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CAPITAL MARKETS

TOPICS

» SEBI issues Guidelines for Capital Protection Orientation Scheme

SEBI has Vide Notification No. S.O. No.1254 (E) dated August 3, 2006 issued guidelines for Mutual Funds to issue a new scheme called Capital Protection Oriented Scheme (□CPO Scheme□).

The main features of the scheme are as follows:

1. A CPO Scheme means □a mutual fund scheme which is designated as such and which endeavors to protect the capital invested therein through suitable orientation of its portfolio structure;
2. The mutual funds shall disclose in the offer document, Key Information Memorandum (□KIM□) as well as in the advertisements that the scheme offered is □oriented towards protection of capital□ and □not with guaranteed returns□. It should also be indicated that the □orientation towards protection of the capital originates from the portfolio structure of the scheme and not from any bank guarantee, insurance cover□;.
3. The units of the scheme should be rated by a registered credit rating agency. Moreover, the ratings should be reviewed on a quarterly basis;
4. The scheme should be close ended;
5. The listing of the scheme in a recognized stock exchange within 6 months from the date of closure of the subscription is not mandatory;
6. The scheme should comply with other requirements as may be specified by SEBI in this regard.
7. The Asset Management Company (□AMC□) should not purchase units of the scheme before the end of the maturity period.

Experts feel that a significant portion of the fund □- say 80-85% □- will be invested in highly rated debt instruments like government securities ensuring protection of capital to a large extent while the rest would be invested in equity.

In this respect, CPO Scheme draws from Fixed Maturity Plans Schemes (□(FMP Schemes□). FMP Schemes, which are close-ended debt-oriented funds, invest in debt instruments and the yield is locked in till the maturity of the scheme to curtail interest rate risk.

In some ways, the capital protection scheme is a form of an Assured Return Scheme, which SEBI had banned some years back. The key difference here is that the Asset Management Company (☐AMC☐) is assuring the investor of protecting his capital, and not returns, as used to be the case earlier.

The close-ended structure will enable the fund manager to manage the portfolio without any worries about redemptions and fresh inflows given the pre-defined maturity period. For investors this is a good sign but means blocking of funds and hence investors should make sure that they invest only that portion of their capital which they will not need in the near future.

The AMC will have to get the proposed portfolio structure (indicated in the offer document and the KIM) of the CPO Scheme rated by a SEBI-registered credit rating agency. The objective of this requirement is to assess the degree of certainty for achieving the objective of capital protection. Also as per SEBI's guidelines, the rating should be reviewed on a quarterly basis and the AMC should ensure that the debt component of the portfolio structure has the highest investment grade rating (AAA, P1+ for instance). Thus, the investor will draw comfort from the rating knowing that the portfolio quality is under a constant regulatory watch.

Industry watchers feel that the scheme will bring a lot of retail money into the mutual fund industry. CPO Schemes can serve as a good transition product for low risk investors who primarily invest in fixed deposits, public provident fund schemes and National Saving Certificates and have so long avoided the mutual funds because of the market linked nature of the yield.

as However, there exists lack of clarity as to how the capital guarantee clause will be ensured if there is a loss of capital. Also, CPO Schemes are particularly attractive only during a high interest rate regime when locking the yield at higher level makes sense and as per the current scenario when yields are low they may seem unattractive..

[TOP]

» Revisiting the Participatory Notes Debate

Participatory notes (☐PNs☐) are instruments used by foreign funds / investors who are not registered with the Securities and Exchange Board of India (☐SEBI☐) but are interested in taking exposure in Indian securities. Foreign Institutional Investors (☐FIIs☐) that do not wish to register with the SEBI but would like to take exposure in Indian securities also use the participatory notes.

The problem with PNs.

The Lahiri Committee, set up to check the ☐Vulnerability of the Capital Market to Speculative Flows☐, described PNs as akin to ☐contract notes issued against an underlying security, usually to investors that are not otherwise eligible to invest in India☐. The problem, as this definition suggests, is that they are not a direct and transparent investment and can sidestep the stringent Know Your Customer (☐KYC☐) rules that are required to be followed by Indian investors in the domestic markets. Investment through PNs creates an unequal playing field between Indian and overseas investors in terms of disclosure, identification and transparency.

It is estimated that over Rs.40, 000 crore of PNs have been issued abroad by foreign brokers and are actively traded in some markets. Reliable reports say that a significant chunk of PN subscriptions come from tax-evaded domestic money which round-trips its way to the Indian capital market. This exposes bad policy making, poor revenue collection systems and the Finance Ministry□s double standards. The Finance Ministry is focussing on squeezing more taxes out of legitimate domestic tax payers (fringe benefit tax, cash withdrawal tax, cash-flow statements and passing on tax collection responsibility to the people, education cess etc.) but the bigger leakage of taxable income is apparently escaping its attention. Worse, they enjoy tax exemptions by routing money through tax haven countries. The money might even be linked with such illegal activities as smuggling and drug-running.

Giving Hedge funds a free run of our market mocks domestic investors who have to adhere to strict disclosure norms and KYC rules. It is especially unfair since Indian investors are still not allowed to invest abroad, except in a limited way through mutual funds. Though FIIs registered with SEBI are bound to give details of their direct investment in India, the investments through PNs (a kind of legally accepted derivatives in many overseas markets and not a legal instrument of trading in India), do not strictly fall in the regulatory domain of SEBI. As they follow applicable overseas rules and practices, it is difficult for the Indian regulator to coax FIIs present in the local market into divulging trading details on an instrument issued mostly by their overseas associates or parents.

S.S. Tarapore Committee Report on PNs

The S.S. Tarapore Committee on Fuller Capital Account Convertibility, in its Report submitted recently to the Reserve Bank of India (□RBI□), by a 2-1 majority has recommended that Foreign Institutional Investors (□FIIs□) be prohibited from raising fresh money through Participatory Notes (□PNs□) and suggested that existing PNs be phased out within a year by providing an exit route.

