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VOL. XIV- JUNE 2008 ISSUE 4 www.aralaw.com

CAPITAL MARKETS

TOPICS

» Time for new real estate investment vehicles to hit markets

This note highlights a few key aspects/features of some new investment vehicles ready to occupy the real estate investment space in a more innovative and regulated manner;

Real Estate Mutual Funds;

By SEBI Circular dated April 16, 2008, a new Chapter VIA has been inserted in SEBI (Mutual Funds), Regulations, 1996(Regulations) dealing with the Real Estate Mutual Fund Schemes. A Real Estate Mutual Fund (REMF) scheme invests directly or indirectly in real estate assets or other permissible assets in accordance with the provisions and guidelines under the SEBI (Mutual Funds), Regulations, 1996. Every REMF scheme shall be close-ended and its units shall be listed on a recognized stock exchange.

Under the Regulations a real estate asset means an identifiable immovable property which is located within India in cities mentioned in list of million plus urban agglomerations, those million plus cities which appear in Census Statistics of India (2001) or in a special economic zone within the meaning of clause (za) of section 2 of the Special Economic Zones Act, 2005 (28 of 2005);

- on which construction is complete and which is usable; which is evidenced by valid title documents; which is legally transferable; which is free from all encumbrances; which is not subject matter of any litigation;

The term real estate asset shall not include:-

- a project under construction; or vacant land; or deserted property; or land specified for agricultural use; or a property which is reserved or attached by any Government or other authority or pursuant to orders of a court of law or the acquisition of which is otherwise prohibited under any law for the time being in force;

A few of the key aspects of the REMF scheme are as under;

- It is mandatory to invest at least 35 per cent of its corpus directly in real estate assets (ready flats, bungalows, shops). These could be either residential or commercial properties, but must be finished and ready-to-use and not under construction;
- SEBI mandates that at least 75 per cent of the corpus should be invested in real estate or related securities;
- No mutual fund shall, under all its real estate mutual fund schemes, invest more than 30 per cent of its net assets in a single city;
- No mutual fund shall, under all its real estate mutual fund schemes, invest more than 15 per cent of its net assets in the real estate assets of any single real estate project;

Since the amendment notification, RBI has been expressing concerns of REMFs violating foreign direct investment norms in the realty sector. Highlighting that the scheme allowed NRIs and FIIs to invest in real estate sector in conflict with the policy, the apex bank had asked finance ministry to intervene and take up the issue with SEBI. In a clarification to RBI, the finance ministry has stated that investment through REMFs could be allowed as there was no linkage between the investments made by a fund and its investors. REMF investors only own units in the fund and don□t drive its investments decisions on assets. Furthermore SEBI had prescribed several restrictions on investments by REMFs in the Regulations itself so as to take care of any such concerns.

Real Estate Investment Trusts

A Real Estate Investment Trust (□REIT□) is an entity that invests in immoveable property and operates in conjunction with Real Estate Investment Management Company (□REIMC□). Much like mutual funds, an investor can purchase units in the REIT for the specific schemes it promotes.

In India, a proposal to venture into real estate investments was initiated by SEBI, which released its draft regulations on REIT under the SEBI Act, 1992 i.e. Securities and Exchange Board of India (Real Estate Investment Trusts) Regulations, 2008 (□SEBI REIT Draft Regulations□).

The salient features of SEBI REIT Draft Regulations are:

- The REIT scheme will be managed by a REIMC incorporated in India with the objective of organizing, operating and managing real estate investment schemes. The Trust Deed for the REIT should provide for undertaking the real estate investment schemes as per the regulations. The Trustees can be a scheduled bank, trust company, financial institutions, insurance company or a body corporate. Individuals shall not act as trustee.
- The minimum net worth of REIT and REIMC at the time of making application must be Rs. 3 crores which shall be increased to Rs. 5 crores within three years from the date of grant of registration.
- Only close ended schemes with a purpose of investing in real estate and generating returns to unit holders derived mainly from the rental income or capital gains of the real estate is permissible. The net asset value (□NAV□) per unit of a scheme is calculated as and when an annual valuation report is issued by a reputed principal valuer (a firm or the company) for the relevant period. The NAV should be disclosed annually. Credit rating is to be obtained from a Credit rating agency.

- No REIT under all its schemes shall invest more than 25 percent in real estate projects developed, marketed, owned or financed by a group of companies. Investment in partly developed properties is to be allowed only up to 20 percent of its total assets. It cannot invest more than 15 percent in any single real estate project. The scheme is also prohibited from investing in vacant land or engaging or participating in property development activities.
- Restrictions have been imposed on the borrowings to be made by the fund which has been restricted to one fifth of the value of total gross assets of the scheme. Mortgage of assets for obtaining loan is permitted;
- At least 90 percent of the annual net income after tax is to be distributed as dividends each year to unit holders. Valuation of property of the Fund is to be done as per valuation standards on properties published from time to time by the concerned Indian Institute or the International valuation standards issued from time to time.

