1

INTRODUCTION TO FINANCIAL REGULATIONS

Unit Structure

1.0 LEARNING OBJECTIVES

After studying this unit, you will be able:

- To understand the need and significance of Indian financial system regulations
- To discuss structure of financial regulations in India
- To analyse Global financial crisis – response of the Indian regulations

1.1 INTRODUCTION

Financial regulation is a type of regulation or supervision that places limitations, rules, and guidelines on financial institutions with the goal of preserving the integrity and stability of the financial system. Governmental or non-governmental organisations may manage this. Because there are now more financial products available as a result of financial regulation, this has also had an impact on how banking sectors are structured. One of three legal categories that make up the content of financial law—the other two being market practices and case law—is financial regulation.

1.2 NEED AND SIGNIFICANCE OF INDIAN FINANCIAL SYSTEM REGULATIONS

Financial regulation entails placing restrictions on the ability of banks and other financial institutions to implement particular practices. Regulations make sure banks handle risk reasonably well so they don't choose risky assets. As a shock absorber, bank capital helps manage disastrous investments.

Regulations are also employed to make it less likely for people to remove large sums of money suddenly. Additionally, banks are protected by deposit guarantee programmes in the event that they fall short of a predetermined deposit threshold. To cover any unforeseen withdrawals, banks must also have cash on hand or other liquid assets.

The importance of Indian financial system regulations can be understood in the following ways:

o Maintaining Financial Stability: The regulations aim to promote the stability of the financial system in India by ensuring that financial institutions are well-capitalized, have adequate risk management systems, and follow sound lending practices. This helps to prevent financial crises and reduces the likelihood of bank failures and defaults.

o Consumer Protection: The regulations aim to protect consumers by ensuring that financial institutions operate with transparency and accountability, provide accurate and timely information, and adhere to ethical practices. This helps to reduce the risk of financial frauds, scams, and mis-selling of financial products to customers.

o Encouraging Investment: The regulations encourage investment by providing a transparent and fair playing field for investors. The regulations aim to ensure that investors have access to reliable information, and that capital markets operate in a fair and efficient manner. This helps to promote investor confidence, which in turn attracts more investment to the Indian economy.

o Promoting Economic Growth: The regulations aim to promote economic growth by ensuring that the financial system is sound and efficient. A stable and efficient financial system provides the necessary infrastructure for economic growth by facilitating capital formation, mobilization, and allocation.

o Supporting Government Policies: The regulations support government policies aimed at promoting economic development, financial inclusion, and social welfare. The regulations ensure that the financial system supports the needs of the economy and the society and aligns with the broader objectives of the government.

1.3 STRUCTURE OF FINANCIAL REGULATIONS IN INDIA

The financial regulatory framework in India is a complex system comprising several regulators responsible for overseeing different segments of the financial sector. The primary regulators include:

o Reserve Bank of India (RBI): The RBI is the central bank of India and is responsible for regulating the monetary policy of the country. It regulates and supervises the banking system in India and provides oversight to other financial institutions like non-banking financial companies (NBFCs) and payment systems.

○ Securities and Exchange Board of India (SEBI): The SEBI is the regulator for the securities market in India. It is responsible for regulating the issuance and trading of securities, overseeing market intermediaries like brokers, and ensuring fair and transparent trading practices.

○ Insurance Regulatory and Development Authority of India (IRDAI): The IRDAI is responsible for regulating and promoting the insurance sector in India. It oversees the registration, functioning, and performance of insurance companies and agents.

○ Pension Fund Regulatory and Development Authority (PFRDA): The PFRDA is responsible for regulating and promoting pension funds in India. It oversees the registration, functioning, and performance of pension funds and pension fund managers.

○ Ministry of Corporate Affairs (MCA): The MCA is responsible for regulating companies in India. It oversees the registration, functioning, and performance of companies in India.

In addition to these primary regulators, there are several other regulators and self-regulatory organizations that oversee specific segments of the financial sector. These include:

- National Bank for Agriculture and Rural Development (NABARD): Regulates and supervises the rural financial sector, including rural cooperative banks, regional rural banks, and agricultural credit societies.

- Small Industries Development Bank of India (SIDBI): Regulates and supervises the micro, small, and medium enterprise (MSME) sector in India.

- Financial Stability and Development Council (FSDC): Coordinates the work of various financial regulators and monitors the overall stability and development of the financial sector.

- Association of Mutual Funds in India (AMFI): Self-regulatory organization for the mutual fund industry in India.

- Clearing Corporation of India Limited (CCIL): Provides clearing and settlement services for financial transactions in India.

1.4 GLOBAL FINANCIAL CRISIS – RESPONSE OF THE INDIAN REGULATIONS

The mid-2007 to early-2009 era of high stress in the world's banking institutions and financial markets is referred to as the global financial crisis (GFC). A decline in the US home market during the GFC served as the impetus for a worldwide financial crisis that expanded from the US through connections in the global financial system. Many banks experienced significant losses and needed assistance from the government to stay afloat. As the major industrialised economies went through their biggest recessions since the Great Depression in the 1930s, millions of people lost their employment. Additionally, compared to other recessions that were not accompanied by a financial crisis, the recovery from the crisis was much slower.

Main Causes of the GFC

1. Excessive risk-taking in a favourable macroeconomic environment

Economic conditions in the US and other nations were favourable in the years before to the GFC. Strong and consistent economic growth was accompanied by low rates of unemployment, inflation, and interest. In this setting, home values climbed rapidly.

Homes were bought and built with reckless borrowing by households, particularly in the US, who anticipated that home prices would climb further. Property developers and households in European nations (such as Iceland, Ireland, Spain, and certain countries in Eastern Europe) similarly took on excessive debt due to similar expectations regarding home prices. Particularly in the United States, many mortgage loans were for sums that were comparable to (or even higher than) the purchase price of a home. Investors looking to make quick money by "flipping" homes and "subprime" borrowers (who have higher default risks due mostly to their income and wealth being relatively low and/or they have missed loan repayments in the past) made up a significant portion of this hazardous borrowing.

For a variety of reasons, banks and other lenders were prepared to issue growing numbers of riskier loans:

o Individual lenders competed more fiercely to offer ever-larger housing loans, which at the time appeared to be quite profitable given the booming economy.

o Many lenders who offered mortgages did not carefully examine the applicants' capacity to repay their loans. This also demonstrated the popular expectation that the favourable circumstances would persist. Lenders also had little motivation to exercise caution when making loans because they did not anticipate suffering any losses. Instead, they offered investors a sizable number of loans, typically packaged into securities known as "mortgage-backed securities" (MBS) and made up of thousands of different home loans of variable quality. MBS products grew more complicated and opaquer over time, yet external organisations maintained to rate them as being extremely safe.

o Investors who bought MBS products believed they were purchasing a very low risk asset because it was believed that most mortgage loans in the package would be repaid, even if some of them were not. Large US banks as well as international banks from Europe and other nations that desired larger profits than could be attained in their home markets were among these investors.

2. Increased borrowing by banks and investors

Up until the Great Financial Crisis, banks and other investors in the US and overseas borrowed more money to increase their lending and buy MBS securities. Leverage increases when money is borrowed to buy an asset, which can increase both potential gains and losses. [1] As a result of taking on so much debt, banks and investors suffered significant losses as housing values started to collapse.

In addition, banks and certain investors borrowed money for longer and longer periods of time, even overnight, to buy assets that were difficult to sell. As a result, they were forced to depend more and more on lenders, including other banks, who provided new loans as old short-term loans were returned.

3. Regulation and policy errors

MBS products and subprime loans were subject to too little regulation. Particularly, there was insufficient regulation of the organisations that produced and offered investors sophisticated, opaque MBS. Not only were many individual borrowers given loans that were too big for them to manage, but fraud was also becoming more prevalent. Examples include exaggerating a borrower's income and misleading investors about the security of the MBS products they were being offered.

Additionally, many governments and central banks failed to properly comprehend the extent to which subprime loans had been extended during the boom and the numerous ways in which mortgage losses were spreading throughout the financial system as the crisis developed.

Role of Reserve Bank of India:

The Reserve Bank of India (RBI) played a critical role in responding to the crisis. Some of the key measures taken by the RBI include:

- Providing liquidity support: The RBI injected liquidity into the financial system to support banks and financial institutions facing liquidity pressures. The RBI also reduced the cash reserve ratio (CRR) and the statutory liquidity ratio (SLR) to provide additional liquidity to the banking system.

- Regulatory measures: The RBI introduced several measures to strengthen the regulatory framework of the banking sector. It revised the prudential norms for asset classification and provisioning and introduced more stringent norms for the valuation of securities. The RBI also tightened the regulatory oversight of non-banking financial companies (NBFCs) to enhance their resilience.

- Exchange rate management: The RBI intervened in the foreign exchange market to stabilize the exchange rate and prevent excessive volatility in the currency market.

In addition to the RBI, other regulators like SEBI, IRDAI, and PFRDA also took several measures to strengthen the regulatory framework of their respective sectors. SEBI, for instance, introduced new regulations to enhance transparency and reduce systemic risk in the securities market. IRDAI and PFRDA introduced new guidelines to strengthen the risk management practices of insurance companies and pension funds.

1.4 SUMMARY

- Financial regulation entails placing restrictions on the ability of banks and other financial institutions to implement particular practises. Regulations make sure banks handle risk reasonably well so they don't choose risky assets.
- A financial crisis results as a result of this spreading to other areas of the financial system.
- The Capital Market deals with transactions that have been going on for more than a year and is intended to finance long-term investments.
- Economic conditions in the US and other nations were favourable in the years before to the GFC.
- Individual lenders competed more fiercely to offer ever-larger housing loans, which at the time appeared to be quite profitable given the booming economy.
- Leverage increases when money is borrowed to buy an asset, which can increase both potential gains and losses.

1.5 UNIT END QUESTIONS

A. Descriptive Questions:

Short Answers:

1. Explainthe need of Indian financial system regulations.

2. Discuss the **role of RBI** Indian financial system regulations.

3. What are the causes of GFC?

4. Write note on Financial Regulations.

5. Explain structure of Financial regulations in India.

B. Fill in the blanks:

1. ………………….. regulates and supervises the banking system in India and provides oversight to other financial institutions like non-banking financial companies (NBFCs) and payment systems.

2. ……… provides clearing and settlement services for financial transactions in India.

3. IRDAI and ……………..introduced new guidelines to strengthen the risk management practices of insurance companies and pension funds.

4. The ……………… also reduced the cash reserve ratio (CRR) and the statutory liquidity ratio (SLR) to provide additional liquidity to the banking system.

5. CRR stands for …………..

Answers:

1- RBI, 2- Clearing Corporation of India Limited., 3- PFRDA, 4-RBI, 5-cash reserve ratio

1.6 REFERENCES

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2

RESERVE BANK OF INDIA AND SECURITIES EXCHANGE BOARD OF INDIA

Unit Structure

2.0 LEARNING OBJECTIVE:

- To enable students to describe the functioning of the Reserve Bank of India in detail.
- Students will understand the Monetary Control Mechanism of Reserve Bank Of India
- To acquaint Students with Securities Exchange Board Of India And its functioning.

2.1 RESERVE BANK OF INDIA

Introduction

Reserve Bank of India is the apex financial institution governing and regulating the Indian Banking sector. The Reserve Bank of India is the Central Bank of the country or Bank of Economy. Reserve Bank of India came into existence in 1934 by passing an act in the parliament. It started functioning from 1st April 1935. Earlier the Reserve Bank of India was a private shareholders' Bank and it got nationalized in 1949. After nationalization RBI was empowered with the power of the Central Bank of the economy. Reserve Bank of India has four headquarters in the 4 metropolitan cities i. e. Mumbai, Delhi, Kolkata and Chennai.

Functions of RBI

Functions of RBI are classified in three categories

1. Traditional Functions
2. Regulatory and Supervisory Functions
3. Promotional and Developmental Functions

Traditional functions

1. Issuing currency

Reserve Bank of India as a Central Bank of economy has a sole right to print and issue currency notes in the country. RBI issues the currency notes of all denominations i.e. Rs.5, Rs.10, Rs.20, Rs.50 , Rs.100, Rs.200, Rs.500, Rs.2000. Rupee 1 notes and coins are issued by the Government of India. The Minimum Reserve system followed by the RBI for issuing currency notes in India.