Dissenting member A.V. Rajwade said that the PN issue had already been extensively debated by the Lahiri Committee and the views of the same should be respected. The Lahiri Committee, while taking note of the possibility of misuse of the instrument, had favoured the continuation PNs with the rider that □SEBI should have full powers to obtain information regarding the final holder/beneficiaries or of any holder at any point of time in case of any investigation or surveillance action.

The dilemma with banning PNs.

As news reports suggest, the Finance Ministry has clarified that it is in no hurry to ban PNs. From just around 15 to 20% of net FII inflows coming through PNs in 2002-03, the figure rose to 47% in April last year and jumped further to 52% in March 2006. The dilemma is clear. The ramifications of an immediate ban can be serious. That is why, the policy debate has always recommended phasing out of PNs, but in reality, their issuance has been rising continuously.

The officials of SEBI should carry out surprise checking of the information to be supplied by FIIs, so that FIIs maintain the proper accounts as to where there funds are being maintained in compliance with the guidelines framed by SEBI. Interestingly, Regulation 20 of the Securities and Exchange Board of India (Foreign Institutional Investors) Regulations, 1995 (□FII Regulations□) clearly says every FII shall, as and when required by the market regulator or RBI, submit as the case may be, any information, record or documents in relation to its activities as required by the regulators.

SEBI recently slapped a fine of Rs.1 crore on a SEBI registered FII sub-account for issuing Offshore Derivative Instruments (□ODI□) to an Overseas Corporate Body (□OCBs□). While imposing the ban, SEBI noted that in the past OCBs have misused the ODI route to park their illegal money and to manipulate Indian securities market without the fear of their identity getting detected.

Recent Developments

The SEBI, as per a recent news report, would soon come out with specific guidelines specifying reporting requirements for investing through the PN route. The High-Level Committee on Capital Markets (HLCC) appointed by SEBI, has proposed change in the regulatory requirement by making it mandatory for PNs to be issued only to entities that are `regulated by a financial regulator' of a country. The change in wording from a `regulated entity' to □an entity regulated by a financial regulator' would bring about a world of difference in SEBI's powers to track holders of PNs. This is because, according to the International Organization of Securities Commissions (□IOSCO□) agreement, it would become mandatory for a financial regulator to disclose details of holders of PN if sought by SEBI, since the Indian regulator is a party to the agreement.

In an interesting development, a US Court recently struck down the US Securities and Exchange Commission (□SEC□) (the SEC is the securities regulator in US and comparable to SEBI in India though the SEC has much effective regulatory powers) rules requiring hedge funds to face SEC inspection and follow stringent disclosure standards and reporting formats. The Chairman of the SEC has reportedly said that SEC would not go on appeal against the US Court order. With the world□s biggest securities market body refraining from challenging the order, regulators in emerging markets, including India, will possibly make a mental note of the event.

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» SEBI allows Mutual Funds to invest in ADRs/ GDRs/ Foreign Securities and Overseas ETFs

Vide its Circular No. SEBI/IMD/CIR No.7/73202/06 dated August 2, 2006 SEBI has notified conditions for investment in DRs/ GDRs/ Foreign Securities and Overseas ETFs (hereinafter collectively referred to as □Misc. Foreign Securities□) by Mutual Funds.

Specific Conditions for Investment in ADRs/GDRs/Foreign Securities.

Mutual Funds can invest in i) ADRs/GDRs issued by Indian companies; (ii) equity of overseas companies listed on recognized stock exchanges overseas; (iii) foreign debt securities in the countries with fully convertible currencies, short term as well as long term debt instruments with highest rating (foreign currency credit rating) by accredited/registered credit rating agencies; (iv) government securities where the countries are AAA rated; and (v) units/securities issued by overseas mutual funds or unit trusts which invest in the aforesaid securities or are rated as mentioned above and are registered with overseas regulators.

The mutual funds can invest in ADRs/GDRs/Foreign Securities within overall limit of US$2 billion with a sub-ceiling for individual mutual funds which should not exceed 10% of the net assets managed by them as on March 31 of each relevant year, subject to a maximum of US $100 million per mutual fund.

Specific Conditions for investment in Overseas Exchange Traded Funds (□ETFs□):

Either of the 2 eligibility conditions must be met: (i) The Mutual Fund must have been in existence for a minimum period of 10 years as on July 31, 2006 and managing schemes or (ii) the Mutual Fund or its Sponsors should have experience, to be certified by the Trustees, of investing in foreign securities, and an appropriate disclosure regarding the nature of experience should be made in the offer document.

The mutual funds can invest in overseas ETFs within overall limit of US$ 1 billion. with a sub-ceiling for individual mutual fund which should not exceed 10% of the net assets managed by them as on March

31 of each relevant year, subject to a maximum of US $50 million per mutual fund.
Additional conditions for investment in Misc. Foreign Securities.

