

The new measure may have an impact on the shareholding pattern of UTI Asset Management Company, requiring its promoters to lower their stake to 10% or below in next one year. State Bank of India, Punjab National Bank, Bank of Baroda and Life Insurance Corporation are having their own mutual funds and at the same time they hold 18.24% stake each in UTI AMC<sup>5</sup>.

### **Proposed framework for listing of Security Receipts issued by ARCs under SEBI Regulations:**

In the Union Budget Speech of 2017-18, the Finance Minister announced that listing and trading of Security Receipts issued by a securitization company or a reconstruction company under the SARFAESI Act will be permitted in SEBI registered stock exchanges, which will enhance capital flows into securitization industry and will be helpful to deal with bank NPAs. Accordingly, SEBI Board approved the framework for listing of Security Receipts issued by Asset Reconstruction Companies (ARCs), under SEBI (Public Offer and Listing of Securitised Debt Instruments) Regulations, 2008.

The SEBI Board has proposed a separate Chapter detailing the framework for listing of Security Receipts. The decision taken by the SEBI Board will enhance the capital flows into the securitization industry. It will also be helpful to deal with the non-performing assets of the bank.

### **Amendments to Regulations relating to REITs & InvITs:**

With an objective to facilitate growth of Infrastructure Investment Trusts ('InvITs') and Real Estate Investment Trust ('REITs'), the SEBI Board has approved certain amendments to the related Regulations. The amendment includes:

- (i) Allowing REITs to invest at least 50% stake in Holding Companies/SPVs and similarly allowing Holding Companies to invest at least 50% stake in SPVs, subject to certain safeguards,
- (ii) Rationalizing the definition of Sponsor group in case of REITs,
- (iii) Enabling investments by REITs in unlisted shares under the 20% investment category,
- (iv) Minor amendments to the REIT and InvIT Regulations for harmonization of the terms and definitions in the Regulations.

The SEBI Board's decision of allowing REITs to invest at least 50% stake in Holding Companies/SPVs will facilitate the REITs listing. On the issue relating to participation by Strategic Investor(s) in InvITs and REITs, SEBI recently issued a circular<sup>6</sup> and prescribed the operational modalities for such participation. Strategic investor(s) shall, either jointly or severally, invest not less than 5% and not more than 25% of the total offer size. The investment manager or manager on behalf of the InvIT / REIT, shall enter into a binding unit subscription agreement with the strategic investor(s), which propose(s) to invest in the public issue of InvIT / REIT. Subscription price per unit, payable by the strategic investor(s) shall be set out in the unit subscription agreement and the entire subscription price shall be deposited in a special escrow account prior to opening of the public issue. The price at which the strategic investor(s) has/have agreed to buy units of the InvIT/REIT shall not be less than the issue price determined in the public issue. The draft offer document or offer document, as applicable, shall disclose details of the unit subscription agreement. The units subscribed by strategic investors, pursuant to the unit subscription agreement, will be locked-in for a period of 180 days from the date of listing in the public issue.

For the other amendments relating to REITs and InvITs, the respective Regulations will be amended in due course.

## **Easing of Access Norms for Investment by Foreign Portfolio Investors:**

SEBI Board noted that a Consultation Paper titled 'Easing of Access Norms for Investment by FPIs' was issued. Based on public comments, the SEBI Board approved the following changes:

- (i) Rationalization of fit and proper criteria for FPIs,
- (ii) Modification in encumbrance obligation to enable statutory payments,
- (iii) Simplification of broad based requirement for FPIs,
- (iv) Discontinuance of requirements for seeking prior approval from SEBI in case of change in local custodian/ Designated Depository Participant (DDP) of FPI,
- (v) Rationalization of procedure for submission of Protected Cell Company (PCC)/ Multi-Class Vehicle (MCV) Declarations and Undertakings and investor grouping requirement at the time of continuance of registration of FPIs,
- (vi) Permitting reliance on due diligence carried out by erstwhile DDP at the time of change of custodian/ DDP of FPIs,
- (vii) Exemption to FPIs having Multiple Investment Managers (MIM) structure from seeking prior approval from SEBI in case of Free of Cost transfer of assets,
- (viii) Simplification of process for addition of share class by FPIs,
- (ix) Permitting FPIs operating under the MIM structure to appoint multiple custodians,
- (x) Permitting appropriately regulated Private Banks/ Merchant Bank to invest on their own behalf and also on behalf of their clients,
- (xi) Expansion of entities considered as "appropriately regulated persons" in terms of Regulation 5(b) (ii) of SEBI (Foreign Portfolio Investors) Regulations, 2014,
- (xii) Permitting broad based funds to regain the status in three months,
- (xiii) Permitting conditional registration to existing India dedicated funds.

The SEBI Board has eased the provisions relating to FPIs by expanding the eligible jurisdictions for registration by including countries with diplomatic tie-ups with India. SEBI Board has rationalized the fit and proper criteria for FPIs and simplified the broad based requirement. The SEBI Board's decision is aimed at easing the process for direct registration for FPIs and at the same time avoiding inflow of money in India through Participatory Notes. The decisions of the SEBI Board will be effective when the SEBI (Foreign Portfolio Investors) Regulations, 2014 are amended or SEBI issues Circular or Guidelines to implement the aforesaid changes.