2. Controlling Credit

Commercial Banks create credit in multiples of their deposits. RBI controls credit created by banks. Various monetary control techniques are used by the RBI to control the credit creation vis -s vis to money supply in the economy. Depending on the situation of the economy RBI uses various tools of monetary control via monetary policy.

3. Banker to government

The Reserve Bank of India acts as banker to the government. All the funds and transactions of the government are routed through the Reserve Bank of India. RBI maintains the consolidated fund of the country. RBI maintains the accounts of Central Government and state governments. The Reserve Bank of India acts as agent and financial advisor to the Government of India.

4. Banker to Bank

Reserve Bank of India is banker to bank. It performs the functions of a banker likewise other commercial banks perform for their customers. The Reserve Bank of India provides loans to banks in the country. Commercial Banks are required to maintain reserves with RBI.

5. Custodian of foreign exchange

RBI keeps strict control on uses of foreign exchange by the government and citizens. RBI maintains and manages the foreign exchange of the country and it acts as custodian of foreign exchange of the country.

6. Lender of last resort and Bank of rediscount

RBI is a banker to commercial banks hence at the time of the financial crisis RBI helped commercial banks by providing funds to them. These funds are often extended at higher rates of interest but help banks to tackle financial emergencies and difficulties.

Supervisory function

1. Granting license to banks

RBI has the right to issue licenses to the banks who apply in a prescribed format. RBI can issue licenses as well as withdraw licenses of banking companies. All banks have to take permission from RBI for launching new branches as well as relocating the existing branches.

2. Inspection of banks

In order to maintain stability in the banking sector RBI monitors the functioning of banking companies in India. The Reserve Bank of India can inspect the accounts of banks and it keeps record of all the details of the day today working of banks. It can ask banks to produce required documentation information as and when required.

3. Implementing deposit insurance scheme

The Reserve Bank of India introduced the deposit insurance scheme 1962. India is the second country to issue such a scheme after the USA who issued this scheme in 1933. This scheme provides a safety net for banks in the consequences of bankruptcy.

4. Controlling Non-Bank finance companies

Non-Bank finance companies are the agencies which provide various finance services to the people. All these NBFCs have to get registered with the RBI and RBI supervises the working of NBFCs.

Promotional and development functions

1. Development of the financial system.

RBI works on preparing comprehensive parameters for regulating and smooth functioning of banking as well as financial sector of the country.RBI conducts system wide risk analysis to promote confidence and improve efficiency of Financial Institutions.

2. Development of agriculture

India is an agrarian economy where the majority of the population is engaged in agriculture and allied activities. Regular flow of finance is expected to develop and modernize the agricultural sector. Hence the Reserve Bank of India provides the funds to agriculture by the route of National bank for agriculture and rural development (NABARD). Nabard is the apex institution for agriculture finance in India. NABARD is the outcome of the agriculture credit function of RBI. It started functioning from 12th July 1982.

3. Providing industrial finance

Adequate and timely supply of funds to the industry accelerates the economic growth in the country. In India the industrial sector faces the problem of inadequate finance. Banks provide finance to the industrial sector but not at a required level. In order to promote industrial growth vis-vis the economic growth of a country RBI promoted some institutes at various levels to provide finance to the industrial sector.

i. Industrial finance corporation of India-1948

ii. State Financial Corporations - 1951-52

iii. Industrial development Bank of India- 1964

iv. The unit trust of India -1964

v. Industrial Credit and Investment Corporation of India Ltd. (ICICI) - 1955.

vi. Refinance Corporation for Industry Ltd. (RCI) - 1958

vii. Industrial Reconstruction Corporation of India Ltd. (IRCI), 1971.

In order to administer the credit guarantee scheme of small scale industries, RBI had launched the Industrial Finance (credit) Department in 1957 which was later on closed in 1981 after introducing deposit insurance and guarantee Corporation.

4. Promoting Export

Exports play a significant role in economic development. India as a developing country; increasing exports strengthen the balance of payment of the country. RBI takes an active part in promoting export by launching various schemes.. In order to meet the short term finance needs of exporters in India, RBI launched the export financing scheme in 1967. RBI directs and controls the export finance of commercial banks. In India export finance is available in rupees as well as in foreign currencies.

5. Economic Data Collection

The Reserve Bank of India collects the economic and statistical data of the country by conducting research. These data later on compile and published via RBI bulletin. RBI collects data regarding banking companies, export management, price trends in the country, agriculture credit, industrial finance, security market etc.

6. Publishing Reports

The Reserve Bank of India publishers various reports. Some reports are occasional, the sum are periodical i.e. monthly quarterly half yearly and yearly.

RBI publishers following reports

a. Annual report

b. Report on trends and progress of banking industry

c. Report on currency and Finance

d. Handbook on statistics of Indian economy

e. State finances : A study of budget

f. Monetary policy report

g. Financial stability report

h. RBI bulletin etc.

2.3 MEASURES OF CREDIT CONTROL /MONETARY CONTROL

RBI uses various instruments of credit control in order to control money supply in the country. These techniques include both quantitative and qualitative credit control methods.

.**Quantitative (General) Credit control method**

1. B**ank Rate Policy**

Bank rate is the interest rate at which RBI rediscounts bills produced by commercial banks. In the case of inflation RBI increases the bank rate to contract the money supply in the country whereas in deflation in order to expand the money supply RBI decreases the bank rate.

2. Open market operations

Open Market operation deals with buying and selling of government securities by RBI in the open market. In inflation RBI tightens the money supply selling government securities and in deflation RBI purchases the government securities which enable increased money supply in the country.

3. Cash Reserve Ratio (CRR)

Cash Reserve Ratio (CRR) is the portion of total deposits of a bank maintained with RBI. Maintenance of CRR is obligatory to every bank in the country. Cash Reserve Ratioe is to be maintained in the form of liquid cash. CRR helps to keep inflation under control. During high deflation RBI decreases CRR to increase the amount of money left with banks for sanctioning loans to the general public. It increases the flow of money in the economy, which induces investments and brings up price change in the economy. In inflation the same action is taken reversed.

4. Statutory Liquidity Ratio (SLR)

Statutory Liquidity Ratio or SLR is a minimum percentage of deposits that a commercial bank has to maintain in the form of liquid cash, gold or other securities. During high inflation RBI raises the level of SLRR to squeeze the lendable amount of money with the banks. It decreases the money supply in the country. In deflation RBI adopts low SLR policy to reverse the effect of inflation.

5. Repo

REPO stands for Repurchase Agreement / Repurchase Option. Repurchase Agreement (repo) is a kind of short-term lending offered by

RBI to the commercial banks in the country. Repo Rate (RR) is the rate at which the Reserve Bank of India (RBI) extends short term finance to commercial banks against government securities. It is basically an agreement between the RBI and the bank where both the parties agree to repurchase securities at a predetermined date and price. Changes in the repo rate are connected with the position of the money supply. In order to tighten the money supply RBI increases the Repo Rate and vice versa.

6. Reverse Repo Rates

Reverse repo rate is the rate at which the Reserve Bank of India borrows money from commercial banks. It is the arrangement where commercial banks park their surplus funds with RBI. Reverse Repo Is a tool of monetary control exercised via monetary policy. Lowering of reverse repo increases purchasing power in the country and vice versa.

B. Qualitative (Selective) Credit Control Methods

1. Consumer Credit Regulations

Consumer Credit Regulation is used to control flow of consumer credit in the country. Under this system, consumers pay a certain percentage of the price of the durable goods in cash and the remainder is paid through bank finance. Consumers have to pay the same balance amount in installments. The Reserve Bank of India can control consumer credit by changing the amount of consumer durable loan and by changing the number of installment over which the loan can be repaid.

2. Margin Requirements

Difference between market value of a security or collateral and available maximum loan for the same security is called Margin requirement. Changes In margin requirement influences flow credit in the economy. For example if the market value of a security is Rs. 1000 and margin requirement is 50% then maximum value of loan will be Rs.500. If margin requirement is increased to 60% then borrowing amount will drop to Rs. 400. Means increase in margin requirement reduces the borrowing amount and vice versa.

3. Credit Rationing

Under Rationing of credit the Central Bank of a country puts limits on the maximum amount of loans a bank can grant to specific sectors. Sometimes the central bank fixes ceiling specific categories on loans and advances of specific categories.

4. Directives

Reserve Bank of India issues directives on various issues of monetary control. Commercial banks are advised to follow the said directives of RBI. First directive was issued on 17th may 1956. It was towards restricting credit against paddy and rice.

5. Moral Suasion

Central bank implements monetary policy. Moral suasion deals with guiding, requesting, persuading the commercial banks to cooperate with the central bank in the implementation of its monetary policy. Moral Suasion is used by central banks mainly to morally influence commercial banks to follow its policies.

6. Direct Action

In this method RBItake action against those banks which do not follow the guidelines, conditions and requirements given by RBI on time to time basis. As a penal action RBI can refuse their rediscounting offer, charging higher interest rate on credit demanded, refuse granting loan to a bank etc.

2.4 FINANCIAL INCLUSION

Financial inclusion is considered as a key driver of attaining Sustainable Development Goals.When people do not have access to common financial services like, saving account, credit, cashless transactions; it is referred as financial exclusion. Financial Excluded people live in such a socio-economic environment where they do not meet the requirements of common banking services.

Financial inclusion means providing excess to the formal Financial Services to financial excluded classes population. Financial excluded classes population includes lower income group people, marginalised labourers, unorganised sector workers and people living with valuable conditions. Formal financial services means saving deposits, loans or credit, cashless transactions and other traditional banking services.

Definition:

"Financial inclusion means that individuals and businesses have access to useful and affordable financial products and services that meet their needs – transactions, payments, savings, credit and insurance – delivered in a responsible and sustainable way." - The World Bank Group

Financial inclusion has been defined as "the process of ensuring access to financial services, timely and adequate credit for vulnerable groups such as weaker sections and low-income groups at an affordable cost". (Committee on Financial Inclusion - Chairman: Dr C Rangarajan, RBI, 2008)

Regulatory Measures taken by RBI to facilitate Financial Inclusion

RBI has taken many initiatives to promote financial inclusion in India.

1. No frills account

These accounts were introduced by the RBI in 2012. NO frill accounts are saving accounts which do not have a minimum balance requirement rule. The account holder is given with a debit card, access to ATMs across the country and access to internet banking too. These accounts are also known as zero balance accounts. Unnecessary rules or 'frills' are not applicable to types of accounts. In 2020 'No Frill Accounts' were renamed as 'BSBDA – Basic Savings Bank Deposit Account'. Unlimiteddeposits, No fine on inactive accounts, Zero charges on debit cards and ATM use are the key highlights of these accounts

2. BSBDA – Basic Savings Bank Deposit Account

In 2020 No Frill Accounts were converted as BSBDA by the government. So all the facilities of NO FrillAccounts are applicable to Basic savings bank deposit accounts.

3. LBS – Lead banking scheme

The Lead Bank Scheme was launched in 1969. Under this scheme individual banks were assigned the lead role. Every Lead bank was allotted with a district. The lead bank was expected to act as a leader and to coordinate among the all credit institutions of allotted districts. Which will in turn increase the flow of credit to agriculture, small scale industries and other economic activities in the district..

4. PMJDY – PradhanMantri Jan DhanYojana

PradhanMantri Jan DhanYojana was launched with the slogan 'MeraKhata – BhagyaVidhata' means my bank account is my god. Under this scheme people were allowed to open BSBDA in banks or with business correspondents. In this scheme Adhar linked PMJDY account holders are given the overdraft facility of Rs. 10,000, Rupay Debit Card, accident cover of 2 lakhs, etc.