1. The Mutual Fund should appoint a dedicated Fund Manager for making investments in Misc. Foreign Securities. Existing schemes which have already made such investments can comply within a period of 6 months from the date of this Circular.
2. Boards of AMCs and trustees shall exercise due diligence in making investment decisions.
3. The following disclosures must be made by mutual fund schemes proposing to invest in foreign securities - Intention to invest in foreign securities/ETFs; the attendant risk factors and returns; disclosure of how such investments will help in the furtherance of the investment objectives of the schemes; name of the dedicated Fund Manager for making investments in Misc. Foreign Securities; in case of schemes investing in ETFs the nature of experience of mutual fund or its Sponsors of having invested in foreign securities; and exposure limits.
4. In case the offer document of an existing scheme does not provide for investment in Misc. Foreign Securities, the scheme may make such investments in accordance with these guidelines, provided that prior to investment for the first time, the AMC shall ensure that a written communication about the proposed investment is sent to each unitholder and an advertisement is given in one English daily newspaper having nationwide circulation as well as in a newspaper published in the language of the region where the Head Office of the mutual fund is situated. The communication to unitholders shall also disclose the risk factors associated with such investments.
5. Existing schemes of mutual funds where the offer document provides for investment in foreign securities and attendant risk factors but which have not yet invested, may invest in foreign securities, provided a dedicated fund manager has been appointed for making investments in ADRs/ GDRs/ Foreign Securities. Any additional disclosure as specified above shall be informed to unitholders by way of addendum.
6. Asset Management Companies (□AMCs□) must send detailed periodical reports to the trustees about the amount invested in various schemes and performance of investments made in foreign securities and overseas ETFs in various countries.
7. The Board of AMCs and trustees should review the performance of investments made in foreign securities/overseas EFTs by comparing yield with investment opportunities in domestic markets and decide future course of action.
8. AMCs and trustees should offer their comments on compliance with guidelines in quarterly and half-yearly reports filed with SEBI.
9. Clause 4 of Seventh Schedule of the SEBI (Mutual Funds) Regulations 1996 which restricts investments in mutual fund units upto 5% of net assets and prohibits charging of fees, shall not be applicable to investments in mutual funds in foreign countries made in accordance with guidelines as per aforesaid circular. However, the management fees and other expenses charged by the mutual fund(s) in foreign countries along with the management fee and recurring expenses charged to the domestic mutual fund scheme shall not exceed the total limits on expenses as prescribed under Regulation 52(6).

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» Indian Government Proposes Amendments to India-Mauritius DTAA Treaty

A high level delegation from Central Board of Direct Taxes (□CBDT□) and Securities and Exchange Board of India (□SEBI□) recently met authorities in Mauritius for discussing possible steps to prevent misuse of India-Mauritius Double Taxation Avoidance Agreement (□DTAA Treaty□). Some of the measured discussed were as follows:

1. The Tax Residency Certificate (□TRC□) will no longer be a one time certificate issued by the Commissioner of Income Tax of Mauritius (□CIT, Mauritius□) for an indefinite period of time but would be subject to annual renewal. The undertaking given by Board of Directors (□BOD□) of Companies applying for TRC would be reviewed on an annual basis. This would coincide with the renewal of the Global Business License 1 (□GBC 1 License□) of companies by the Financial Services Commission of Government of Mauritius (□FSC□) and the latter would recommend the renewal of the TRC as appropriate to the CIT, Mauritius.
2. The FSC would inform their Indian counterparts whenever a company holding a GBC 1 License is in breach of its GBC 1 License undertakings (necessitating a review of the TRC), gets its license revoked or has been wound up.
3. The FSC will be looking closely at □conduit□ companies with a two or multi tier structure i.e. parent companies in other jurisdictions holding subsidiaries or Special Purpose Vehicles (□SPVs□) in Mauritius only to avail of treaty benefits with India or other treaty jurisdictions.
4. The Indian Government has proposed that only Mauritian companies listed on a recognized stock exchange should be eligible for capital gains tax exemption under the DTAA Treaty. The Indian Government has also proposed that a company should have a total expenditure of US $ 2,00,000/- or more on operations in the resident state for at least two years from the date the capital gains arise. Also, a shell or a conduit company with negligible or nil business operations will not be allowed to enjoy the capital gains tax exemption even in case these two clauses are incorporated.

The Government of India is also set to act on the suggestion by the Comptroller and Auditor General of India (□C&AG□) to the CBDT, asking it to consider giving instructions to Assessing Officers (□AOs□) to ensure that third country residents do not get the benefit of capital gains tax waiver on income from sale of shares under the DTAA Treaty. As per Circular No. 1/2003 dated February 10, 2003 issued by the CBDT, companies resident in Mauritius could be taxed in India if the department finds that the company is also resident in India and effectively managed from India. The C&AG has questioned the efficacy of this Circular in checking misuse of the DTAA Treaty where the directors of companies were found to be non-residents having their permanent addresses in foreign countries and as such could not be said that the control and management was in India.

Hon□ble Finance Minister Mr. P.Chaidambaram clarified that based on the discussions with the Mauritian authorities and the recommendations of C&AG, only some of the provisions of the DTAA Treaty would be reviewed and not the whole treaty.

Two factors seem to have necessitated steps by the Government of India to put pressure on the Government of Mauritius to review the DTAA Treaty. One is the signing of a Direct Tax Avoidance Agreement between India and Singapore (□India Singapore DTAA Treaty□) which has noticeably less favourable benefits for investors into India. The other reason may be recent imposition of fine of Rs.1 million by SEBI on a bank for infringement of its rules. According to SEBI, the bank had issued offshore derivative instruments in Mauritius and had incorrectly declared that none of them have been bought by Indian residents. An Indian investor is not entitled to the benefits of DTAA Treaty unless he can genuinely assert residence in Mauritius □ the crux of the complaints by the Indian tax authorities.

The Indian Government has adopted a carrot and stick policy for renegotiating the DTAA Treaty. The carrot comes in the form of a US $100 million line of credit through the Exim Bank of India to help Indian companies set up shop in Mauritius. Government officials stated that the carrot was necessary because although the DTAA Treaty provided for periodic reviews of the agreement it did not allow the reopening of the treaty unless both countries agreed to it. In case this does not help in convincing Mauritius, the Government of India would wield its stick by giving tax benefits similar to those available under the DTAA Treaty to countries like Singapore and other ASEAN members with which it is negotiating comprehensive economic co-operation agreements. Such a step would take away Mauritius's advantage as the preferred investment destination.

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» Legal Snapshots

SEBI requires Portfolio Manager to appoint Custodian & amends the definition and qualification of □principal officer:

Securities and Exchange Board of India (□SEBI□) has vide its Notification No. S.O. No. 997(E) dated July 5, 2006 directed all Portfolio Manager (□PMs□) to appoint a Custodian in respect of securities managed and administered by them. However, PMs who have total assets under management of value less than Rs. 500 crores or who perform purely advisory functions have been exempted from this requirement.