The new investment channels like REITs & REMFs are likely to open new frontiers of investment in the Indian real state space. This would enable the common masses to invest, participate and own their share of real estate space through these innovative real estate investment vehicles.

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» Special Economic Zones □ An Idian Perspective

INTRODUCTION

In this era of globalization, most developing countries are witnessing a shift away from an import substitution based development strategy to an export promotion policy. A Special Economic Zone (SEZ) is a geographical region that has economic laws more liberal than a country's typical economic laws. By offering privileged terms, Special Economic Zones attract investment and foreign exchange, spur employment and boost the development of improved technologies and infrastructure;

Special Economic Zones were announced by the Government of India in April 2000 as a part of the Export-Import policy of India. The government realized the need to enhance foreign investment, promote exports from the country and at the same time provide a level playing to the domestic enterprises, while ensuring manufacturers to be competitive globally;

BENEFITS OF THE ACT;

The Special Economic Zones Act, 2005 was passed by Parliament in May, 2005 with an aim to (a) generation of additional economic activity ; (b) promotion of exports of goods and services; (c) promotion of investment from domestic and foreign sources; (d) creation of employment opportunities; (e) development of infrastructure facilities;

The basic motive behind developing a Special Economic Zone in India primarily in developing countries is to attract mass foreign investments in the country. The Indian real estate investments have attracted huge foreign funds and thus the Special Economic Zones have increased by and large.

Some of the major incentives and facilities offered to the units in SEZs are duty free import or domestic procurement of goods for development, operation and maintenance of SEZ units, 100% Income Tax exemption on export income for SEZ units, exemption from minimum alternate tax, external commercial borrowing by SEZ units up to US $ 500 million in a year, no import license requirements, exemption from Central Sales Tax and Service Tax levies.

The major incentives and facilities available to SEZ developers include exemption from customs or excise duties for development of SEZs for authorized operations approved by the BOA, income tax exemption on export income for a block of 10 years in 15 years, exemption from minimum alternate tax, exemption from dividend distribution tax, exemption from the Central Sales Tax and exemption from the service tax.

The effects of Special Economic Zones are contingent upon the success of these zones in attracting investment, in particular, Foreign Direct Investment. The government has to ensure that strategies are developed in a timely manner to strengthen the opportunities that are likely to emerge, protect interests of the Special Economic Zones workers, and forge linkages between Special Economic Zones and the domestic economy. Such a regulated and monitored approach is the only means of attaining the actual potential of these Special Economic Zones.

REAL ESTATE AND SEZ

The bout of non-captive real estate development activity in India and the clamour to develop SEZs can partly be explained by the economics of an SEZ and the real estate opportunity.

Given the peaks of SEZs have to offer more and more incentives a mad rush to set up SEZs has begun, and this looks more like a real estate rush than an export rush. The government has allowed up to 75% of the area of SEZs to be used for non-export purposes such as housing, schools, entertainment and banks.

As per a recent survey conducted, of the 191 notified special economic zones (SEZs) in the country, 135□or 71%□are promoted by the private sector. More importantly, nearly 70% of the SEZs promoted by the private sector are non-captive in nature. In other words, the promoters plan to lease it out, fully or partly, to other parties. Thus giving rise to a real estate opportunity;

More insidious is the land-grab taking place in an opaque fashion under this scheme. Unless and until the entire real-estate business is made transparent and legitimate, wherein law-abiding individuals can participate without the fear of the "land mafia", SEZ schemes may not really facilitate earning foreign exchange or attracting FDI. It is indeed sad that many of the State governments have become real-estate brokers. The special economic zones were created for growth, but if they are based on irrational thinking then their true purpose will not be served.

CONCLUSION

Surrounded by controversies of insidious land-grab taking place in an opaque fashion under this scheme resulting in displacement of farmers with meager compensation, generation of little new activity as there may be relocation of industries to take advantage of tax concessions, revenue loss as result of the tax incentives and hidden subsidies being provided to SEZ developers and producers within the zone, acquisition of prime agricultural land, having serious implications for food security, misuse of land by the developers for real estate, and uneven growth aggravating regional inequalities have demonstrated these zones more as Special □Exploitation□ Zone and real estate zones. It can be said that if the government finds a solution to tackle such issues, then these new emerging generation SEZ□s, will widen the scope of human capital formation and technology upgrading and attract huge amounts of foreign direct investment in India.

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» Due Diligence in Real Estate/Immovable Property

Buying an immovable property is a lifetime decision. The real ordeal begins after the property of choice is identified. A buyer needs to be aware of legalities and paperwork involved, so that he doesn□t end up in courts and hence should familiarize with terms such as leasehold, freehold, title deeds, completion/occupation/possession certificates etc. The buyer should make sure that before striking the deal all the documentation is in place and evaluate the title / ownership of immovable property before buying the same. This article is an attempt to educate the concept of immovable property in India and the checks and balances required in India before the immovable property is purchased.

What is Immovable Property?

As per Transfer of Property Act, 1882 *□Immovable Property□* does not include standing timber, growing crops or grass;

As per section 3(26) of General Clauses Act *□Immovable Property□* shall include land, benefits to arise out of land, and things attached to the earth, or permanently fastened to anything attached to the earth.