5. Business correspondent system / Bank Mitra

Banks appoint some retail agents to provide banking services at locations other than a bank branch and ATM; they are called as Business Correspondents. Simply Business Correspondents are the representatives of banks who help villagers in banking transactions e.g., opening bank accounts, depositing and withdrawing money etc.

2.5 SECURITY EXCHANGE BOARD OF INDIA

Security exchange board of India is Apex institution governing and controlling the capital market in India. Security exchange board of India is established by the provisions of SEBI act 1992. Firstly it was established as a non-statutory body in 1988 and later on it was given a status as a statutory body in 1992.

Security exchange board of India Act was passed in 1992.this act is divided into 7 chapters and 35 sections. The structure of SEBI Act is as follow;

Chapter I : Preliminary

Chapter II : Establishment of the Securities and Exchange Board of India

Chapter III : Transfer of Assets, Liabilities, etc., of the Existing Securities and Exchange Board to the Board

Chapter IV : Powers and Functions of the Board

Chapter V : Registration Certificate

Chapter VA: Prohibition of Manipulative and Deceptive Devices, Insider Trading and Substantial Acquisition of Securities or Control

Chapter VI : Finance, Accounts and Audit

Chapter VIA: Penalties and Adjudication

Chapter VIB : Establishment, Jurisdiction, Authority and Procedure of Appellate Tribunal

Chapter VII : Miscellaneous

Functions of SEBI

Securities exchange board of India mainly focuses on protecting the interest of investors. SEBI has handed over with the three types of functions

1. Protective functions
2. Regulatory functions
3. Developmental functions

Let's have a detailed view of those three types of function.

1. Protective functions

Protective Functions of SEBI includes following

- To keep watch on price rigoring
- To prohibit insider trading
- To prevent unfair and fraudulent trade practices in financial markets.
- To promote fair practices
- To educate and create awareness among the investors.

2. Regulatory functions

Security exchange board of India regulates the functioning of the Indian capital market. Regulatory Functions includes following

- To register brokers, sub brokers, merchant bankers and other financial intermediaries in the capital market
- To regulate the takeovers of companies
- To conduct enquiries and audit of stock exchange
- To Design guidelines for proper functioning of financial intermediaries.
- To Register and regulate credit rating agencies

3. Developmental functions

Besides regulating the capital market SEBI also plays a vital role in developing the capital market. Development functions of SEBI Includes following

- To train an educate financial intermediaries
- To conduct research
- To promote fair trading practices
- To develop and promote activities in the stock exchanges
- To Encourage self-regulatory organizations

Powers of SEBI

As like three tier functions SEBI is allotted with three tier powers

1. Quasi-judicial powers

In order to maintain fairness and transparency in the functioning of stock exchange and capital market SEBI can hear and pass judgment on the legal cases pertaining to Fraudulent and unfair practices in the capital market.

2. Quasi legislative powers

To reduce fraudulent and Malpractices in capital market SEBI drafts rules, regulations and other policies which in terms helps to protect the interest of investors, intermediates and traders. SEBI also frames listing obligations, insider trading regulations, and disclosure requirements.

3. Quasi executive powers

SEBI has a power to inspect records of the parties involved in any suspicious activity found in capital market transactions. SEBI has power to take legal action against those who violate the given regulations.

2.6 UNIT END QUESTIONS

Multiple Choice Questions

1. The Reserve Bank of India started functioning from ……….

a. 1st April 1934

b. 1st April 1935.

c. 1st January 1934.

d. 1st January 1935.

2. Under ………… the Central Bank of a country puts limits on the maximum amount of loans a bank can grant to specific sectors.

a. Margin Requirement

b. Capital Rationing

c. Credit Rationing

d. Moral Suasion

3. ………..means providing excess to the formal Financial Services to financial excluded classes' population.

a. Financial inclusion

b. Financial Digitization

c. Financial Upgradation

d. Financial Intermediation

4. Under the Lead bank scheme a Lead bank was allotted with a ………..

a. Village

b. Sub District

c. District

d. State

5. India is the ………country to issue a deposit insurance scheme.

a. First

b. Second

c. Third

d. Fourth

6. In the case of inflation RBI ………the bank rate to contract the money supply

a. Increases

b. Decreases

c. Keeps stable

d. Cancels

True or False

1. The Minimum Reserve system followed by the RBI for issuing currency notes in India.
2. Security exchange board of India Act was passed in 1992
3. NO frill accounts are saving accounts which do not have a minimum balance requirement rule.
4. Rupee 1 notes and coins are issued by the Reserve Bank of India.
5. Deposit insurance schemes provide a safety net for banks in the consequences of bankruptcy.
6. Difference between market value of a security or collateral and available maximum loan for the same security is called Margin requirement.
7. In deflation in order to expand the money supply RBI increases CRR.
8. Open Market operation deals with buying and selling of gold Reserves

Short Notes

1. Tradition functions of RBI
2. Promotional Functions of RBI
3. Supervisory Functions of RBI
4. Quantitative (General) Credit control method
5. Qualitative (Selective) Credit control method
6. SEBI Act 1992

Explain in Details

1. Functions of RBI
2. Techniques of Monetary Control
3. Measures taken by RBI towards Financial Inclusion
4. Powers and Functions of SEBI

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3

INTRODUCTION TO IMPORTANT SEBI REGULATIONS PERTAINING TO CAPITAL MARKET

Unit Structure

3.0 LEARNING OBJECTIVE:

- To facilitate Students with various capital market regulations issued by SEBI
- To introduce learners with various Issue of capital regulations

3.1 ISSUE OF THE CAPITAL DISCLOSURE REQUIREMENTS 2009

The SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 were published by SEBI on 26th August, 2009.

These regulations are divided into ten chapters and twenty schedules

Chapter I	PRELIMINARY
Chapter II	COMMON CONDITIONS FOR PUBLIC ISSUES AND RIGHTS ISSUES.
Chapter III	PROVISIONS AS TO PUBLIC ISSUE
Chapter IV	RIGHTS ISSUE
Chapter V	MANNER OF DISCLOSURES IN THE OFFER DOCUMENTS

Chapter VI	GENERAL OBLIGATIONS OF ISSUER AND INTERMEDIARIES WITH RESPECT TO PUBLIC ISSUE AND RIGHTS ISSUE
Chapter VII	PREFERENTIAL ISSUE
Chapter VIII	QUALIFIED INSTITUTIONS PLACEMENT
Chapter IX	BONUS ISSUE
Chapter X	ISSUE OF INDIAN DEPOSITORY RECEIPTS

These guidelines regulate following issues

- Public Issues and Offers for Sale by any company
- Rights issue, in excess of ₹ 50 lakhs by a listed company
- Preferential Allotments; Bonus Issue; QIPs by listed companies
- An issue of Indian Depository Receipts

Public Issue: Public Issue means Initial Public Offer or further Public Offer.

<u>Initial public offer</u> means an offer of specified securities by an unlisted issuer to the public for subscription and includes an offer for sale of specified securities to the public by any existing holders of such securities in an unlisted issuer; whereas <u>further public offer</u> means an offer of specified securities by a listed issuer to the public for subscription and includes an offer for sale of specified securities to the public by any existing holders of such securities in a listed issuer.

<u>Conditions for Public Issue</u>

In order to go for public issue an issuer must satisfy the following conditions.

• Net tangible assets	At least 3 crore rupees in each of the preceding 3 full years, of which not more than 50% are held in monetary assets.
• Distributable profit in terms of section 205 of companies act	for at least three out of the immediately preceding 5 years

• Net worth	at least one crore rupees in each of the preceding three full years
• Issue size	the aggregate of the proposed issue and all previous issues made in the same financial year in terms of issue size does not exceed five times its pre-issue net worth as per the audited balance sheet of the preceding financial year
• Name Change	if it has changed its name within the last one year, at least fifty per cent. of the revenue for the preceding one full year has been earned by it from the activity indicated by the new name

If an issuer fails to satisfy above mentioned regulation then such issuer can go for public offer by book building process. Where issuer Undertaker to allot at least 50% of net offer to public to Qualified Institutional Buyers and to refund full subscription money if it fails to make allotment to the Qualified Institutional Buyers.

Also issues allowed to make an initial public offer of convertible dep instruments without making a prior public issue of its equity shares and listing thereof.

Right Issue: Rights issue means an offer of specified securities by a listed issuer to the shareholders of the issuer as on the record date fixed for the said purpose.

Conditions for Public Issue

Record Date.	• A listed issuer wishing to go for a rights issue has to announce a record date for the purpose of determining the shareholders eligible to apply for specified securities in the proposed rights issue. • The issuer is not allowed to withdraw rights issue after announcement of the record date. • If the issuer withdraws the rights issue after announcing the record date, it shall not make an application for listing of any of its specified securities on any recognised stock exchange for a period of twelve months from the record date

Restriction	• No issuer shall make a rights issue of equity shares if it has outstanding fully or partly convertible debt instruments at the time of making rights issue, unless it has made reservation of equity shares of the same class in favour of the holders of such outstanding convertible debt instruments in proportion to the convertible part thereof. • The equity shares reserved for the holders of fully or partially convertible debt instruments shall be issued at the time of conversion of such convertible debt instruments on the same terms on which the equity shares offered in the rights issue were issued.
Letter of offer / abridged letter of offer	• The abridged letter of offer, along with application form, shall be dispatched through registered post or speed post to all the existing shareholders at least three days before the date of opening of the issue:
Pre-Issue Advertisement	• The issuer has to issue an advertisement for rights issue which includes The date of completion of despatch of abridged letter of offer , the centers other than registered office of the issuer where the shareholders or the persons entitled to receive the rights entitlement and other matters related to right issue.

Issuers can make Reservation for employees along with rights issue (but value of allotment to any employee shall not exceed one lakh rupees)

Preferential Issue: Preferential issue means an issue of specified securities by a listed issuer to any selected person or group of persons on a private placement basis and does not include an offer of specified securities made through a public issue, rights issue, bonus issue, employee stock option scheme, employee stock purchase scheme or qualified institutions placement or an issue of sweat equity shares or depository receipts issued in a country outside India or foreign securities;

<u>Conditions for preferential issue</u>

Special resolution: A special resolution has been passed by its shareholders;

Dematerialised form: All the equity shares, if any, held by the proposed allottees in the issuer are in dematerialised form;

Compliance: The issuer is in compliance with the conditions for continuous listing of equity shares as specified in the listing agreement with the recognised stock exchange where the equity shares of the issuer are listed;

Permanent Account Number: The issuer has obtained the Permanent Account Number of the proposed allottees

Bonus Issue: Bonus issue means offering free additional shares to existing shareholders. This issue is made by capitalizing the reserves of a company.

Conditions for Bonus issue:

1. **Provision in Articles of Association:** A company can issue bonus shares if it is authorised by its articles of association for issue of bonus shares, capitalisation of reserves, etc. If there is no such provision in the articles of association, the issuer shall pass a resolution at its general body meeting making provisions in the articles of associations for capitalisation of reserve;
2. Issuer should **not have defaulted in payment of interest or principa**l in respect of fixed deposits or debt securities issued by it.
3. It has sufficient reason to believe that it has n**ot defaulted in respect of the payment of statutory dues of the employees** such as contribution to provident fund, gratuity and bonus;
4. The partly paid shares, if any outstanding on the date of allotment, are made f**ully paid up**

Issue of Indian Depository Receipts

Depository receipt is a way to raise funds from foreign countries. Foreign companies can enter into the Indian securities market by issuingIndian depository receipts. An issuing company should be listed in its home country and not prohibited to issue securities by any regulatory body. Also the issuing company should have a track record of compliance with securities market regulations in its home country.

Conditions for issue of IDR

Issue Size	Issue size shall not be less than fifty crore rupees;
Procedure	procedure to be followed by each class of applicant for applying shall be mentioned in the prospectus
minimum application amount	minimum application amount shall be twenty thousand rupees;
Manner of allocation	1. At least fifty per cent. of the IDR issued shall be allotted to qualified institutional buyers on

	proportionate basis as per illustration given in Part C of Schedule XI; 2. The balance fifty per cent. may be allocated among the categories of non-institutional investors and retail individual investors including employees at the discretion of the issuer
Denomination of IDR	At any given time, there shall be only one denomination of IDR of the issuing company.