The definition of □Principal Officer□ (□PO□) has also been modified to mean □an employee of the portfolio manager who has been designated as such by the portfolio manager□. The professional qualifications of the PO which have also been modified to require that the PO of the applicant has either □ (i) a professional qualification in finance, law, accountancy or business management from a university or an institution recognised by the Central Government or any State Government or a foreign university; or (ii) an experience of at least ten years in related activities in the securities market including in a portfolio manager, stock broker or as a fund manager.

Ministry of Information and Broadcasting modifies the Advertising & Programme Code for cable television services and the DTH Guidelines

The Ministry of Information and Broadcasting, Government of India Vide Notification No. G.S.R. 459(E) dated August 2, 2006 notified the Cable Television Networks (Amendments) Rules, 2006. The main features of the amendments are as follows:

1. Insertion of a new condition in the Programme Code contained in Rule 6 of the Cable Television Networks Rules, 1994 (hereinafter □Cable TV Rules□) to provide that □no film or film song or film promo or film trailer or music video or music albums or their promos, whether produced in India or abroad, shall be carried through cable services unless it has been certified by the Central Board of Film Certification (CBFC) for unrestricted public exhibition in India□.
2. SEBI Modification of Advertising Code contained in Rule 7 of the Cable TV Rules to specify that □no advertisement which violated the Code for self-regulation in advertising, as adopted by the Advertising Standard Council of India (ASCI), Mumbai for public display in India, from time to time, shall be carried in the cable service conditions.

The Ministry of Information and Broadcasting has Vide its Order No. 8/12/2006-BP&L dated July 31, 2006 also amended the guidelines for providing Direct-to-Home (DTH) Services to provide that the applicant for setting up of DTH platform in India will be subject to security clearance of Board of Directors as well as key executives of the company such as CEO etc. in consultation with the Ministry of Home Affairs and for clearance of satellite use with the Department of Space. Existing licensees will also be required to obtain security licensees as specified herein.

Government proposes legislation to value property based on □Carpet Area□;

The Urban Development Ministry is considering legislative measures to impose a new system of calculating real estate value on the basis of □actual usable area□ (i.e. carpet area in industry terms). Under the prevailing industry practice, property value is computed on □super area□ which is the carpet area and areas which are of no use to end-consumer like space occupied by walls, terraces and porticos etc. Such a move would substantially reduce the already inflated real estate prices as on an average the carpet area of a property is 15-20% lesser than the super area.

Maintenance of Collateral by FII for transactions in derivative segment;

The Reserve Bank of India (□RBI□), vide its Circular A.P.(DIR Series) Circular No. 4 dated July 28, 2006 has decided to allow Foreign Institutional Investors (□FIIs□) to offer foreign sovereign securities with AAA ratings as collateral to the recognized stock exchange in India for their transactions in derivative segment.

SEBI would separately issue operational guidelines in this regards. Thereafter, recognized stock exchanges in India may approach the RBI, Foreign Exchange Department, Central Office, Mumbai-400001 for specific approvals as may be necessary under the Foreign Exchange Management Act, 1999.

Necessary amendments to Foreign Exchange Management (Transfer or Issue of Any Foreign Security) Regulations, 2004 would be issued separately in this regard.

RBI Issues Clarification on mode of payment by NRIs and PIOs for purchase of Immovable Property in India.

RBI, has vide Notification No. Circular No. 5 dated August 16, 2006 clarified that the mode of payment for purchase of immovable property (other than agricultural property, plantation or a farm house) in India by Non-resident Indians (□NRIs□) and Person of Indian Origin (□PIO□) as governed by the Foreign Exchange Management (Acquisition and transfer of immovable property in India) Regulations, 2000 (□FEM (Immov. Property) Regulations□) shall be out of (i) funds received in India through normal banking channels by way of inward remittance from any place outside India or (ii) funds held in any non-resident account maintained in accordance with the provisions of the FEM (Immov. Property) Regulations and the regulations made by Reserve Bank of India from time to time.

RBI further clarified that such payment cannot be made either by traveller's cheque or by foreign currency notes or by other mode other than those specifically mentioned above and the amended Regulation 3 & 4 of FEM (Immov..Property) Regulations.

Simpler wordings of an Insurance Policy.

The Insurance Regulatory and Development Authority (IRDA) has stipulated that all product literature should be in simple language and all insurance companies should follow the same sequence of presentation while registering their products with IRDA. This will come into force on September 30. However, insurers have been asked not to vary the scope of coverage, terms and conditions or the wordings of covers that are under currently under price regulation (tariff) until March 31, 2008:

The design and rating of product must be on sound and prudent underwriting basis. Insurers have also been asked to follow similar wordings for describing the same cover or same requirement across all their products such as clauses on renewal of insurance, due diligence clause, cancellation clause. The product should be genuinely an insurance of an insurable risk with a real risk transfer. Insurance companies have been asked to ensure that competition does not lead to unprincipled rate cutting and other improper underwriting practices. Once a product has been filed, the regulator will not agree to frequent changes without justification;

Parliament passes G □ Secs Bill;

The Parliament passed the Government Securities Bill 2006 on 14 August, 2006 to consolidate and amend the law relating to Government securities and its management by the Reserve Bank of India.

The Central Coordination and Monitoring Committee (CMC), co-chaired by the SEBI Chairman and Secretary, Company Affairs, stated that SEBI could crosscheck the records of companies wanting to float an initial public offer (IPO) with the Registrar of Companies (RoCs), whenever required before giving its go ahead to ensure that the investors' interests are effectively protected.