As per Transfer of Property Act, 1882 *□attached to the earth□* means- (a) rooted in the earth, as in the case of trees and shrubs; (b) imbedded in the earth, as in the case of walls or buildings; or (c) attached to what is so imbedded for the permanent beneficial enjoyment of that to which is attached;

By combined reading of the aforesaid definitions, it can be concluded that, anything which is attached permanently to earth would be considered as immovable property. Set out below are some of the examples of immovable properties:

- buildings, malls, flats, row houses, warehouses etc. are immovable properties.
- a fruit bearing tree would not be standing timber, and would be classed as immovable property.
- Grass is movable property, but a right to cut grass would be an interest in the land and therefore immovable property.
- Lease hold rights in a land or flat is immovable property;

Due Diligence;

□Due Diligence□ as such is a measure of prudence, activity, as is properly to be expected from, and ordinarily exercised by, a reasonable and prudent man under the particular circumstances; not measured by any absolute standard, but depending on the relative facts of the special case□;

The most important factor in a due diligence of immovable property is to be considered whether the Vendor (seller/owner) of the property has a good title which is free from any or all encumbrances and beyond reasonable doubt. It should be checked whether (i) the property is transferable and heritable, (ii) the Vendor is competent and/or authorized to transfer the property, (iii) the transferee is qualified to be a transferee, (iv) the object or consideration for the transfer is lawful, and (v) the transfer has been made and completed is the manner prescribed by law;

In order to determine the good title of the Vendor, an investigation of the title is required to be conducted of the immovable property. Following searches are required to be conducted in addition to the review of the ownership documents i.e., sale deed or conveyance or will (will is required to be probated in case of state of Maharashtra).

- Search at the office of Sub-Registrar of Assurances (35-40 years) ☐
  - [as per Article 61 of the Limitation Act 1963 the period of redemption of the mortgage is 30 years]; Objective: It can determine as regards, who the owner of the property is and whether any charge or encumbrances are created for the said Property or against the owner;
- Search at the office of Registrar of Companies
  - [now MCA]; Objective: In case of a Company (private or public) it can determine whether the property has been charge / encumbrances with any bank / financial institution or any other persons for rising funds;
- Public Notice in two local news paper one in English language and another in local language;
  - Objective: If any third party has any claim against the owner or against the property, then a claim can be notified and an action can be initiated against the vendor;
- Search at the office of Municipal Corporation of Grater Mumbai;
  - Objective: In order to determine the development plan in which for which the property is assigned under the Development Control Plan 1991;
- Search at the office of Collectors (if the land is owned or leased by the Collectors land);
  - Objective: In can be determined whether a Collectors NOC is required for transferring the land or flat in favour of the purchase;

Whilst reviewing the ownership documents i.e., sale deed or conveyance, it is very important to trace how the title of the ownership of the property is passed in favour of the Vendor. Further, additional documents may have to be revised like partnership deeds, settlements deeds between partners, family settlements etc.;

Verification of the Stamping and & Registration of the ownership documents;

It is important to verify whether the ownership documents are adequately stamped and registered with the office of sub-registrar of assurance. If the same is not done, then the title is defective (imperfect). However, if there is defect in stamping the Agreement (sale deed / conveyance) then the same can be rectified by making paying the penalty under the provisions of Stamp laws of the state and get the Agreement stamped. If registration is not done within the timeline provided under the Registration Act, then in that case, the same is not possible as the timeline as per the Registration Act is lasped;

Conclusion:

It is extremely important to get the due diligence done prior the immovable property is purchased. If the same is not done, than it is possible that the acquirer may land up with the immovable property which may not have a clear title (defective title).

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» Non pooling mandate for Portfolio Managers: Analysis & Implications

Portfolio Managers registered and regulated under the SEBI (Portfolio Managers) Regulations, 1993

(☐PMS Regulations☐) since long have been operating products wherein they pool the monies of all the clients to form a common investible corpus and invest on their behalf in select portfolio companies. This practice defied the very sanctity behind the PMS Regulations which contemplates a Portfolio Manager to cater to the individual and specific needs and manage tailor-made specific investment portfolios for it☐s different clients separately.

In order to address the concerns as raised above, SEBI vide its Press Release No. 104/2008 dated May 13, 2008 declared that *Portfolio Managers should not float a scheme or pool the resources of the client in a way which is akin to mutual fund activity. Accordingly, Portfolio Managers will not be permitted to float a scheme or pool the resources of the clients. They would be required to keep assets of each client separately and not in a pooled manner. A time frame of 6-months from the date of notification has been given to convert their operations managed on pooled basis to individual basis.* The necessary amendments would be made to the Regulations, which are being awaited.

The regulatory intent behind the above dictate is clear. SEBI requires a portfolio manager to maintain it☐s client securities in a separate custody account individually for all it☐s clients. It also requires all the client☐s monies to be kept in a separate individual clients☐ bank account. There should be no pooling of either cash or securities at any stage. This will also envisage that the securities are held in the clients name and not in the name of the portfolio manager. Although intended to be a step towards ensuring greater transparency amongst the portfolio managers rendering Portfolio Management Services (PMS), the implications would be manifold. The exact language of the change being proposed in the Regulations is still awaited.