3.2 SEBI (PROHIBITION OF INSIDER TRADING) REGULATIONS 2015

Insider trading is considered as unethical practice. Insider trading means buying and selling of a company's securities by people who have nonpublic or material information which can influence investment decisions. Employees, promoters, directors, executives of a company have access to the company's internal or strategic information; by virtue of their position in the company. These Employees, promoters, directors, executives are called insiders. Insiders use strategic information of a company for buying and selling of a company's securities. Securities Exchange Board of India strongly prohibits practicing Insider Trading in Stock Market. Because such activities are detrimental to the interest of general investors. If company's employees take undue benefit of their position to trade in the market then other common shareholders will be at disadvantage. But if such strategic, non-public information is made open to general public or common investors then such practice won't be considered as illegal insider trading.

For example, a director of a company knows about a proposed merger of the company. He discussed this confidential information in family gatherings with his relatives. Very next day all relatives and their friends sold out all their holdings in the company before such a proposal was officially announced by the company. Here the said director did Insider Trading.

According to SEBI (Prohibition of Insider Trading) Regulations 2015; Insider means A Person connected to a company or person having Unpublished Price Sensitive Information (UPSI). Connected Person means any person who has any connection i.e. directly or indirectly with company in any capacity, Unpublished Price Sensitive Information (UPSI) means Any information relating to Company or, Its securities which can affect price of the security in the market. This information includes information about financial results, dividend declaration, proposed merger or acquisition, change in the management and capital structure of the company. The definition of trading includes buying, selling,dealing , subscribing or entering into agreement to buy or sell securities of said company.

Restriction on Communication And Trading by Insiders

Chapter II - Regulation 3 of SEBI (Prohibition of Insider Trading) Regulations 2015 prohibits insiders fromecommunicating unpublished price sensitive information, related to a company or securities of company whether listed or to be listed ; to any person including company's other employees (insiders). Insiders are only allowed to share such information in case of discharging their legal duties and obligations. This regulation also prohibits outsider from procuring any Unpublished Price Sensitive Information from Insiders. Also directors are expected to maintain confidentiality and follow non disclosure obligations. The regulation entrusts the duty of maintaining a digital database of concerned insiders having access to such unpublished information.

Trading when in Possession of Unpublished Price Sensitive Information

Chapter II - Regulation 4 of SEBI (Prohibition of Insider Trading) Regulations 2015 prohibits insiders possessing Unpublished Price Sensitive Information trading in the securities of company whether listed on to be listed. But an Insider entering into such a transaction is exempted from above regulation if he proves that the transaction was

- an off market transaction among themselves(inter se),
- block deal transaction i.e.(single transaction of minimum Rs.Crore)
- pursuant to statutory or regulatory obligation
- pursuant to exercise pre- determine (pre priced)stock option plan
- Undertaken through trading plan (Regulation 5 explain Trading Plan as an insider should prepare a trading plan, present it and get approved from compliance officer,make public disclosure of such plan and then carry out the trading according to that plan)

Disclosures of Trading By Insiders:

Chapter III - Regulation 6 of SEBI (Prohibition of Insider Trading) Regulations 2015 throws light on General provision of Disclosures of Trading to be made Insiders. According to this regulation an insider has to make all disclosures in prescribed manner only. Insider has to give disclosure of trading by immediate relatives, disclosure of trading in derivatives of securities and the traded value of the derivatives. Companies should maintain record of these disclosures for a minimum period of five years in a specified manner.

Regulation 7 (1) explains initial disclosures which states that, A Key Managerial Personnel or Director (promoter) has to give disclosure of his holdings in the company since he was appointed as promoter within the seven days from the appointment as promoter.

Regulation 7 (2) explains Continual Disclosures which states that, A Promoter or Director has to disclose to a company regarding acquisition and disposal of shares or securities; if value of transaction or serious transactions exceeds Rupees Ten Lakhs (or any other specified amount) in one calendar quarter. Also the company has to give disclosure to Stock Exchange regarding the above said transaction within two days of receipt of such disclosure.

Regulation 7 (3) explains Disclosures by Other Connected Persons which states that, in order to monitor compliance with these regulations, a company whose securities are listedon a stock

exchange may, at its discretion can ask any other connected person or class of connected persons to make disclosures of holdings and trading in securities of the company in prescribed form.

Code of Fair Disclosure

Chapter III - Regulation 8 of SEBI (Prohibition of Insider Trading) Regulations 2015 explains Code of Fair Disclosure. According to this regulation The board of directors of every company, whose securities are listed on a stock exchange, should formulate a code of practices and procedures for fair disclosure of unpublished price sensitive information ; and publish on its official website. Company should sent prompt intimation of every such code of practice and procedures for fair disclosure of unpublished price Sensitive information and every amendment thereto to the stock exchanges where the securities are listed.

3.3 SEBI (PROHIBITION OF FRAUDULENT AND UNFAIR TRADE PRACTICES RELATED TO SECURITIES MARKET) REGULATIONS- 2003

Securities Exchange Board of Indiais entrusted with a primary responsibility of protecting the interest of investors. SEBI regulates operations in the security market and tries to bring transparency in the mechanism. SEBI prohibits fraudulent and unfair trade practices in the security market for which it keeps close eye on the security market operations.

As per SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations, 2003 *"Fraud includes any act, expression, omission or concealment committed whether in a deceitful manner or not by a person or by any other person with his connivance or by his agent while dealing in securities in order to induce another person or his agent to deal in securities, whether or not there is any wrongful gain or avoidance of any loss".*

The definition of fraud also includes knowing misrepresentation of the truth, concealment of material fact, wrong suggestion , fake promise, reckless and careless representation, fraudulent act or omission specified under law, deceptive behaviour, false statement, giving misinformation.

Prohibition of unfair dealings in Securities

Chapter II- regulation 3 of SEBI (Prohibition of Fraudulent and Unfair Trade Practices Related to Securities market) Regulations- 2003 states that Nobody is directly or indirectly allowed to sell, buy or deal in securities in a fraudulent way. No one is allowed to use any manipulative or deceptive mechanism to breach the provisions of the Act; No one is allowed to use any scheme or device or a strategy to defraud the dealings connected with securities (listed or proposed to be listed). No one should get engaged with any fraudulent activity which against the provisions of the Regulations

Prohibition of Manipulative, Fraudulent and Unfair trade practices

Chapter II-Regulation (4) of SEBI (Prohibition of Fraudulent and Unfair Trade Practices Related to Securities market) Regulations- 2003 states that No person shall enter in a transaction having frauds or unfair trade practices in the securitiesmarket. Manipulative, fraudulent or an unfair trade practice involves

- Knowingly creating false or misleading appearance of trading in securities market;
- Dealing in securities in order to inflate or cause fluctuations in securities. (A person should have intention of transfer of ownership only.)
- Paying money or money equivalent to any person for the artificially inflating,depressing, maintaining of creating fluctuations in the price of securities
- Doing any act which can manipulate the price of securities. This includes manipulating or influencing reference price or benchmark price.
- Publishing or reporting any kind of false information relating to securities, including financial results, financial statements, mergers and acquisitions, regulatory approvals, to make a person handle with securities
- Entering into securities transaction without any intention of performing the said transaction or changing ownership of involved security in said transaction
- dealing, selling, or pledging with stolen, counterfeit (fake or fraudulently issued securities.

Investigation/ Investigating Authority

Chapter III-Regulation (5) of SEBI (Prohibition of Fraudulent and Unfair Trade Practices Related to Securities market) Regulations- 2003 deal with

Power of the SEBI to order investigation. It states that If any person or intermediary is found dealing in any securities market transaction in such a way that is detrimental to investors interest , violating these Regulations or any provision of Securities Exchange Board of India Act, in such case SEBI can appoint 'Investigating Authority' to investigate affairs of such person or intermediary. Investigating authority has to report SEBI in the manner prescribed in Section 11C of Securities Exchange Board of India Act.

In order to conduct investigation Authority is conferred with following powers

- To call for information or records from any person specified in section 11(2)(i) of the SEBI Act;
- To undertake inspection of any book, register, or other document or record of any listed public company or a public companywhich intends to go for securities listing on any recognised stock exchange, and has violated these regulations.
- To furnish information or to ask to produce any book, register, or other document or record from any intermediary or person associated with the securities market.
- To keep custody of books, registers, or other documents or records produced for the purpose of investigation, these documents are kept in the custody of Investing Authority maximum upto one month which can be further extended upto six months. Investing authority has power to call such documents again if required.
- To orally examine any person who is under investigation or any director, partner, member or employee of such person and record his statement to use as evidence against him. But the signature of the said person is mandatory on these notes.
- To examine on oath any manager, managing director, officer or any other employee of any intermediary or any person associated with the securities market in any manner in relation to his business.

Regulation 7 says that investing authority can exercise following powers with prior approval of Chairman or members of SEBI.

- To call for information or records in respect of any transaction which is under investigation; from any bank , authority , board or corporation established under Central, State or Provincial Act.
- To seize books, registers, or other documents or records If investing authority believes that book, register, or other document or record of any intermediary or person associated to securities market are under threat of destroyal, mutilation ,falsification, alteration, or secretion during course of investigation, investigating authority can apply to First Class Judicial Magistrate who has jurisdiction to issue order for seizure of such books, registers, or other documents or records

- To keep custody of books, registers, or other documents or records seized under these regulations. These documents are kept in custody till the conclusion of the investigation.
- Search and seizure in these regulations should be carried out in accordance with The Code of Criminal Procedure 1973 (2 of 1974).

According to Regulation 8; every person who is under investigation should cooperate with the investing authority. After completing the investigation the investing authority has to submit a report to SEBI. If required, the investing authority may submit an interim report. (Regulation 9)

Enforcement by Board

Chapter III-Regulation (10) of SEBI (Prohibition of Fraudulent and Unfair Trade Practices Related to Securities market) Regulations- 2003 deal with Enforcement by SEBI. After considering the report submitted by investing authority if SEB Iis satisfied that there is violation of these regulation and after giving reasonable opportunities of hearing SEBI can take following actions (Mentioned in Regulation 11 and 12)

- Suspension of trading of security found to be involved in fraudulent or unfair trade practice in any recognised stock exchange.
- Restraining a person from accessing the securities market and prohibiting dealing in securities.
- Suspending any office bearer of any stock exchange from holding such a position.
- Retaining or impounding proceeds from such a transaction in securities which is in violation of these regulations.
- Directing any intermediary or person associated with the securities market in respect of not to dispose of or alienate the assets forming part of fraudulent and unfair trade practice.
- Calling upon any officer,employee or representative of the person concerned to refrain from dealing in securities in a particular manner.
- Prohibiting the person from disposing of any securities acquired in contravention to these regulations.
- Directing the person in disposing of any securities acquired in contravention to these regulations in the manner prescribed by SEBI.

SEBI has to release a press note and notification on the official website in respect of the final order.

SEBI Substantial Acquisition and Takeover Regulations - 2011

In order to regulate the acquisition of shares in listed companies in India SEBI issued Substantial Acquisition and Takeover Regulations in 2011

Chapter 1 -Article 2 explains the various terms like, acquisition, acquirer,control etc.

“Acquisition” means, directly or indirectly, acquiring or agreeing to acquire shares or voting rights in, or control over, a target company.

“Acquirer” means any person who, directly or indirectly, acquires or agrees to acquire whether by himself, or through, or with persons acting in concert with him, shares or voting rights in, or control over a target company

“Control” includes the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner

According to Chapter II -Regulation 3 - no one is allowed to acquire more than twenty percent of the shares or voting power of the target company without making a public announcement of an open offer of acquisition of shares of the target company.

If any person already has twenty percent or more voting power but less than maximum permissible non-public shareholding with him and he acquires additional five percent voting power in a financial year then mandatory public announcement of an open offer of acquisition of shares of the target company is required.