## **Consultation Paper for "Amendments to SEBI (Investment Advisers) Regulations, 2013":**

SEBI had floated two consultation papers seeking public comments on the clarifications/amendments to the Investment Advisers, Regulations. Based on the feedback received, SEBI Board has approved the following proposals:

- (i) There should be clear segregation between the two activities of the entity i.e. providing investment advice and distribution of the investment products/execution of investment transactions,
- (ii) Mutual Fund Distributors, while distributing their mutual fund products can explain the features of products to client, and shall ensure principle of 'appropriateness' of products to the client.

In relation to decision taken by the SEBI Board, SEBI issued a Consultation Paper on January 2, 2018 to amend the SEBI (Investment Advisers) Regulations, 2013. According to the Consultation Paper, there should be clear segregation between the two activities of the entity i.e. 'providing investment advice' and 'distribution of the investment products/execution of investment transactions'. Individuals who are willing to get registered as 'Investment Advisers' shall not provide any distribution services in financial products, either directly or through any of their immediate relatives. According to the Consultation Paper, the banks, NBFCs, body corporates, LLPs and firms who are willing to get registered as Investment Advisers, shall not

provide any distribution services in financial products, either directly or through their holding company or associate company or subsidiary company. According to the Consultation Paper, existing registered investment advisers who are offering distribution services through immediate relatives or through separately identifiable division or department or through holding / subsidiary / associate company shall choose among providing investment advice or the distribution services before March 31, 2019.

### **Integration of trading in commodity derivatives market with other segments of securities market at exchange level**

Finance Minister, while presenting the Union Budget for the FY 2017-2018, proposed that the commodities and securities derivative markets will be further integrated by integrating the participants, brokers, and operational frameworks. Accordingly, the SEBI Board decided that the integration would be achieved in two phases, as follows:

- (i) Phase - I: Integration at Intermediary level,
- (ii) Phase - II: Necessary steps would be taken to enable a single exchange to operate various segments such as equity, equity derivatives, commodity derivatives, currency derivatives, interest rate futures & debt etc.

With regards to the implementation of the Phase - I, all necessary steps required to enable integration of commodity derivatives market with rest of the securities markets at intermediary's level have been taken by SEBI. With respect to the implementation of the Phase – II, the SEBI Board approved the proposal to remove the restrictions by making suitable amendments to Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporation) Regulations, 2012. The amendments to the said Regulations would be effective from October 1, 2018.

This decision by the SEBI Board would benefit the National Stock Exchange, the Bombay Stock Exchange and the Multi Commodity Exchange, which currently trade in either of the two categories – equity or derivatives. The concept of Universal Exchanges was in the works since the commodities regulator, Forward Markets Commission, was merged with SEBI in 2015<sup>7</sup>.

### **Fees Payable by Stock Brokers Trading in 'Options' in Commodity Derivatives**

On introduction of Options contract in Commodity Derivatives, SEBI Board resolved to amend SEBI (Stock Brokers and Sub Brokers) Regulations, 1992, whereby the manner of calculation of turnover fees for Options contracts in Commodity Derivatives shall be computed the same way as computed for Options contract in Equity Derivatives. The SEBI Board's decision of calculating the turnover fees for Options contracts in Commodity Derivatives in the same way as it is computed for Options contract in Equity Derivatives is linked to the decision taken by the SEBI Board w.r.t. the integration of trading in commodity derivatives market with other segments of securities market at exchange level.

### **Conclusion**

The SEBI Board in its meeting (held on December 28, 2017) discussed and addressed quite a few critical issues of the securities market and the intermediaries in the securities market. However, the SEBI Board has not deliberated on the proposed provisions relating to disclosure by listed companies in case of default in repayment of bank loans or interest. The SEBI Board has also not deliberated on Uday Kotak Committee's recommendations on Corporate Governance norms in India. In the ensuing Board meeting of the SEBI, it is expected that these two issues would be discussed and accordingly the relevant regulations are amended.

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- [1.](#) SEBI PR No. 68/2017 dated December 28, 2017
- [2.](http://www.moneycontrol.com / news/business / sebi-directs - credit-rating - agencies-not - to-withdraw - ratings-abruptly-2473519.html) <http://www.moneycontrol.com / news/business / sebi-directs - credit-rating - agencies-not - to-withdraw - ratings-abruptly-2473519.html>
- [3.](#) SEBI circular CIR/MRD/DP/05/2012 dated February 01, 2012
- [4.](http://www.moneycontrol.com / news/business / economy/sebi - mulls-increasing – minimum - public-shareholding-from-25-to-30-35-2431767.html) <http://www.moneycontrol.com / news/business / economy/sebi - mulls-increasing – minimum - public-shareholding-from-25-to-30-35-2431767.html>
- [5.](http://economictimes.indiatimes.com / articleshow / 62283975.cms?utm _ source = contentofinterest&utm _ medium = text&utm _ campaign=cppst) [//economictimes.indiatimes.com / articleshow / 62283975.cms?utm \\_ source = contentofinterest&utm \\_ medium = text&utm \\_ campaign=cppst](http://economictimes.indiatimes.com / articleshow / 62283975.cms?utm _ source = contentofinterest&utm _ medium = text&utm _ campaign=cppst)
- [6.](#) SEBI/HO/DDHS/CIR/P/2018/10 dated January 18, 2018.
- [7.](http://www.business-standard.com/article / markets / bourses-to-provide - trading-in - stocks-as-well - as-commodities - from-oct-2018-117122800895_1.html) [http://www.business-standard.com/article / markets / bourses-to-provide - trading-in - stocks-as-well - as-commodities - from-oct-2018-117122800895\\_1.html](http://www.business-standard.com/article / markets / bourses-to-provide - trading-in - stocks-as-well - as-commodities - from-oct-2018-117122800895_1.html)