Current practice

Fund managers pool-in the investments received from clients and invest on behalf of the group of investors. Such bulk buying and selling provides the benefit on size, cost and time. The bunch of stocks purchased are then allotted in proportion to the clients☐ portfolio as per their investments into the PMS. Hence, there is a minimum documentation involvement and also easier operations for the PMS provider.

Implications & Analysis

The intent of the Regulator behind the move is to make investments through PMS lot more transparent and investor friendly, but the same would definitely result in an increase in documentation and administrative costs for the Portfolio Managers. A few of the findings could be analyzed and summarized as under:-

- It is surely an investor-friendly step which SEBI has aimed at. Though the major concern for the Portfolio Managers as a result of the SEBI dictum would be an increase in their workload as they would be under an obligation to maintain separate accounts and records of the assets of each client.
- With the amended law in place, even brokerages will be forced to execute trades for each and every client separately which under the pool system they had been executing trades for hundreds of clients at one go. Hence brokerages will be forced to pass on additional transaction costs in form of multiple number of trades to customers and would hence need more number of people to run their operations.
- SEBI has provided for a time frame of six months for PMS providers to adopt themselves with the changed regulations. Thousands of crores of investor☐s monies are housed in various portfolio management schemes, of which majority is operated in the pool format. Hence, it would be a big challenge in front of the Portfolio managers in next 6 months to try designing

the portfolios in a prescribed manner, i.e. individually for the clients instead of the joint operations carried on as of now.

Concluding remarks

As a result of the possible amendment to PMS Regulations on lines of the SEBI Press Release, the operational and administrative costs are likely to increase substantially for the portfolio managers and they would also be deprived of the advantages of operating on a large scale. The greatest task in front of the industry participants would now be to find new solutions to reduce transaction cost under the proposed regime, comply with the investor disclosure norms, and provide better services to the investors.

The major concern confronting the industry players has been the questionable fate of their currently running schemes which already have hundreds or thousands of investors invested in them. Whether should they wind up their schemes, or should look forward to convert the same within six months as per SEBI dictate, has been the big cause of concern. The time frame provided appears to be too short to take any concrete decisions, and a retrospective applicability on the presently running schemes would act as a real hardship from the administrative, operational and economic point of view for the portfolio managers. Also, the proposed amendment to the PMS Regulations, have come at a time when along with the high net worth individuals, many of the small investors had started availing the PMS services. This was in lieu of the fluctuating stock market conditions, wherein the investment through a PMS appeared to be a rather safer mode of investment for the small investors, as they could rely on the large scale research and investment abilities of the Portfolio Manager instead of investing in their own wisdom.

The SEBI step may prove to be in the interest and benefit of the investors in the longer term, but it□s immediate impact might be a cause of concern. SEBI is expected to provide some more clarity and insight on its intent in this regard soon.

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» Legal Snapshots

RBI- Reserve Bank of India:

Security for External Commercial Borrowings □ Liberalization

The Reserve Bank vide it□s circular RBI/2008-09/92 A. P. (DIR Series) Circular No. 01 dated July 11, 2008 issued the following guidelines relating to External Commercial Borrowings:

- According to the existing ECB guidelines, the choice of security to be provided to the overseas lender / supplier for securing an ECB is left to the borrower;
- Proposals for creation of charge on behalf of the borrower to secure the ECB under automatic / approval route are considered by the Reserve Bank; As a measure of rationalization, AD Category - I banks have been allowed to convey □no objection□ under (FEMA) for creation of charge to secure the ECB;
- They would have to ensure beforehand that it is in compliance with the ECB Guidelines and that the security clause exists in the Loan Agreement;
- It is important that both parties sign it and the loan registration number should also be obtained; This □no objection□ can be granted only to a resident ECB borrower and the period

has to be co-terminus with the maturity of the ECB; It is not to be construed as ☐permission☐ to acquire immovable assets in India;

- In the event of enforcement / invocation of the charge, the immovable asset (property) will have to be sold only to a person resident in India and the sale proceeds shall be repatriated to liquidate the outstanding ECB;
- AD Category ☐ I banks may convey their 'no objection' under FEMA, 1999 to the resident ECB borrower for the pledge of shares of the borrowing company held by promoters as well as in domestic associate companies of the borrower to secure the ECB subject to the following conditions:
    - The period of such pledge shall be co-terminus with the maturity of the underlying ECB;
    - In case of invocation the transfer shall be in accordance with the extant FDI policy.
    - A certificate from the Statutory Auditor of the company stating that the ECB proceeds have been / will be utilized for the permitted end-use is required:
- The ☐no objection☐ may be conveyed after obtaining ☐
    - The Board Resolution for issue of corporate guarantee from the company issuing such guarantees, specifying names of the officials authorized to execute such guarantees on behalf of the company or in individual capacity;
    - Specific requests from individuals to issue personal guarantee indicating details of the ECB;
    - The period of such corporate or personal guarantee should be co-terminus with the maturity of the underlying ECB.
- AD Category ☐ I banks may specify that the ☐no objection☐ should not be construed as an approval by any other statutory authority or Government under any other laws / regulations.
- If further approval or permission is required from any other authority or Government under the relevant regulations, the applicant should do so before undertaking the transaction.