<u>Delisting Offer</u>

Regulation 5A deals with delisting offer. When the acquirer makes a public announcement of an open offer for acquiring shares or voting rights or control of a target company as per sub regulation (1) of regulation 3, regulation 4 or regulation 5, the acquirer may seek the delisting of the target company by making a delisting offer in accordance with this regulation:

Provided that the acquirer shall have declared his intention to so delist the target company at the time of making such a public announcement of an open offer as well as at the time of making the detailed public statement.

<u>Voluntary Offer</u>

An acquirer, holds shares or voting rights in a target company entitling them to exercise twenty-five per cent or more but less than the maximum permissible non-public shareholding, can voluntarily make a public announcement of an open offer for acquiring shares in accordance with these regulations, subject to their aggregate shareholding after completion of the open offer not exceeding the maximum permissible nonpublic shareholding. Provided that where an acquirer has acquired shares of the target company in the preceding fifty-two weeks without attracting the obligation to make a public announcement of an open offer, he shall not be eligible to voluntarily make a public announcement of an open offer for acquiring shares under this regulation:

3.4 MUTUAL FUND: SEBI (MUTUAL FUNDS) REGULATIONS -1996

Chapter I, Section 2(q) defines mutual fund as — *“mutual fund means a fund established in the form of a trust to raise monies through the sale of units to the public or a section of the public under one or more schemes for investing in securities including money market instruments or gold or gold related instruments or real estate assets.”*

Registration of Mutual Fund (Chapter 2

Sponsors have to make an application to SEBI for the registration of MutualFund. This application has to be made in Form alongwith non-refundable application fees mentioned in Schedule II of the regulation. SEBI can reject incomplete applications.

Eligibility Criteria

- Sponsors should have a sound track record and general reputation in fair business activities. Sound track record means

1. Carrying business in financial services for not less than five years
2. Positive net worth for immediately preceding five years
3. Net Worth of immediately preceding one year should be more than capital contribution made in asset management company.
4. Sonser should have profit after depreciation, interest and tax for immediately preceding five years.

- For existing funds; trust deed must be approved by SEBI
- Sponsor has contributed at least 40% to the net worth of Asset management company.
- Sponsor, director or principal officer should not be guilty of any fraud or any economic offense or convicted of offenses involving moral turpitude.
- Appointment of trustees to the fund ,asset management company, custodian (Custodian of securities gold and other instruments) should be made as per the provisions of regulations.

Those sponsors who fulfill above mentioned criteria get Registration Certificate.
Note :*“Sponsor means any person who, acting alone or in combination with another body corporate, establishes a mutual fund”*

Trustees and Trust Deed (Chapter III)

Mutual funds operate in the form of trust. Trust deed is the instrument of trust. Trust deed has to be registered as per Indian Registration Act 1906. Sponsor Executes this deed in favour of Trustees. Chapter III also puts light on appointment of trustees, disqualification of trustees, rights and obligations of trustees.

Asset Management Company

The Asset Management Company has to apply for approval with SEBI. Thais application s made in the Form D. Sponsors or trustees can appoint the asset management company which has got approval from SEBI. In order to get approval from SEBI an asset management company should fulfill following criteria

- Asset Management Company should have a sound track record and general reputation in fair business activities.
- Directors Or key personnel of asset management company should not be guilty of any fraud or any economic offense or convicted of offenses involving moral turpitude.
- At least 50% of the board of directors should not be associated in any manner with any sponsor, subsidiary of sponsor or the trustees.
- The Chairman should not be a trustee of any other mutual fund company.
- The Asset Management Company should have networth of not less than Rs. Fifty crore

Custodian

In order to carry out custodial services every mutual fund has to appoint a custodian. As soon as an appointment is made mutual fund has to intimate SEBI about such appointment within fifteen days. Custodian in which the sponsor, associates of sponsor hold 50% or more voting rights or 50 % or more directors of custodian representing the interest of sponsor should be appointed as custodian for the same sponsor. Mutual funds have to enter in the agreement with custodian.

A real estate mutual fund scheme

A real estate mutual fund scheme of a mutual fund registered under this regulation mainly (at least 35%) invests in the real estate. Every real estate mutual fund scheme has to invest at least 75% of net assets of the scheme in real estate assets; mortgage backed securities, equity shares or debentures of companies engaged in dealing in real estate assets or in undertaking real estate development projects, whether listed on a recognized stock exchange in India or not; and the balance (25%) in other securities.

Infrastructure debt fund scheme

Infrastructure debt fund scheme means a mutual fund scheme that invests primarily (minimum 90% of scheme assets) in

- The debt securities or securitized debt instrument of infrastructure companies or infrastructure capital companies or infrastructure projects or
- special purpose vehicles which are created for the purpose of facilitating or promoting investment in infrastructure, and other permissible assets in accordance with these regulations or
- Bank loans in respect of completed and revenue generating projects of infrastructure companies or projects or special purpose vehicles.

Procedure and Action in Case of Default (Chapter IX)

If any mutual fund contravenes or violates the provisions specified under this regulation, or fails to furnish information required, does not cooperate with the inspection carried out by SEBI,guilty of misconduct, fails to resolve complaints etc,

Such cases are dealt as per the provisions given under the Securities and Exchange Board of India (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002.

The Board may suspension or cancellation of registration of an intermediary holding a certificate of registration who fails to exercise due diligence or to comply with the obligations under these regulations

3.5 UNIT END QUESTIONS

Multiple Choice Questions

1. …………means an offer of specified securities by an unlisted issuer to the public for subscription

a. Initial public offer
b. Further Public Offer
c. Preferential Allotment
d. Private Placement

2. Rights issue means an offer of specified securities by a listed issuer to the …………of the issuer.

a. Employees
b. Promoters
c. Shareholders
d. Creditors

3. Mutual funds operate in the form of ……….

a. Company
b. Association
c. Trust.
d. Registered Society

4. In order to carry out custodial services every mutual fund has to appoint a …………..
a. Merchant Banker
b. Issuer Manager
c. Agent
d. Custodian

5. Securities Exchange Board of India is entrusted with a primary responsibility of protecting the interest of ………
a. Investors
b. Policyholderss
c. Customers
d. Employees

True or False

1. Further public offer means an offer of specified securities by a listed issuer to the public for subscription
2. Insider trading is considered as unethical practice
3. Acquisition means, directly or indirectly, acquiring or agreeing to acquire shares or voting rights in, or control over, a target company.
4. Trust deed is the instrument of trust.
5. An acquirer, holds shares or voting rights in a target company entitling them to exercise twenty-five per cent or more but less than the maximum permissible non-public shareholding, can voluntarily make a public announcement of an open offer for acquiring shares in accordance with these regulations,
6. Insider trading means buying and selling of a company's securities by people who have non-public or material information which can influence investment decisions.

Write Short Notes

1. Investigating Authority
2. Conditions for Public Issue
3. Conditions for Right Issue
4. Conditions for Bonus Issue
5. Conditions for Preferential Issue
6. Conditions for Issue of Indian Depository Receipt
7. Real Estate Mutual Funds
8. Infrastructure Debt Fund

Explain in Details

1. Issue of the Capital Disclosure Requirements 2009
2. Prohibition of Insider Trading Regulations 2015
3. Prohibition of Fraudulent and Unfair Trade Practices Related to Securities market Regulations- 2003
4. Substantial Acquisition and Takeover Regulations - 2011
5. Mutual Funds Regulations -1996

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4

IRDA

Unit Structure

4.0 LEARNING OBJECTIVES

After studying this unit, you will be able to:

- To describe Salient features of the IRDA Act, 1999
- To understand IRDA (protection of policy holder interests) Regulations 2002 (duties, power and functions)
- To discuss competition Commission of India Concept of competition
- To describe Development of Competition Law
- To analyze Competition Policy – Competition Act, 2002

4.1 INTRODUCTION

The idea of insurance has been around for more than 6,000 years, and people back then were likewise looking for some sort of safety net. When this need was recognised, the idea of insurance was born. "An agreement by which an organisation commits to offer a guarantee of compensation for defined loss, damage, illness, or death in return for payment of a specified premium," according to the dictionary, is what insurance is.

This concept of security's expanding necessity gave rise to general insurance first, then life insurance. When insurance was first introduced in India, it was governed by law. However, a separate regulatory organisation known as the Insurance Regulatory and Development Authority was established to establish a stand-alone body to oversee the operation of the expanding insurance industry.

The apex body that oversees and controls the insurance industry in India is called IRDA, or Insurance Regulatory and Development Authority of India. The main goals of the IRDA are to protect policyholder interests and promote the expansion of insurance in the nation. The IRDA oversees both general insurance businesses operating in the nation as well as life insurance when it comes to insurance industry regulation.

4.2 SALIENT FEATURES OF THE IRDA ACT, 1999

1. The insurance sector in India is thrown open to the private sector. The 2nd and 3rd schedules of the Act provide for removal of existing corporations (or companies) to carry out the business of life and general (non-life) insurance in India.

2. An Indian insurance company is a company scheduled under the Companies Act, 1956, in which foreign equity does not exceed 26% of the total equity shareholding, including the equity shareholding of NRIs, FIIs and OCBs.

3. After start of an insurance company, the Indian promoters can hold more than 26% of the total equity holding for a period of 10 years, the balance shares being held by non-promoter Indian shareholders who will not include the equity of the foreign promoters, and the shareholding of NRIs, FIIs and OCBs.

4. After the permissible period of 10 years, excess equity above the prescribed level of 26% is disinvested as per a phased programme to be indicated by IRDA. The Central Government is empower to extend the period of ten years in individual cases and also to provide for higher ceiling on share holding of Indian promoters in excess of which disinvestment is required.

4.3 IRDA (PROTECTION OF POLICY HOLDER INTERESTS) REGULATIONS 2002 (DUTIES, POWER AND FUNCTIONS)

Under Section 14 of the IRDA Act, 1999, the responsibilities, authority, and functions of the IRDA are outlined. In accordance with the terms of this Act and any other applicable laws that are being enforced, the IRDA Authority is responsible for promoting, regulating, and ensuring the orderly expansion of the insurance and re-insurance industries throughout India.

Without limiting the breadth of the IRDA Act's sub-section (1) provisions, the Authority shall have the following powers and duties:

- A certificate of registration will be given to the applicant, and any registration that is judged inappropriate will be modified, renewed, withdrawn, suspended, or cancelled.
- defending the rights of policyholders in situations involving the transfer of insurance policies, policyholder nominations, the payment of insurance claims, insurable interests, policy surrender values, and other terms and conditions based on insurance contracts.
- Specifying requisite qualifications, practical training and code of conduct for insurance intermediaries, insurance brokers and agents.
- Specifying the code of conduct for surveyors and loss assessors.
- Promotion of efficiency in the conduct of insurance business.
- Promoting and regulating professional organizations connected with the insurance and re-insurance business across India.
- Levying fees, commission and other charges for carrying out the purposes of this Act.
- Calling for data or information from, undertaking inspection of, conducting enquiries and investigations, conducting audit of the insurers, intermediaries, insurance intermediaries and other organizations connected with the insurance business.
- Under section 64U of the Insurance Act, 1938 (4 of 1938), controlling and regulation of the rates, advantages, terms and conditions etc that may be offered by insurers (or Insurance Companies) in respect of general insurance business not so controlled and regulated by the Tariff Advisory Committee.
- Specifying the manner and form in which books of account shall be maintained and statement of accounts, financial statements etc shall be rendered by insurers and other insurance intermediaries.
- Keeping a tab, exercising control and regulating investment of funds by insurance companies.

- Regulating the maintenance of margin of solvency by the Insurers.
- Adjudication of disputes between insurers and intermediaries or insurance intermediaries, hospitals, healthcare organizations or with customers.
- To effectively supervise the functioning of the Tariff Advisory Committee.
- Specifying the percentage of premium income of the insurer to finance schemes for promoting and regulating professional organizations referred to in clause (f);
- Specifying the percentage of life insurance business and general (or non-life) insurance business to be undertaken by the insurance company in the rural or social sector.
- Exercising any such other powers that may be prescribed with passage of time.

4.4 COMPETITION COMMISSION OF INDIA

In order to administer, implement, and enforce the Competition Act, 2002, the Government of India formed the Competition Commission of India (CCI) in March 2009.