It was found that a number of companies, which had come out with an IPO and then vanished, had furnished a different set of records - balance sheet - with the RoCs and SEBI. The Government has taken action against the vanishing companies and their promoters/directors by filing prosecutions through the RoCs under the Companies Act 1956 in respect of 107 companies out of a total of 114 vanishing companies;

In addition, FIRs have also been filed in respect of 100 companies and their promoters/directors for the offences punishable under the Indian Penal Code.

SLR status gives banks more leeway to access resources to lend

SEBI, vide its Notification No. 807(E) dated May 26, 2006 made substantial amendments to the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 (SAST Regulations□).

The Cabinet Committee on Economic Affairs (CCEA) has approved the conversion of recapitalisation bonds issued to nationalised banks into tradable securities that would also qualify for Statutory Liquidity Ratio (SLR) status which is an amount that banks in India have to maintain in cash, gold or approved securities. Currently, the quantum is specified as 25 per cent of the demand and time liabilities of a bank.

The Government had since the mid-nineties issued bonds worth more than Rs 22,800 crore (in two tranches) as recap bonds and perpetual securities to help certain weak State-run banks to tide over financial stress and improve their capital adequacy. These bonds/securities could not be traded and were to be held to maturity. The Finance Ministry is expected to convert these recap bonds into tradable securities with SLR status in tranches of around Rs 5,000 crore every quarter. bank.

SEBI to resume UIN registration;

Besides the Permanent Account Number (PAN) being mandatory for trading in shares from October 1, investors may also have to get their unique identification number (UIN) to be allotted by SEBI. UIN was part of a major initiative of SEBI to create a database of market participants and investors (Mapin) but was subsequently, discontinued after many investors expressed apprehensions in the process of obtaining UIN including bearing its cost;

Listing Now SEBI has again decided to resume fresh registration. To begin with, the cut - off limit for obtaining UIN for natural person has been raised from the existing limit of a trade order value of Rs 1 lakh to Rs 5 lakh or more. For a trade order value of less than Rs 5 lakh, option will be available to investors to provide either their PAN or UIN obtained under MAPIN. Investors to the mutual fund would be exempted from the requirement of obtaining UIN. Listed companies or those companies intended to get listed, along with its promoters, directors, officers and designated employees would be required to obtain UIN.

Internet-based forex service allowed;

The Reserve Bank of India has now allowed banks to offer Internet-based foreign exchange services. It has been decided that banks may be permitted to offer Internet-based foreign exchange services for permitted underlying transactions, in addition to the local currency products already allowed to be offered on Internet-based platforms. The services offered through Internet for banks' customers on an Internet-based platform for dealing in foreign exchange, should allow only reporting and initiation of foreign exchange related transactions. The actual trade transactions should be permitted only after verification of physical documents.

RBI revises norms on banks' exposure to VCFs

The Reserve Bank of India has revised the norms on prudential framework governing banks' exposure to venture capital funds (VCFs). Banks have to obtain prior approval of the RBI for making strategic investment in VCFs, i.e. investments equivalent to more than 10 per cent of the equity or unit capital of a VCF. For investment in VCFs set up in the form of companies, the bank will not hold more than 30 per cent of the paid-up capital of the investee company or 30 per cent of its own paid-up share capital and reserves, whichever is lower. Investments in VCFs in the form of equity or units, the investment by a bank in a subsidiary company, financial services company, financial institution, stock and other exchanges should not exceed 10 per cent of the bank's paid-up capital and reserves and the total investments in all these together should not exceed 20 per cent of the bank's paid-up capital and reserves. Banks' investments in unquoted shares, bonds or units of VCFs will be classified under Held to Maturity (HTM) category for initial period of three years and will be valued at cost during this period. For the investments made before issuance of these guidelines, the classification would be done as per the existing norms.

SBI Act amendment.

The Union Cabinet on 24 August, 2006 gave its approval to amend the existing State Bank of India (SBI) Act, 1955, to enable the bank to access funds from the capital market and also discharge its functions more efficiently. The SBI (Amendment) Bill would enable State Bank of India to attract a large number of small individual investors and would enable SBI to issue bonus shares as well as preference shares. It would also allow the RBI stake to be lowered to 51 per cent in the bank.

India plans security law on FDI:

The government is planning a comprehensive law to streamline the process of assessing security threats arising from business transactions and enable its agencies to decide on the cases of Foreign Direct Investment in sensitive areas. The Bill (National Security Exception Act) 2006 is its formative stage.

The highlights of the proposed bill are as follows.

- Bringing in security ☐ related clauses for companies getting in foreign direct investment through the automatic route.
- Govern participation of foreign firms in global tenders floated by public sector companies and government departments.

Many investors worry about the discretionary powers that the government wields that could be intrusive.

Withholding tax on payments made to non-residents for services rendered abroad:

The Authority for Advance Rulings (□AAR□) in a recent ruling (AAR/671/2005) has held that there will be a withholding tax requirement on payments made to a non-resident agent, even if such payments are made outside India and the services are performed outside India, if the agent□s entitlement to the income has arisen in India.

As per this ruling, places other than those where the service is rendered, may be the source of income. Services could therefore be rendered abroad and income from those services still be considered to have accrued or arisen in India if they are dependant on certain events which take place in India.

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Amendments to Transfer Pricing Guidelines.

In a recent move that will benefit multinational companies entering into international transactions (as defined under Indian transfer pricing guidelines) with their Indian affiliates, the Finance Ministry has decided to increase the threshold limit for transfer pricing scrutiny of international transactions from Indian Rupees Five crores to Indian Rupees Fifteen crores.

The above enhancement of threshold has currently been finalized by CBDT for scrutiny of non-corporate taxpayers for the fiscal year 2006-07. However, senior Finance Ministry officials have indicated that the new norms are set to apply for compulsory scrutiny of corporate taxpayers as well. This would be a welcome relief for the sectors such as banking, diamond trade, IT, ITES, auto and pharma, which have been hardest hit by the recently concluded transfer pricing audits, due to the large number of international transactions entered into by the entities operating in these sectors.