Overseas Direct Investment by Registered Trust / Societys

The Reserve Bank vide its Circular No. RBI/2007-08/ 387A. P. (DIR Series) Circular No. 53 dated June 27, 2008 declared that:

- In order to liberalize the policy on overseas investments, Registered Trusts and Societies engaged in manufacturing / educational sector will now be allowed to make investments in a Joint Venture or Wholly Owned Subsidiary outside India, with the prior approval of the Reserve Bank.

- Trusts / Societies satisfying the eligibility have to submit the application/s in Form ODI-Part I, through their AD Category - I bank/s. The application is to be then sent to RBI for consideration.

Criteria for Overseas Investment by Registered Trust / Society;

Trust:

- The Trust should be registered under the Indian Trust Act, 1882;
- The Trust deed should permit the proposed investment overseas;
- The proposed investment should be approved by the trustee/s;
- The Authorized Dealer bank should be satisfied that the Trust is KYC (Know Your Customer) compliant and is engaged in a bonafide activity;

- The Trust should have been in existence for at least three years;
- The Trust should not have come under the adverse notice of any Regulatory / Enforcement agency like the Directorate of Enforcement, CBI etc.

Society:

- The Society should be registered under the Societies Registration Act, 1860;
- The Memorandum of Association and rules and regulations should permit the Society to make the proposed investment and it should be approved by the governing body / council or a managing / executive committee;
- The Authorized Dealer bank should be satisfied that the Society is KYC (Know Your Customer) compliant and is engaged in a bonafide activity;
- The Society should have been in existence for a period of atleast three years;
- The Society should not come under the adverse notice of any Regulatory / Enforcement agency like the Directorate of Enforcement, CBI etc.

Valuation of Non-SLR Securities issued by the Government of India

The Reserve Bank vide its circular RBI/2007-2008/376 RPCD.CO.RF.BC.No.79 /07.02.03/2007-08 dated 23rd June, 2008 has amended the provisions relating to the valuation of Non-SLR Securities:

- The Government of India has, from time to time, issued several special securities which do not qualify for the purpose of complying with the SLR requirements of State / Central co-operative banks;
- Such Government securities are governed by a separate set of terms and conditions and entail a higher degree of illiquidity spread;
- The guidelines issued by FIMMDA regarding the valuation of such non-SLR securities provide that such securities be valued by applying a mark-up of 50 basis points (bps) above the corresponding yield on Government of India securities;
- The issue of valuation of such special securities has since been examined and it has been decided that, for the limited purpose of valuation, all special securities issued by the Government of India, directly to the beneficiary entities, which do not carry SLR status, may be valued at a spread of 25 bps above the corresponding yield on Government of India securities; This amendment would come into force from the financial year 2008-09;
- At present, such special securities comprise of Oil Bonds, Fertilizer Bonds, bonds issued to the State Bank of India (during the recent rights issue), Unit Trust of India, Industrial Finance Corporation of India Ltd., Food Corporation of India, Industrial Investment Bank of India Ltd., the erstwhile Industrial Development Bank of India and the erstwhile Shipping Development Finance Corporation.

Interest on Exchange Earner's Foreign Currency (EEFC) Account

As per A. P. (DIR Series) Circular No. 04 dated August 4, 2008, RBI has reviewed the A.P. (DIR Series) Circular No.13 dated October 6, 2007 which stated that all exporters were permitted to earn interest on Exchange Earners' Foreign Currency (EEFC) accounts to the extent of outstanding balances of USD 1 million per exporter. It has decided to withdraw such facility from November 01, 2008. Accordingly, with effect from November 01, 2008 all EEFC accounts shall only be permitted to open and maintain non-interest bearing current accounts.

PRICING NORMS FOR ADRs & GDRs LIKELY TO BE MODIFIED;

The Corporates raising equity capital overseas, are likely to get more flexibility in pricing the American Depository Receipts (ADRs) and Global Depository Receipts (GDRs). This arises out of the concerns raised by many of the corporate houses regarding the current pricing norms under the existing regulations, pursuant to which their offerings are not likely to find many takers in light of the sluggish market conditions;

As per the current regulations, companies have to price their issue at the higher point of the preceding six months' average price or last 15 days' average price before the issue. As there has been a sharp fall in prices over the past few months, the fear is that in most of the cases the 6-month average would become the benchmark. This price in majority of the cases would be a lot higher than the current prevailing price;

The Finance Ministry has proposed that the period of trading used to compute the price at which equity shares could be issued in global markets may be shortened. The intention being to compress it to a higher point of the two months☐ average price (i.e. from the current six months) or 15 days average price preceding the decision to issue shares overseas. There may be some other alternatives as well which could be considered by the Finance Ministry;

The intent would be to make the issue price more realistic, and closer to the current existing price in the market. The final changes are likely to be notified by the Government shortly after reviewing the public comments..