In India, the CCI regulates the market for goods and services. The Commission was founded in 2003, but it wasn't until 2009 that it reached full functionality. Through active involvement with all stakeholders, the government, and international jurisdiction, it seeks to create a competitive environment in the Indian economy. The Commission's goals are as follows:

- in order to stop actions that hurt competitiveness.
- to encourage and maintain market competition.
- to safeguard consumers' interests.
- to guarantee trade freedom.

The CCI was established by the Vajpayee government, under the provisions of the **Competition Act 2002**.

1. The **Competition (Amendment) Act, 2007** was enacted to amend the Competition Act, 2002.
2. This led to the establishment of the CCI and the Competition Appellate Tribunal.

- The **Competition Appellate Tribunal** has been established by the Central Government to hear and dispose of appeals against any direction issued or decision made or order passed by the CCI.

- The government replaced the Competition Appellate Tribunal (COMPAT) with the National Company Law Appellate Tribunal (NCLAT) in 2017.

4.5 DEVELOPMENT OF COMPETITION LAW

Competition law, also known as antitrust law in some countries, is a legal framework designed to promote fair competition and prevent anti-competitive practices in the marketplace. The development of competition law can be traced back to the late 19th and early 20th centuries, when industrialization led to the growth of large corporations and concerns about monopolies and their negative effects on competition and consumers.

One of the earliest competition laws was the Sherman Antitrust Act, which was enacted in the United States in 1890. The law prohibited monopolies and other anti-competitive practices, such as price fixing and market allocation agreements. The Sherman Act was followed by other U.S. antitrust laws, including the Clayton Antitrust Act in 1914 and the Federal Trade Commission Act in 1914, which established the Federal Trade Commission to enforce the antitrust laws.

In Europe, competition law developed later than in the United States, with the first European competition law being the German Law Against Restraints of Competition in 1958. The Treaty of Rome, signed in 1957, also included provisions on competition policy and established the European Economic Community, which later became the European Union. The European Commission was given the responsibility of enforcing EU competition law, which has become one of the most influential competition regimes in the world.

Competition law has continued to evolve and expand over the years, with many countries around the world enacting their own competition laws and regulatory agencies. The focus of competition law has also shifted over time, with an increased emphasis on protecting consumer welfare and promoting innovation and economic growth. Today, competition law remains a key tool for promoting competition and preventing anti-competitive practices in the global marketplace.

4.6 COMPETITION POLICY – COMPETITION ACT, 2002

Indian competition law is governed by the Competition Act, 2002, which was passed by the Indian Parliament. In 2003, the Act was given presidential approval.

1. The Competition Act of 2002 replaced the Monopolies and Restrictive Trade Practices Act of 1969 (MRTP Act).

- Based on the Raghavan Committee's recommendations, this was carried out.

2. The Act:

- prohibits agreements that are anti-competitive
- prohibits businesses from abusing their dominant position, and
- regulates mergers and acquisitions (M&A), control acquisitions, and other combinations that may or may not have a significant negative impact on Indian competition.

3. The Act adheres to the principles of contemporary competition laws.

Competition Commission of India – Functions

The Competition Act's preamble emphasises the need of preventing unfair business practises and fostering healthy competition for the growth of the nation's economy.

1. Ensuring that consumer welfare and benefits are maintained in the Indian market is one of the CCI's primary responsibilities.
2. A faster and more inclusive pace of economic growth by promoting fair and healthy competition in the country's economic operations.
3. Ensuring the effective use of the nation's resources through putting competition policies into practise.
4. The Commission also advocates for increased competition.
5. It also serves as the small business antitrust ombudsman..
6. In order to make sure that any foreign firm that joins the Indian market through a merger or purchase complies with India's competition regulations, the Competition Act, 2002, the CCI will also closely examine the company.
7. CCI also facilitates communication and collaboration with the other economic regulatory bodies. This will guarantee that the sectoral regulatory legislation and the laws governing competition are compatible.
8. It also serves as a business facilitator by making sure that there is harmonious coexistence between small and large businesses and that a small number of companies do not come to dominate the market.

4.6.1 Anti-Competitive Agreements

Anti-competitive agreements are agreements between businesses that restrict competition and harm consumers by limiting their choices and increasing prices. The Competition Act, 2002, prohibits anti-competitive agreements that have an adverse impact on competition in the market. Here are some examples of anti-competitive agreements:

- Price-fixing: This is an agreement between competitors to set prices at a certain level, which can result in higher prices for consumers and restrict competition.

- Market allocation: This is an agreement between competitors to divide markets or customers among themselves, which can reduce competition and result in higher prices for consumers.

- Bid-rigging: This is an agreement between competitors to rig bids in order to eliminate competition and increase prices.

- Collusive tendering: This is an agreement between businesses bidding for a contract to share information and coordinate their bids, which can eliminate competition and result in higher prices.

- Output restrictions: This is an agreement between competitors to limit the production or supply of goods or services, which can result in higher prices for consumers.

- Exclusive dealing: This is an agreement between a supplier and a customer that restricts the customer from dealing with competitors of the supplier.

- Refusal to deal: This is an agreement between competitors to refuse to deal with certain customers or suppliers, which can harm competition and restrict consumer choice.

Competition-preventing, -restraining, or -distorting agreements are known as anti-competitive agreements. Anti-competitive agreements, decisions, and activities are forbidden by Section 34 of the Competition Act. Competitors who agree to fix, control, or maintain the pricing of goods or services are said to be engaged in price fixing.

4.6.2 Abuse of dominant position

In English, "dominant position" refers to something that, in comparison to others, is in a better position. However, unless someone is abusing their power, remaining in a superior position doesn't hurt anyone. Thus, holding a dominant position cannot be viewed as inherently evil. However, it is deemed insufficient to abuse a position based on superiority.

Abuse of the dominating position makes it impossible for other competitors to compete with the dominant enterprise on the basis of merit, prevents fair competition between the firms, and abuses consumers. The Act views misuse of dominance rather than it being anti-competitive. The focus of competition policy should be on abuse of dominance rather than dominance itself. Competition authorities should condemn any abuse of dominance that stifles, restricts, or distorts competition.

Abuse of dominant position includes:

- Imposing unfair condition or price
- Predatory pricing
- Limiting production/market or technical development
- Certain barrier to entry
- Applying dissimilar conditions to similar transactions
- Denying market access
- Using dominant position in one market to gain advantages in another market

4.6.3 Combination, regulation of combinations

Combination refers to a merger or amalgamation of two or more businesses, as well as the acquisition of control, ownership, voting rights, or assets of a business by a third party, provided that I the financial requirements outlined in Section 5 of the Act are met, and (ii) the merger, amalgamation, or acquisition is not subject to any notification of an exemption. According to Section 6(2) of the Act, anyone or any enterprise that intends to join into a combination must notify the Commission before the deal is finalised. However, schedule l of the Combination Regulation's types of combinations are typically not anticipated to have a materially unfavourable impact on competition in India, hence notice under subsection (2) of section 6 of the Act is typically not required.

The Commission may modify or prohibit a combination if it has or is likely to have a materially unfavourable impact on competition in the relevant market in India.

The Competition Act of 2002 established the Indian Competition Commission. The Competition Act may be governed and enforced by this legislative authority, including through the imposition of fines. When the Vajpayee administration's liberalisation made a robust competitive environment required, it was founded.

A chairman, a minimum of two board members, and a maximum of six board members make up the Commission. These members must have at least 15 years of professional experience in their respective disciplines.

Its goals, responsibilities, and authority are listed in the Competition Act of 2002. Its primary responsibility and goal is to guarantee that Indian markets retain a healthy and fair competitive environment, and it has the authority to do so.

In order to conduct business in India, one must be aware of and follow all applicable laws and regulations. Market competition is a significant challenge that requires careful management.

Businesses must understand that while competition leads to wealth, thriving and striving must be an ongoing effort. The following are some of the various considerations for commercial establishments:

- Markets are prone to cartel development, which increases the possibility of monopoly formation.
- It is crucial to understand that such associations are prohibited by the Competition Act of 2002.
- When discussions are made with competitors documentation of the same should be done.
- Any meetings wherein any matter is being discussed, which shall raise issues under the Competition Law shall be avoided.
- It is advisable to avoid discussions pertaining to price and the actual cost to the company.
- Appointment of an Ombudsman for advice on the Competition Law so as to prevent any legal issues may be done.
- Communication aspects although seem trivial may leave an impact when it comes to abuse of dominant position issues. Any statements made shall be weighed carefully.

The Competition Act, 2002 is a comprehensive law and the intent of the legislation is to promote fair competition, catch up with the global economy, safeguard the interest of the consumers and ensure a stable market for India.

4.6.4 Competition commission of India

The Competition Commission of India (CCI) is an independent statutory body established under the Competition Act, 2002, which is the primary legislation governing competition law in India. The Act was enacted with the objective of promoting competition in the Indian market and preventing anti-competitive practices.

The Competition Act, 2002, provides for the establishment of the CCI as a quasi-judicial body with the power to investigate and adjudicate on cases related to anti-competitive practices and abuse of dominant position. The Act also provides for the establishment of an appellate body, the Competition Appellate Tribunal (COMPAT), which hears appeals against the orders of the CCI.

The CCI has a wide range of powers and functions, including:

- Investigating and adjudicating on cases of anti-competitive agreements, abuse of dominant position, and combinations (mergers and acquisitions).

- Regulating and promoting competition in various sectors of the economy.
- Making recommendations to the central government on competition-related issues.
- Conducting advocacy and creating awareness about competition law and its benefits.
- The CCI has the power to impose fines and penalties on companies found to be in violation of the Competition Act, 2002. The penalties can be as high as 10% of the turnover of the company in the preceding financial year. In addition to fines and penalties, the CCI can also issue orders directing companies to cease and desist from anti-competitive practices, modify agreements, or even dissolve companies in certain cases.

Overall, the Competition Commission of India plays a critical role in ensuring a level playing field in the Indian market and promoting competition for the benefit of consumers and the economy as a whole.

4.6.5 Appearance before commission and Appellate Tribunal

The Competition Act, 2002 provides for the procedure to be followed by parties appearing before the Competition Commission of India (CCI) and the Competition Appellate Tribunal (COMPAT). Here are some key points to keep in mind:

- Appearance before the CCI: Parties appearing before the CCI must do so in person or through their authorized representatives. They have the right to be heard and present evidence in support of their case.
- Written submissions: Parties may submit written arguments and evidence to the CCI, either before or after their appearance in person. The CCI may also request parties to submit additional information and evidence.
- Confidentiality: Parties may request confidentiality for any information or evidence submitted to the CCI, but the CCI has the final decision on whether such information will be treated as confidential or not.
- Opportunity to respond: The CCI will provide parties with an opportunity to respond to any evidence or arguments presented by the other party.
- Orders of the CCI: The CCI may issue interim orders or final orders after the hearing, depending on the nature of the case. These orders may require parties to take certain actions or refrain from certain activities. The orders are enforceable by law.
- Appeals before the COMPAT: Parties aggrieved by the orders of the CCI may file an appeal before the COMPAT. The appeal must be filed

within 60 days of the date of the order. The COMPAT has the power to confirm, modify or set aside the order of the CCI.

- Appearance before the COMPAT: Parties appearing before the COMPAT must do so in person or through their authorized representatives. They have the right to be heard and present arguments and evidence in support of their case.

- Written submissions: Parties may submit written arguments and evidence to the COMPAT, either before or after their appearance in person. The COMPAT may also request parties to submit additional information and evidence.

- Opportunity to respond: The COMPAT will provide parties with an opportunity to respond to any evidence or arguments presented by the other party.

- Orders of the COMPAT: The COMPAT may issue orders after the hearing, which may confirm, modify or set aside the order of the CCI. The orders of the COMPAT are final and binding on the parties.

4.6.6 Compliance of Competition Law

Compliance with competition law is important for businesses as it helps promote fair competition and prevents anti-competitive practices. Here are some key steps that businesses can take to ensure compliance with competition law:

- Develop a compliance program: Businesses should develop and implement a comprehensive compliance program that includes policies and procedures for identifying and addressing potential competition law risks.