SEBI requires Portfolio Manager to appoint Custodian & amends the definition and qualification of □principal officer□:

Securities and Exchange Board of India (□SEBI□) has vide its Notification No. S.O. No. 997(E) dated July 5, 2006 directed all Portfolio Manager (□PMs□) to appoint a Custodian in respect of securities managed and administered by them. However, PMs who have total assets under management of value less than Rs. 500 crores or who perform purely advisory functions have been exempted from this requirement.

Further, the definition of □Principal Officer□ (□PO□) has also been modified to mean □an employee of the portfolio manager who has been designated as such by the portfolio manager□. The professional qualifications of the PO which have also been modified to require that the PO of the applicant has either □ (i) a professional qualification in finance, law, accountancy or business management from a university or an institution recognised by the Central Government or any State Government or a foreign university; or (ii) an experience of at least ten years in related activities in the securities market including in a portfolio manager, stock broker or as a fund manager.

Specific Conditions for Investment in ADRs/GDRs/Foreign Securities;

Mutual Funds can invest in i) ADRs/GDRs issued by Indian companies; (ii) equity of overseas companies listed on recognized stock exchanges overseas; (iii) foreign debt securities in the countries with fully convertible currencies, short term as well as long term debt instruments with highest rating (foreign currency credit rating) by accredited/registered credit rating agencies; (iv) government securities where the countries are AAA rated; and (v) units/securities issued by overseas mutual funds or unit trusts which invest in the aforesaid securities or are rated as mentioned above and are registered with overseas regulators. Further, they can invest within overall limit of US$2 billion with a sub-ceiling for individual mutual funds which should not exceed 10% of the net assets managed by them as on March 31 of each relevant year, subject to a maximum of US $100 million per mutual fund.

Specific Conditions for investment in Overseas Exchange Traded Funds (□ETFs□);

Either of the 2 eligibility conditions must be met: (i) The Mutual Fund must have been in existence for a minimum period of 10 years as on July 31, 2006 and managing schemes or (ii) the Mutual Fund or its Sponsors should have experience, to be certified by the Trustees, of investing in foreign securities, and an appropriate disclosure regarding the nature of experience should be made in the offer document. Further, they can invest within overall limit of US$ 1 billion. with a sub-ceiling for individual mutual fund which should not exceed 10% of the net assets managed by them as on March 31 of each relevant year, subject to a maximum of US $50 million per mutual fund.;

Additional conditions for investment in Miscellaneous Foreign Securities:

- The Mutual Fund to appoint a dedicated Fund Manager for making investments.
- Boards of AMCs and trustees shall exercise due diligence in making investment decisions.
- Additional disclosures like intention to invest, risk factors, returns, quantum of investments, name of the dedicated fund manager, exposure limit, etc. to be made by mutual fund schemes proposing to invest in foreign securities.
- If the existing scheme does not provide for investment in Miscellaneous Foreign Securities, the scheme may make such investments in accordance with guidelines subject to fulfillment of specific conditions.:
- Asset Management Companies (□AMCs□) must send detailed periodical reports to the trustees about the amount invested in various schemes and performance of investment.
- AMCs and trustees should offer their comments on compliance with guidelines in quarterly and half-yearly reports filed with SEBI.
- The Board of AMCs and trustees should review the performance of investments made in foreign securities/overseas EFTs by comparing yield with investment opportunities in domestic markets and decide future course of action.
- Such other additional conditions as prescribed under the circular.

SEBI issues Clarifications on Mandatory Quoting of PAN.

SEBI has vide its Circular No. MRD/DoP/Dep/Cir-09/06 dated July 20, 2006 has issued clarifications in relation to mandatory quoting of PAN. As per the clarification all entities having difficulty producing PAN may open the Beneficiary Owner Account (□BO□) on the condition that PAN card would be submitted to the Depository Participants (□DPs□) within 30 days. Power of Attorney (□POA□) given by the FIIs/FII sub-accounts to the Custodians can be accepted as proof of address of FIIs/sub-acounts. NRIs/PIOs unable to obtain PAN but are holding securities in physical form and desire to sell the same, may be permitted to open a □limited purpose BO account□ without PAN on the following conditions:

- only credits arising out of corporate benefits and demat of physical shares will be permitted;.
- account cannot be used for getting credit from IPOs, off-market transactions or any secondary market transactions etc.;
- account can remain operational only for a limited period;

- the account holder may sell the securities in these accounts only through registered broker.

Any investor having PAN but not the PAN card may open BO Accounts subject to producing the PAN allotment letter. In case of Hindu Undivided Family (□HUF□), Association of Persons (□AoP□), Partnership Firm, Unregistered Trust, etc. □- though the BO account would be in the name of natural persons, PAN of the respective HUF, AoP, Partnership Firm, Unregistered Trust, etc. shall be obtained. As regards Registered Trust, Corporate Bodies and minors, PAN of the respective entities shall be obtained when accounts are opened in their respective names.□.

Ministry of Information and Broadcasting modifies the Advertising & Programme Code for cable television services and the DTH Guidelines

The Ministry of Information and Broadcasting, Government of India Vide Notification No. G.S.R. 459(E) dated August 2, 2006 notified the Cable Television Networks (Amendments) Rules, 2006. The main features of the amendments are as follows:

1. All film or film song or film promo or film trailer or music video or music albums or their promos, whether produced in India or abroad, shall be carried through cable services unless shall be certified by the Central Board of Film Certification (CBFC) for unrestricted public exhibition..
2. NSENo advertisement which violated the Code for self-regulation in advertising, as adopted by the Advertising Standard Council of India (ASCI), Mumbai for public display in India, from time to time, shall be carried in the cable service.