SEBI ☐ Securities Exchange Board Of India

SEBI vide its circular dated May 05, 2008 has set out a Comprehensive Risk Management Framework for the cash market. In order to improve the efficiency of the use of the margin capital by market participants and as an initial step towards cross margining across cash and derivatives markets, margins shall be levied on cash market position which have off-setting stock futures positions in the derivatives market as given below:

- Cross margin facility will be available initially for institutional trades;
- Cross margin facility will be available to positions in cash market having corresponding off-setting positions in the stock futures market;
- For positions in the cash market which have corresponding off setting positions in the stock futures, VaR margin shall not be levied on the cash market position to the extent of the off-setting stock futures market position;
- Extreme Loss Margin and Market to Market Margin shall continue to be levied on the entire cash market position;
- Near month stock futures positions shall not be considered for cross margin benefit three days prior to expiry (as currently being done in the case of calendar spread.); There will be no change in the margins on the F&O positions.

The Stock Exchanges have been advised to:

- Put in place the adequate systems and issue the necessary guidelines for implementing the above decision;
- Make necessary amendments to the relevant bye-laws, rules and regulations for the implementation of the above decision;
- Bring the provisions of this circular to the notice of the member brokers/clearing members of

the Exchange and also to disseminate the same on the website;
- Communicate to SEBI the status of the implementation of the provisions of this circular in the Monthly Development Report:

Modifications to FII investments in Debt Securities:

SEBI, vide its circular dated June 6, 2008 has enhanced the cumulative debt investment limits from US $3.2 billion to US $5 billion and US $1.5 billion to US $3 billion for FII investments in Government Securities and Corporate Debt respectively. The enhanced limits shall be allocated among the FIIs on a ☐first come first served basis in terms of the circular dated January 31, 2008 subject to a ceiling of US$200 million per registered entity.

SEBI notification on Short Selling and Securities Lending and Borrowing and Net Settlement of Government Securities Transactions.

SEBI, vide circular No. 6/127947/08 dated June 6, 2008 has notified that the existing mutual funds scheme may engage in short selling of securities as well as lending and borrowing of securities after making additional disclosures including risk factors in the Scheme Information document. This is in accordance with clause 5 (ii) (b) of SEBI circular dated May 23, 2008.

Parking of funds in short term deposits of scheduled commercial banks by mutual funds.

The SEBI vide Circular no. 7/129592/08 dated June 23, 2008 has clarified the following points in parking of funds in short term securities:

- SEBI vide notification dated April 16, 2007 had dealt in detail parking of Funds in Short Term Deposits of Scheduled Commercial Banks by Mutual Funds. It has been clarified that the said circular shall not apply to term deposits placed as margins for trading in cash and derivatives market;
- Earlier, SEBI circular dated October 26, 2007 dealing with ☐Parking of funds in short term deposits of scheduled commercial banks by mutual funds-Pending deployment☐ stands withdrawn;
- All term deposits placed as margins shall be disclosed in the half yearly portfolio statements under a separate heading. Details such as name of bank, amount of term deposits, duration of term deposits, and percentage of NAV may be disclosed.

Establishment of Connectivity with both depositories NSDL and CSDL Companies eligible for shifting from Trade for Trade Segment (TFTS) to Rolling Segment.

SEBI vide its circular dated June 25, 2008 has clarified that the stock exchanges may consider shifting the trading in the securities to rolling settlement subject to the following norms:

- At least 50% of other than promoter holdings as per clause 35 of Listing Agreement are in dematerialized mode before shifting the trading in securities of the company from TFT segment to Rolling segment. For, this purpose, the listed companies shall obtain a certificate from its Registrar and Transfer Agent (RTA) and submit the same to the stock exchange/s.;
- There are no other grounds/ reasons for continuation of the trading in TFTS.

Mandatory Requirement of Permanent Account Number.

- SEBI vide its circular dated June 30 2008 has clarified that PAN may not be insisted in the case of Central Government, State Government, and the officials appointed by the courts e.g. Official liquidator, Court receiver etc. (under the category of Government) for transacting in the securities market;
- This would be subject to the intermediaries verifying the veracity of the claim of the specified organizations, by collecting sufficient documentary evidence in support of their claim for such an exemption;
- The Stock Exchanges and the Depositories are advised to:
    - make necessary amendments to the relevant bye-laws, rules and regulations for the implementation of the above decision immediately;
    - Bring the provisions of this circular to the notice of the member brokers/ clearing members of the Exchange and depository participants of the Depositories and also to disseminate the same on the website;
    - communicate to SEBI, the status of the implementation of the provisions of this circular in the Monthly Development Report.

FII investments in Debt Securities.