- Training: All employees, especially those involved in sales, marketing, and pricing, should receive regular training on competition law compliance. This will help to raise awareness and ensure that employees understand the importance of compliance.

- Monitor industry trends: Businesses should monitor industry trends and market developments, including the activities of competitors, to identify potential anti-competitive behavior.

- Review contracts: Businesses should review all agreements with competitors, suppliers, and customers to ensure that they do not include any anti-competitive provisions, such as price-fixing, market allocation, or bid-rigging.

- Seek legal advice: Businesses should seek legal advice on competition law matters to ensure that their activities do not violate competition law.

- Conduct internal audits: Businesses should conduct regular internal audits to identify potential competition law risks and take appropriate action to address them.

- Reporting violations: If a business becomes aware of a violation of competition law, it should report it to the appropriate authorities.

- Compliance with competition law is essential for businesses to operate in a fair and competitive market. Failing to comply with competition law can result in significant fines and reputational damage. Therefore, it is important for businesses to take proactive steps to ensure compliance with competition law.

4.7 SUMMARY

- An Indian insurance company is a company scheduled under the Companies Act, 1956, in which foreign equity does not exceed 26% of the total equity shareholding, including the equity shareholding of NRIs, FIIs and OCBs.

- A certificate of registration will be given to the applicant, and any registration that is judged inappropriate will be modified, renewed, withdrawn, suspended, or cancelled.

- The **Competition Appellate Tribunal** has been established by the Central Government to hear and dispose of appeals against any direction issued or decision made or order passed by the CCI.

- The government replaced the Competition Appellate Tribunal (COMPAT) with the National Company Law Appellate Tribunal (NCLAT) in 2017.

- The Competition Act's preamble emphasises the need of preventing unfair business practises and fostering healthy competition for the growth of the nation's economy.

- Competition-preventing, -restraining, or -distorting agreements are known as anti-competitive agreements. Anti-competitive agreements, decisions, and activities are forbidden by Section 34 of the Competition Act.

- Competitors who agree to fix, control, or maintain the pricing of goods or services are said to be engaged in price fixing.

4.8 UNIT END QUESTIONS

A. Descriptive Questions:

Short Answers:

1. Write note on IRDA.

2. Explainin Salient features of the IRDA Act, 1999.

3. Discuss protection of policy holder interests.

4. What is Competition Commission of India?

5. Discuss Competition Act, 2002 in detail.

B. Fill in the blanks:

1. The apex body that oversees and controls the insurance industry in India is called ………….

2. IRDA stands for ……………

3. The Competition Act of 2002 replaced the Monopolies and Restrictive Trade Practices Act of……….

4. In English, "…………….." refers to something that, in comparison to others, is in a better position.

5. In India, the ……………..regulates the market for goods and services.

Answers:

1- IRDA, 2- Insurance Regulatory and Development Authority of India, 3- 1969, 4-dominant position, 5- CCI

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5

FOREIGN EXCHANGE MANAGEMENT AND REGULATIONS

Unit Structure

5.0 LEARNING OBJECTIVE:

- To get learners acquainted with various foreign exchange market related terminology.
- To equip learners with the detailed knowledge of various foreign exchange management regulations.

5.1 INTRODUCTION

Scope of business is not limited to the domestic territories of a country. When a business crosses the borders of a country it gets exposure to wider opportunities and markets around the globe. When a country or business starts transacting with international customers it has to deal with various regulations of different countries. These regulations include foreign exchange rules of various countries too. Every country has its own set of rules and regulations. Foreign exchange plays an important role in promoting foreign trade and exchange transactions of a country. In India, the Reserve Bank of India has authority to control foreign exchange.

FEMA stands for Foreign Exchange Management Act. This is the statute that governs all foreign exchange regulations in India. Foreign Exchange Management Act came into force from 1st June 2000 by passing an act in parliament in 1999. Foreign Exchange Management Act replaced the Foreign Exchange Regulations Act (FERA) which was enacted in 1973.

Objectives of FEMA

- To facilitate international trade and exchange payments.
- To promote orderly development of foreign exchange market in India
- To define procedures and formalities for all for an exchange transactions in India

5.2 IMPORTANT DEFINITIONS UNDER FEMA

Foreign Exchange

"Foreign Exchange" means foreign currency which includes following

(i) deposits, credits and balances payable in any foreign currency,

(ii) drafts, travellers cheques, letters of credit or bills of exchange, expressed or drawn in Indian currency but payable in any foreign currency,

(iii) drafts, travellers cheques, letters of credit or bills of exchange drawn by banks, institutions or persons outside India, but payable in Indian currency"

Foreign Security

"foreign security" means any security, in the form of shares, stocks, bonds, debentures or any other instrument denominated or expressed in foreign currency and includes securities expressed in foreign currency, but where redemption or any form of return such as interest or dividends is payable in Indian currency;

Currency

"currency" includes all currency notes, postal notes, postal orders, money orders, cheques, drafts, travellers cheques, letters of credit, bills of exchange and promissory notes, credit cards or such other similar instruments, as may be notified by the Reserve Bank;

"Currency notes" means and includes cash in the form of coins and bank notes;

Foreign Currency

any currency other than Indian currency is considered as Foreign Currency

Person

"person" includes— an individual, a Hindu undivided family, a company, a firm, an association of persons or a body of individuals, whether incorporated or not, every artificial juridical person, not falling within any of the preceding sub-clauses, and any agency, office or branch owned or controlled by such person;

Person Resident in India

A Person who stayed in India for more than 182 days during preceding financial year is treated as a **Person Resident in India.** but this definition is not applicable to a person who left India for the purpose of employment/ business/ vocation outside India, or for any other reason showing his intention to stay outside India for an uncertain period. Also any person who visits India, for the purpose of employment/ business/ vocation in India, or for any other reason showing his intention to stay in India for an uncertain period is an exception to the above case.

Above said definition is also applicable to any person or body corporate registered or incorporated in India, and an office, branch or agency in India which is owned or controlled by a person who is resident outside India,

Whereas A person who is not resident in India; Is considered as "Person resident outside India"

Service

"service" means service of any description which is made available to potential users and includes the provision of facilities in connection with banking, financing, insurance, medical assistance, legal assistance, chit fund, real estate, transport, processing, supply of electrical or other energy, boarding or lodging or both, entertainment, amusement or the purveying of news or other information, but does not include the rendering of any service free of charge or under a contract of personal service"

Transfer

"transfer" includes sale, purchase, exchange, mortgage, pledge, gift, loan or any other form of transfer of right, title, possession or lien.

5.3 CURRENT ACCOUNT TRANSACTION AND CAPITAL ACCOUNT TRANSACTION

Foreign Exchange Management Act classifies foreign exchange transaction into two types

1. Current Account Transactions

2. Capital Account Transactions

1. Current Account Transactions

A foreign exchange transaction that does not change the assets and liabilities (including contingent liabilities) position outside India is called a Current Account Transaction. Section 5 of FEMA deals with current account transactions. According to section 5 Any person residing in India is free to enter into foreign exchange transactions pertaining to current account except transaction prohibited by Central Government such prohibited transactions includes

- remittance out of winnings from lottery, racing, riding, etc., or any other hobby;
- remittance for purchase of lottery tickets, banned magazines, football pools, sweepstakes, etc.;
- remittance of dividend by any company to which the requirement of dividend balancing is applicable;
- payment of commission on exports under Rupee State Credit Route except commission up to 10% of invoice value of exports of tea and tobacco;
- payment of commission on exports made towards equity investment in Joint Ventures / Wholly Owned Subsidiaries abroad of Indian companies; remittance of interest income on funds held in Non-Resident Special Rupee (Account) Scheme and payment related to "call back services" of telephones.

Current Account Transaction Limit

According to Liberalised Remittance schemeCurrent account transactions per financial are permitted in two ways

I. Upto USD 2,50,000 - without RBI approval.

II. Above USD 2,50,000- requires prior approval of RBI.

2. Capital Account Transactions

A foreign exchange transaction that changes the assets and liabilities (including contingent liabilities) position outside India is called a Capital Account Transaction. Such change in assets or liabilities held outside India can be made by Person who is Resident of India or in assets or liabilities held in India by A person who is resident outside of India.

Provisions towards a Person Resident of India

Schedule I - Regulation 3 states that any person who is resident of India can enter in foreign currency transactions for following capital account transactions. but the amount of said transaction should not exceed permitted limits.

- Investment in foreign securities
- Foreign currency loans raised in India and abroad
- Transfer of immovable property outside India
- Guarantees issued in favor of a person resident outside India.
- Export, import and holding of currency/currency notes
- Loans and overdrafts (borrowings) taken from a person resident outside India.

- Maintenance of foreign currency accounts in India and outside India
- Taking out an insurance policy from an insurance company outside India.
- Loans and overdrafts to a person resident outside India.
- Remittance outside India of capital assets
- Sale and purchase of foreign exchange derivatives in India and abroad and commodity derivatives abroad

Provisions towards a Person Resident Outside India

Schedule I - Regulation 3 states that any person who is resident outside India can enter in foreign currency transactions for following capital account transactions. but the amount of said transaction should not exceed permitted limits.

- Investment in Indian Security issued by a body corporate /entity in India
- investment made by way of capital contribution to the capital of a firm /a proprietorship concern/ an association of persons in India.
- Acquisition and transfer of immovable property in India
- Guarantee in favor of, or on behalf of, a person resident in India.
- Import and export of currency/currency notes into/from India
- Deposits between a person resident in India and a person resident outside India.
- Foreign currency accounts in India
- Remittance outside India of capital assets in India
- Undertaking derivative contracts.

Capital Account Transaction Limit

According to Liberalised Remittance scheme Capital account transactions per financial year are permitted in two ways

I. Upto USD 2,50,000 - without RBI approval.
II. Above USD 2,50,000- requires prior approval of RBI.

The Limit of USD 2,50,000 can be used for Capital Accout Transactions or Current Account Transaction or Combination of Both According to Section 6 of FEMA; if a person who is a Resident of India and he earned foreign currency when he was A Resident outside India can use that earned currency without any restriction Rules of Liberalised Remittance scheme are not applicable to this case.

Prohibited Capital Account transactions

Regulation No. 4 puts lights on prohibited capital account transactions. As per regulation No. 4 any capital account transaction. Which is not covered under Schedule I and Schedule II of the Act are considered as Prohibited Capital Account transactions Also A person who is resident outside India is prohibited to make investment in any entity in India which is engaged /proposes to engage in chit fund company / Nidhi Company, in agricultural or plantation activities, In real estate business, construction of farmhouses , In trading in Transferable Development Rights (TDRs).

5.4 ESTABLISHMENT OF BRANCH & OFFICE IN INDIA

A person resident outside India who fulfills criteria mentioned below is allowed to a open branch office or a liaison office in India.

If A person resident outside India wants to open a Branch Office in India ;he should have a profit making track record during the immediately preceding five financial years in the home country and net worth of not less than USD 100,000 or its equivalent. where as when a person resident outside India wants to open a Liaison Office in India:he should have a profit making track record during the immediately preceding three financial years in the home country and net worth of not less than USD 50,000 or its equivalent.

Criteria	**For Branch Office**	**For Liaison Office**
a profit making track record in home country	immediately preceding five financial years	immediately preceding three financial years
net worth	not less than USD 100,000 or its equivalent.	not less than USD 50,000 or its equivalent.

Those subsidiary companies or persons resident outside India are financially unsound have to submit a Letter of Comfort stating that their parent company is satisfying the net worth and profit criterion**.**

A person resident outside India who is permitted by RBI to open a branch or liaison office in India is allowed to undertake only those activities which are specified in Schedule I or II of the regulations. Which include

Permitted activities for a branch office in India of a person resident outside India

1. Export/import of goods.
2. Rendering professional or consultancy services

3. Carrying out research work in which the parent company is engaged.
4. Promoting technical or financial collaborations between Indian companies and parent or overseas group companies.
5. Representing the parent company in India and acting as buying/selling agent in India
6. Rendering services in Information Technology and development of software in India.
7. Rendering technical support to the products supplied by parent/group companies.
8. Representing a foreign airline/shipping company

Permitted activities For Liaison Office in India of a person resident outside India

1. Representing the parent company / group companies in India.
2. Promoting export / import from / to India.
3. Promoting technical/ financial collaborations between parent / group companies and companies in India
4. Acting as a communication channel between the parent company and Indian companies.