Further, the Ministry of Information and Broadcasting has Vide its Order No. 8/12/2006-BP&L dated July 31, 2006 also amended the guidelines for providing Direct-to-Home (DTH) Services to require that the applicant for setting up of DTH platform in India will be subject to security clearance of Board of Directors as well as key executives of the company such as CEO etc. in consultation with the Ministry of Home Affairs and for clearance of satellite use with the Department of Space. Existing licensees will also be required to obtain security licensees as specified herein.

Government proposes legislation to value property based on □Carpet Area□

The Urban Development Ministry is considering legislative measures to impose a new system of calculating real estate value on the basis of □actual usable area□ (i.e. carpet area in industry terms). Under the prevailing industry practice, property value is computed on □super area□ which is the carpet area and areas which are of no use to end-consumer like space occupied by walls, terraces and porticos etc. Such a move would substantially reduce the already inflated real estate prices as on an average the carpet area of a property is 15-20% lesser than the super area:

Maintenance of Collateral by FII for transactions in derivative segment

The Reserve Bank of India (□RBI□), vide its Circular A.P.(DIR Series) Circular No. 4 dated July 28, 2006 has decided to allow Foreign Institutional Investors (□FIIs□) to offer foreign sovereign securities with AAA ratings as collateral to the recognized stock exchange in India for their transactions in derivative segment.

SEBI would separately issue operational guidelines in this regards. Thereafter, recognized stock exchanges in India may approach the RBI, Foreign Exchange Department, Central Office, Mumbai-400001 for specific approvals as may be necessary under the Foreign Exchange Management Act, 1999.

Necessary amendments to Foreign Exchange Management (Transfer or Issue of Any Foreign Security) Regulations, 2004 would be issued separately in this regard.

RBI Issues clarification on mode of payment by NRIs and PIOs for purchase of Immovable Property in India;

Reserve Bank of India (RBI), has vide its Circular No. 5 dated August 16, 2006 clarified that the mode of payment for purchase of immovable property (other than agricultural property, plantation or a farm house) in India by Non-resident Indians (☐NRIs☐) and Person of Indian Origin (☐PIO☐) as governed by the Foreign Exchange Management (Acquisition and transfer of immovable property in India) Regulations, 2000 (☐Regulations☐) shall be out of (i) funds received in India through normal banking channels by way of inward remittance from any place outside India or (ii) funds held in any non-resident account maintained in accordance with the provisions of the Regulations. RBI further clarified that such payment cannot be made either by traveller's cheque or by foreign currency notes or by other mode other than those specifically mentioned above.

Bill on New Company Law likely in Winter Session

The Bill on new Company Law will be introduced in the winter session. One of the contentious issues is that the revised Clause 49 of the Listing Agreement, which came into effect from 1st January2006, is currently not in sync. with the existing Company Law on the issue of Board composition. As per the revised Clause 49, for a company with an executive chairman, at least 50% of the board should comprise independent directors while in the case of a company with a non-executive chairman, atleast one-third of the board should comprise independent directors. The new Company Law is based on the recommendations of the J.J.Irani Committee Report, which had proposed that the strength of the independent directors should be one-third of the Board size. If the proposals of the J.J.Irani Committee Report are enacted, it would prevail and SEBI would need to redraft Clause 49 of the Listing Agreement.

Time limit extended for investments in bonds

The Finance Ministry, Vide Order F.No. 142/09/2006-TPL dated June 30, 2006 has extended the time limit for making investments under Section 54EC of the Income Tax Act. This provision provides for tax exemption on capital gains arising from the transfer of a capital asset, if such capital gains are invested in certain bonds within a period of six months after the date of such transfer. Investments in bonds recognised under Section 54EC) can be made up to September 30, 2006 in the case of persons whose long-term capital asset was transferred between September 29, 2005 and December 31, 2005 (both days inclusive).

For persons whose long-term capital asset was transferred between January 1, 2006 and June 30, 2006(both days inclusive), The Central Board of Direct Taxes (CBDT) has said that investments in recognised bonds can be made up to December31, 2006 for availing themselves of the Section 54EC benefits which are available only when the capital gains are invested in notified bonds of Rural Electrification Corporation Ltd (REC) and National Highways Authority of India (NHAI).

Trading on mobile may soon be reality

Though it is not yet possible to buy and sell equity shares using mobile telephone, the technology for this with the mobile operators and the stockbroking houses is ready. After the success of Direct online trading, where any layperson can register, and buy and sell shares through the Internet, the players in this field such as ICICI Direct, HDFC Securities, Geojit Securities, Kotak Street and Sharekhan want to extend their services to mobile trading too and have applied to the stock exchanges for permission to offer mobile trading and the stock exchanges in turn are awaiting permission from SEBI.

Bombay Stock Exchange tightens norms for Listing of Shares:

The Bombay Stock Exchange has decided to tighten the norms for listing shares of initial public offering (IPO) and follow-on public issue (FPO) to check fly-by-night operators entering the capital market. The main features of the revised listing norms are as follows:

1. With effect from August 1, 2006 Due Diligence for IPOs and FPOs for less than Rs 10 crore has to be done by Merchant Bankers and Chartered Accountants appointed by the BSE.
2. The minimum number of public shareholders after the issue shall be 1,000 for small-cap companies. The minimum post-issue paid-up capital and minimum issue size for a small cap companies should be Rs 3 crore. Also, for small-cap companies tapping the IPO/FPO market, the minimum market capitalisation is stipulated at Rs 5 crore and the minimum turnover of the company should be Rs 3 crore in each of the preceding 12 months period.
3. For large-cap companies, the minimum post-issue paid-up capital of the applicant company should be Rs 3 crore; and the minimum issue size is stipulated at Rs 10 crore and can be listed on the BSE, if their issued and subscribed equity capital after the public issue is Rs 10 crore. In addition to this, the issuer company should have a post issue net worth (equity capital + free reserves excluding revaluation reserve) of Rs 20 crore.

These new norms would be in addition to the conditions prescribed under SEBI (Disclosure and Investor Protection) Guidelines, 2000.