SEBI vide its circular dated July 4 2008 has now decided to grant a period of up to 5 business days for replacement of the disposed off/matured debt instrument/position along with other conditions such as:

- It shall be the duty of the respective custodians to monitor and provide information of the unutilized limit on an event basis upon expiry of the five day period;
- Any unutilized limit shall stand withdrawn and the same shall be allocated to the next waitlisted entity;
- It is further clarified that switch by way of sell off and replacement between government securities and corporate debt would not be allowed due to individual limits applicable for these investments.

Designated e-mail ID for regulatory communication with SEBI.

SEBI has been communicating with the registered market intermediaries, stock exchanges and depositories etc. through circulars, letters, directions etc. SEBI has already put in place a system for issuance of digitally signed circulars with respect to stock exchanges, depositories and merchant bankers. Now, SEBI vide its circular dated July 7, 2008 has designated e-mail ID for regulatory communication with SEBI. In line with the above, it has decided.

- To extend the system of issuance of digitally signed circulars to all other registered intermediaries;
- All registered intermediaries are required to create a designated email id for regulatory communications. This email id should not be a person centric email id.

Amendments to SEBI (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999

SEBI vide its circular dated August 04, 2008 has set out the following amendments in the SEBI (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999 (hereinafter referred to as the ☐SEBI (ESOS & ESPS) Guidelines☐).

Eligibility of nominee directors for ESOS

- A director, nominated by an institution as its representative on the Board of Directors of a company, is eligible to participate in the ESOS of the company, if the contract / agreement entered into between the nominating institution and the director so appointed specifically provides for acceptance of ESOS of the company by such director and a copy thereof is filed with the company.

Accounting treatment for options granted under graded vesting schemes

- As maintained by SEBI (ESOS & ESPS) Guidelines, where an ESOS provides for graded vesting of options, the vesting period is determined separately for each portion of the option and the accounting value of each such portion is amortised on a straight-line basis over the vesting period of that portion;

- The Institute of Chartered Accountants of India (ICAI), which prescribes the accounting treatment for employee stock options through its Guidance Note on ☐Employee Shared Based Payments☐, has, vide its Announcement issued in March 2007, revised the accounting treatment, reorganisation and measurement of options granted under graded vesting schedule and it has been decided to amend the SEBI (ESOS & ESPS) Guidelines to bring the accounting treatment prescribed by SEBI, for options granted under graded vesting, in line with the accounting treatment provided by ICAI in this regard.

Delisting Norms To get Fair Face

It has been proposed that the companies in which the public shareholding is marginally above the mandatory requirement for remaining listed would be able to delist only if at least 50% of the public shareholders respond to its buyback offer. According to the current norms, if shareholding falls below the minimum prescribed level, then the company can go in for voluntary delisting. The revised guidelines are being vetted by the law ministry and are expected to be notified after receiving its assent from the ministry.

The draft notification which was issued by the finance ministry in 2006 did not address the issue per se but listed out certain conditions necessary to delist their securities from a recognized stock exchange namely.

- That the securities of the company should have been listed for a minimum period of three years on a recognized stock exchange;
- Delisting of such securities should been approved by three- fourth of the shareholders in the general body meeting;
- The promoters and the Directors of the company must commit to purchase the outstanding securities of the minority and non-promoter holders

While all this would make the process of delisting simpler, these proposed norms would ensure its fairness on the shareholders as well as promoters of the company.

NEWS ARTICLES:

Listing Norms may allow staggered State Dilution:

In order to give the promoters an option to offload their stakes in a phased manner, the Government is planning to make modifications to its proposed amendments in the listing norms for Companies. The government is of the view that such companies should be allowed to dilute promoter stake up to a certain percentage so that , till that time the public shareholding can get a minimum prescribed share of the company.

- The Finance Ministry has prescribed 25% minimum public holding in an earlier discussion paper, the figures of which are indicative and could even be less;
- The discussion paper had also anticipated that if the public holdings fall below 25% then the promoters, management and the company shall be jointly and severally liable to bring it to 25% within three months or would have to face action which includes delisting of the company as well;
- On further review it has been decided that the time frame of three months was too little and they are now in the process of evolving a phase-out schedule which would be more feasible and wouldn□t lead to a sudden fall in the share valuation due to the offloading of the promoters;
- After the phase out period, if the stock exchanges find that a company has not complied then it may give a three months notice to comply with the requirements, following which the company would have to face action;
- This proposed norm would also strip stock exchanges and capital market regulators to give exemptions to companies, including public sector ones.

The philosophy behind amending the listing norms is to bring about uniformity and simplicity in the rules and to reduce volatility in the market by reducing concentration of shares in the hands of few and thus the government is expected to finalize the proposed norms in a few months.

Stamp Duty Could Slow March to Limited Liability Partnerships;

The new anticipated corporate form, Limited Liability Partnership (LLP) is to be legislated soon. The Ministry of Corporate Affairs claims that at least half of the country□s 8.65 lakh registered companies would convert themselves into LLPs attracted by the ease in organizing the internal structure of this corporate vehicle. The main optimistic points of this type of an entity would be:

- This would help the partnership firms to expand and use the availability of twin benefits i.e. to have any number of partners as opposed to the limit of 20 in case of partnership firm and secondly would have a corporate like limited liability;
- Another important attraction of LLP form is to have the option to choose the taxation system appropriate to the type and size of the business. The government is still pondering over the question whether the LLP should be taxed as corporate or in the hands of the partners or whether to give the option to the LLP management. The modified bill is silent on this and the corporate affairs ministry is of the opinion that since all the tax matters of the tax entities are governed under the Income Tax Act 1961, the taxation of LLP shall also be addressed and be governed by the same;
- LLP is a suitable option for accepting professionals whose contributions would be in terms of intangible assets (technical skills) rather than capital;
- In addition to the above stated points one of the most underlying feature is that even though LLP is a separate legal entity and would be considered as one which requires perpetual succession, it will virtually be governed by the agreement amongst the partners.

IInspite of all the benefits the reasons why the companies may not be willing to convert to a LLP form of corporate entity because such conversion is potentially a taxable event and the degree of additional potential freedom that the LLP form would allow might not manifestly offset this disadvantage as transferring of such assets would attract stamp duty under the current laws..

New Bankruptcy Laws.;

The Government□s proposal to change the laws relating to sinking companies is facing a few road blocks.

A few aspects and developments in this regard, could be highlighted as under;

- The proposed law would have to be made in accordance with the Securities &Reconstruction of Financial Assets &Enforcement of Security Interest Act,2002;
- The new law is said to be a □sophisticated bankruptcy and restructure proceedings□ and is to be introduced in Parliament by the Ministry of Corporate Affairs soon;
- The Bankruptcy Code has been drafted to ensure that an opportunity for rehabilitation should be provided and liquidation of the company should be resorted to only if revival is an impossibility;
- The proposed new National Company Law Tribunal (NCLT) would also issue a stay on the creditors□ claims to provide the managers with time to find solutions; It is also designed to be less tedious and time consuming and would discourage companies from filing for bankruptcy simply to avoid payments;
- It is meant to channelize resources into more effective business solutions and close unviable ones;
- The new law would also be delayed due to the decision that the Supreme Court has to take regarding the replacement of the Board for Industrial and Financial Reconstruction (BIFR) with the proposed NCLT;

India Inc can bring in more dollars now;

The Government has liberalized the norms for inflow of external debt capital. Companies can now bring in for rupee expenditure a larger proportion of the debt they raise abroad and borrow at a higher rate than in the past.

- The terms are more liberal for infrastructure companies and FII□s can invest 70% more cumulatively in government and corporate bonds;
- The Finance Ministry in consultation with RBI has raised the limit to $100 million for infrastructure companies and $50 million for the rest. The approval of the Central Government though would still be required; '
- Finance Ministry has also raised the interest ceiling of overseas borrowings. Companies will be able to borrow at a higher interest rate and it would benefit smaller companies;
- For a loan of average maturity period of between 3-5 years the cost has been raised to six month LIBOR plus 200 basis points and for a period more than 5years it is six-month LIBOR plus 350 basis points;
- In order to strengthen the debt market the limit on government bonds by foreign investors is now $5billion and $3billion on corporate bonds;
- This would definitely increase FII interest in the Bond Market and also provide the much needed liquidity.

SEBI Proposes changes in shareholding pattern

- Under the current SEBI regulations, shareholders, directors and officers of companies have four working days within which to intimate the company regarding changes in their shareholding or voting rights. The SEBI proposal seeks to shrink this to one working day;

- Directors and officers of a listed company have to disclose their holding upon assuming office;
- They have also to disclose changes in their shareholding; or if the change exceeds Rs 5 lakh in value or 25,000 shares or 1 per cent of total shareholding or voting rights, whichever is lower;
- Also persons crossing the mark of 5 per cent voting shares and those with more than 5 per cent stake will have to report the changes in the shareholding, if the change exceeds 2 per cent voting rights. The time limit for disclosure to the company in all the above cases is currently 4 working days.

Money laundering act to have more teeth;

The government has decided to bring casinos, credit cards and money changers under the ambit of money laundering law. An approval has been granted for the introduction of Prevention of Money laundering (Amendment) Bill, 2008 in Parliament. After this amendment it will become mandatory for financial intermediaries to report all suspected transactions involving international transfers to the Financial Intelligence Units (FIUs). Hitherto only banks and other financial institutions have to report suspicious transaction on a regular basis to the FIUs under the finance ministry.

This bill will arm the government with more powers to prevent the flow of foreign currency coming into country via illegitimate channel and making its way to terror organization. The bill will give more teeth to the legislation with provisions for punitive actions for money laundering. Prevention of Money Laundering Act was enforced in 2005 to prevent money laundering and provide for attachment, seizure and confiscation of proceeds of crime obtained, directly or indirectly from such activities.

Press Note 7 □ cut in FDI in selected sector;

The Department of Industrial Policy & Promotion (Dipp) has issued Press Note 7, 2008 restricting foeign direct investment in retail trading, atomic energy, lottery business, gambling and betting, chit fund business and trading in transferable development rights. The latest Press Note is a summary of the extent FDI policy of the government;

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