As per the existing laws, Internet telephony services can be offered in India either by an Internet Service Provider (ISP) specifically permitted to do so or by a unified access service licensee. However, several service providers such as Skype, Net2Phone, Yahoo, and MSN, are providing Internet telephony services to people in India without specific permission or acquiring licenses. Department of Telecommunication (DoT), Vide a letter sent on July 13, directed that these service providers do not possess the requisite licence as mandated by the Government of India, thus vitiating the level playing field for bona fide licensees, such as Indian ISPs. Moreover, such service offering is resulting in loss of revenue to the Government by way of licence fee as well as by way of service tax and the service could prove to be a threat to national security with no monitoring being done.

Payment and Settlement Bill 2006 soon to be enacted

A Payment and Settlement Systems Bill 2006 (□Settlement Bill□) to empower the Reserve Bank of India (□RBI□) to regulate and oversee the various payment and settlement systems including those operated by non-banks such as Clearing Corporation of India Ltd (CCIL), card companies has been introduced in the Lok Sabha. Under the provisions of the Settlement Bill, a new National Payments Corporation would take over the operations of retail payment systems. The various retail payment systems in operation include the manual paper-based clearing, MICR clearing, Electronic Funds Transfer systems (including the electronic clearing services) and card based paper system.

The Settlement Bill also seeks to give legal recognition to the netting procedure and provides for the finality and irrevocable nature of settlement. Moreover, it also seeks to empower the Securities Appellate Tribunal to settle disputes between the RBI and the payment system providers. Once this bill is enacted, RBI would have the powers to lay down operational and technical standards for various payment systems. Besides specifying the duties of the system providers, RBI would also have the powers to audit and inspect the systems and premises of the system providers.

Lok Sabha passes Actuaries Bill

The Lok Sabha passed a Bill to regulate and develop the profession of actuaries in the country. Some of the important provisions in the Bill are as follows:

- The definition of □actuaries□ has been expanded and made more comprehensive.
- The Actuaries Bill would enable the setting up of the Institute of Actuaries of India.
- This Bill proposes to dissolve the existing Actuaries Society of India and transfer the assets and liabilities of this society to the institute.
- The Actuaries Bill proposes to regulate the profession of actuaries on the same lines as the profession of chartered accountants, cost and works accountants and company secretaries. These professions are currently regulated under the Chartered Accountants Act, Costs and Works Accountants Act and Company Secretaries Act respectively.

Bank Term Deposit Scheme, 2006,

The Income Tax Department of the Government of India vide Notification No. 203/2006 dated July 28, 2006 notified the Bank Term Deposit Scheme, 2006, under which an individual or a Hindu undivided family can invest up to Rs 1 lakh per year in term deposits of scheduled banks to claim benefits under Section 80C of the Income Tax Act. However, the investment in these term deposits, along with investments in other saving schemes, would be subject to the overall ceiling of Rs 1 lakh for the purposes of tax benefit under Section 80C. The term deposits will be of two types □ single holder or joint holder. In the case of joint holder deposits, tax benefit will be available only to the first holder of the deposit. The maturity period of the deposit will be five years. The rate of interest on the deposit will be the same as what the bank is offering at that moment.

Views sought on Draft Broadcast Bill

The Ministry of Information and Broadcasting of the Government of India has proposed a Draft Broadcasting Services Regulation Bill, 2006 (□Draft Broadcast Bill□) Though retaining most of the provisions of the earlier Bill, the revised Bill has some notable deletions, with one of them being a provision that gave the central government powers to control and manage broadcasting services, or even suspend their operations, in case of a war or a natural calamity of national magnitude. The provision of a maximum fine of Rs 25 lakh has been stipulated in the Draft Broadcast Bill. While an Overall ceiling of 15 per cent on the number of channels a broadcast service provider can have has been maintained a portion of the earlier Bill which stated that said no broadcaster shall have more than the prescribed share of the total number of subscribers in a city or a state, subject to the overall ceiling of 15 per cent for the whole country, has been omitted. The government has maintained most of the restrictions pertaining to accumulation of interest in the Draft Broadcast Bill and has deleted the provision given to authorized officers, enabling them to prohibit a service provider from transmitting a programme or channel if it is not in conformity with the prescribed content code, or if it is likely to promote feelings of disharmony or enmity, hatred or ill-will between religious, racial, linguistic or regional groups.

SEBI widens the definition of Foreign Institutional Investors

The Securities and Exchange Board of India (□SEBI□) has vide Notification No. S.O. No.1332(E) dated August 21, 2006 brought modifications to the Securities and Exchange Board of India (Foreign Institutional Investors) Regulations, 1995 thereby permitting the following entities to apply for registration as FIIs:

- An insurance or reinsurance company;
- An international or multilateral organization, an agency thereof, a foreign governmental agency, or a foreign central bank; and
- An investment manager or advisor, established or incorporated outside India and proposing to make investments in India on behalf of broad based funds and its proprietary funds, if any.

Procedural amendments:

If applicable, the name of the investment manager / advisor of the fund is to be disclosed in the application for registration, and details of the broad-based funds on whose behalf the applicant proposes to invest in Indian Securities markets. Details regarding registration with the concerned regulatory authority have also to be provided, including the activities which the applicant is permitted to undertake under the registration / license granted by the authority, and details of the applicant, its associate or group companies, having office in India, being ever registered with SEBI.

SEBI has provided that in case of application for registration of sub-accounts, as against the earlier undertaking form the FII, a joint undertaking (from the FII and the sub-account) would now have to be submitted to SEBI. Further, it has provided for certain additional disclosures in respect of applications for sub-account registration under the □broad-based fund□, □proprietary fund□, □foreign corporate□, and □foreign individual□ categories. It may further, be noted that a joint declaration is required to be given that the FII through whom application for registration of the sub-account is made is authorized to invest on behalf of the sub-account.

In view of the amendment the registration of sub accounts has become more onerous.

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