Such entities are not allowed to enter any other activities other than activities mentioned and activities specifically permitted by the Reserve Bank.

AnyPerson who is resident outside India is not allowed to open a branch and office in India without prior approval of the Reserve Bank. But A banking company resident outside India or An insurance company resident outside India or A company resident outside India in Special Economic Zones (SEZs) established after respective approvals from concerned authorities does not require any approval under these Regulations for establishing any office in India.

5.5 REALIZATION & REPATRIATION OF FOREIGN EXCHANGE

Repatriation means returning or sending to the country of origin. According to Section 8 of the FEMA any person resident in India, is allowed to take all reasonable steps to realise and repatriate to India any amount of foreign exchange is due to him or has accrued to him. He has to take above said all reasonable steps within the time limit and manner specified by the Reserve Bank.

Exemption from realisation and repatriation

a. holding foreign currency including foreign coins up to the limit specified by the Reserve Bank

b. foreign currency account held or operated by such person or class of persons and the limit up to which the Reserve Bank may specify;

c. foreign exchange acquired or received before the 8th day of July, 1947 or any income arising or accruing thereon which is held outside India by any person in pursuance of a general or special permission granted by the Reserve Bank;

d. foreign exchange held by a person resident in India up to such limit as the Reserve Bank may specify, if such foreign exchange was acquired by way of gift or inheritance from a person referred to in clause (c), including any income arising therefrom;

e. foreign exchange acquired from employment, business, trade, vocation, services, honorarium, gifts, inheritance or any other legitimate means up to such limit as the Reserve Bank may specify; and

f. Such other receipts in foreign exchange as the Reserve Bank may specify.

5.6 AUTHORISED PERSON

RBI is custodian of foreign exchange but it cannot control all the foreign exchange tractions in a country and RBI delegates its power to 'Authorized Persons'. Chapter 3 section 10 of foreign exchange management act deals with Authorised Persons. An Authorised person is an entity authorised by RBI to deal in foreign exchange or foreign securities. Subsection 1 gives the list of such entities who can be appointed as authorised person which includes authorised dealer, money changer, off-shore banking unit or any other person who fits to the said role.

While dealing in foreign exchange or in securities all authorised persons have to follow the rules, regulations or orders issued by RBI.

Authorised Person should conduct the activities for which he is authorised, he is not allowed to engage in the foreign exchange or foreign securities transactions for which he is not authorised.

Whenever an authorised person undertakes a transaction in foreign exchange on behalf of any person he should ask for written undertaking stating that such transaction do not involve any element controversial to the provisions of the act. The said person refuses to give written undertaking authorised person should refuse all dealings in the transaction and matter should be reported to the Reserve Bank of India.

5.7 PENALTIES AND ENFORCEMENT

Section 13 says that If any person breaches any provision, rule, regulation, notification, direction, order and RBI's Authorisation , penalty will be charged in the following ways

a. When amount of contravention is quantifiable, penalty up to three times of the amount involved in such where contravention or

b. When the amount of contravention is not quantifiable, penalty up to Rs.2,00,000 and

c. if such contravention is a continued, further penalty which may extend to Rs. 5000 for every day after the first day during which the contravention continues.

Government time to time issues threshold limit for aggregate value of foreign exchange, foreign security or immovable property, to be held outside India. If any person exceeds the threshold limit given under the section 37A, in such case penalty will be charged

a. up to three times of the amount involved in such where contraventions and

b. confiscation of the value equivalent, situated in India

c. Imprisonment for a term which may extend to five years and fine.

5.8 FOREIGN CONTRIBUTION ACT 2010

Foreign Contribution Acts was originally passed in 1976 when India was under national emergency. In this period foreign entities were injecting money in the country in order to dilute internal affairs of the country. This act was passed in order to regulate foreign donations received by Indians and Indian associations so that they should not function against the values of a sovereign democratic republic.

The said act was amended in 2010. This amendment was done to *“consolidate the law to regulate the acceptance and utilization of foreign contribution / funds by certain individuals, associations and companies and to prohibit the acceptance and utilization of foreign contribution / funds for any activities detrimental to national interest”*.

The law was amended again in 2020 and put tighter control and scrutiny over the acceptance and utilization of foreign contribution / funds by NGOs. AS per this amendment any person or NGO wishing to receive any foreign contribution or foreign fund has to register with this act. Such an NGO has to open a bank account with State Bank Of India, Delhi. Such NGOs were strictly advised to use said funds for only those programmes for which it was sanctioned. Diversion of funds is not allowed. Individuals and associations working for social, cultural, economical, educational religious and social programmes were allowed to register under the act.

Registration made by individuals and associations under this Act will remain valid for five years and then applicable for renewal of registration. If any NGO or association found to be violating the regulations of this act will be subject to cancellation of the said registration. If any NGO has not undertaken any activity in its definite programme field for two consecutive years; government can cancel the registration and once the registration is suspended the association can't apply for the re-registration for next three years.

5.9 UNIT END QUESTIONS

Multiple ChoiceQuestion

1. Foreign Exchange Management Act came into force from…………

a. 1st April 2000

b. 1st October 2000

c. 1st June 2000

d. 1st Jan 2000

2. Once the registration under Foreign contribution Act is suspended by the government the association can't apply for the re-registration for next ……….years.

a. Two

b. Three

c. Four

d. Five

3. If A person resident outside India wants to open a Branch Office in India ;he should have a profit making track record during the immediately preceding …….. financial years in the home country and net worth of not less than USD ……….

a. Five , 1,00,000

b. Ten, 2,00,000

c. Three , 1,00,000

d. Two, 2,00,000

4. A foreign exchange transaction that does not change the assets and liabilities position outside India is called a …….. Account Transaction.

a. Capital

b. National Saving

c. Reserve

d. Current

True or False

1. FEMA stands for Foreign Exchange Monitoring Act.
2. An Authorised person is an entity authorised by RBI to deal in foreign exchange or foreign securities.
3. As per FEMA when the amount of contravention is quantifiable, a penalty up to three times of the amount involved in such contravention is charged by the government.
4. A person who is resident outside India is allowed to make investment in any entity in India which is engaged /proposes to engage in chit fund company / Nidhi Company, in agricultural

Write Short Notes

1. Person Resident in India
2. Foreign Contribution Act 2010
3. Penalties and Enforcement Under FEMA 2000
4. Objectives of FEMA 2000
5. Authorised Person
6. Realization & Repatriation of Foreign Exchange

Explain in Details

1. Capital Account Transactions and Current Account Transactions
2. Provisions related to Establishment of Branch & Office India under FEMA

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6

PREVENTION OF MONEY LAUNDERING ACT 2000

Unit Structure

6.0 LEARNING OBJECTIVE:

- Learners will be made aware of genesis of money laundering legislation in India and around the globe
- Learners will know about various provisions of Prevention of money laundering Act
- Learners will get the glimpse of Know Your Customer policy framework in India

6.1 INTRODUCTION:

Money Laundering is considered as a crime. Money Laundering means hiding the source of money generated from illegal or criminal activity so that it can appear as legitimate money. In the common man's words Money Laundering means converting black money into white money. For example, a member of a criminal organisation runs a beach resort and hotel. He deposits his illegal money into the bank by way of the hotel's cash collection. Illegal money is added to the resort's daily cash collection and then deposited into the bank so black money is converted into white money.

Sometimes money laundering can lead to serious issues like terrorism and corruption in the country.

Forms of Money Laundering

Following are some of the common methods of money laundering.

- Hawala,
- bulk cash smuggling,

- fictional loans,
- cash-intensive businesses,
- round-tripping,
- trade-based laundering,
- Shell companies and trusts,
- real estate,
- gambling,
- fake invoicing

Money Laundering is a three step process.

1. Placement
2. Layering
3. Integration

6.2 GENESIS OF PREVENTION OF MONEY LAUNDERING ACT

UN global programme against money laundering

In order to boost the efficacy of global action against money laundering via comprehensive technical cooperation services offered to Governments; United Nations Office of the Drug Control and Crime Prevention implement a programme against Money Laundering

The above said programme involves following three areas of activities. These activities provide various opportunities to Governments and institutions to effectively combat money laundering:

1. **Technical co-operation** includes creating awareness, institution building and training activities
2. **The research and analysis**focuses on providing Key Information to understand the phenomenon of money laundering in a better way and it enables the global community to devise more efficient and effective countermeasure strategies.
3. **The commitment** towards supporting the establishment of financial investigation services for uplifting the overall efficacy of law enforcement measures.

The Financial Action Task Force

The Financial Action Task Force is an intergovernmental organization. FATF was established in 1989 by G7 countries. The Financial Action

Task Force is established to develop a policy framework in order to fight against money laundering.

In 2001 the scope of The Financial Action Task Force was expanded and it was entrusted with the objective of strongly acting against terrorism financing. The Financial Action Task Force observes progress of various countries towards implementing the FATF Recommendations.

Objectives of the FATF are:

- **To monitor** progress of members in applying measures to counter money laundering.
- **To review** money laundering techniques and countermeasures.
- **To promote** the adoption and implementation of appropriate measures by non-member countries.The Financial Action Task Force primary policies issued are the

Since 1990 FATF has issued Forty recommendations on money laundering htough its Primary policies and the Nine Special Recommendations on Terrorism Financing.

The Financial Action Task Force also sets the international standard for anti-money laundering measures and combating the financing of terrorism and terrorist acts.

<u>Indian Scenario</u>

A political declaration asking for adoption of money laundering legislation was made by Members States of the United Nation in the special session of the United Nations General Assembly held in 1999.

Prevention of Money Laundering Act was passed in 2002 in the parliament but it came into force from 1st January 2005. This Act was passed in response to the Vienna Convention. Prevention of Money Laundering Act hasten chapters further divided into seventy five sections.

PMLA is applicable to

- Individuals
- Companies
- Firms
- Association of Person
- Or any other kind of person

This Act was enacted with following objects

1. Preventing and controlling money laundering
2. Confiscating and seizing property obtained from money laundering

3. Dealing with any other issues related with money laundering in India

6.3 IMPORTANT CONCEPTS AND DEFINITIONS UNDER PMLA:

Attachment:

Attachment means Prohibition of transfer, conversion, disposition or movement of property by an order issued by appropriate authority, this attachment has to be done for the period of 90 days from the order is issued and attachment should be conducted as per the second schedule of Income Tax Act 1961.

Proceeds of Crime

Proceeds of crime means any property obtained directly or indirectly by any person as result of criminal activity relating to scheduled offence.

Money Laundering

If anyone directly or indirectly tries to indulge, knowingly assist or knowingly party or actually involved in any process or activity connected with crime and shows that it is uncorrupt (clean source) property shall be guilty of Money laundering offence.

Property

Any asset or property of any description. It includes corporal and corporal property, movable and immovable property, tangible and intangible property, deeds and instruments evidencing title touch property.

Payment System

A system that enables payment to be effected between a payer and a beneficiary, involving clearing, payment or settlement service or all of them. It includes the credit card operations, debit card operations, smart card operations, money transfer or similar kind of operations.

Transfer

"transfer" includes sale, purchase, mortgage, pledge, gift, loan or any other form of transfer of right, title, *possession or lien.*

Person

People include individuals, Hindu Undivided Family, a company, a firm, an association of persons, body of individuals whether incorporated or not, artificial judicial person.

Obligation of Banking Companies, Financial Institutions & Intermediaries

Verification of Identity [Section 11 A]

The bank, financial institutions and intermediary has to verify the identity of the client and the beneficial owner. This verification can be done by

a. Authentication under Aadhar if reporting entity is Banking Company or

b. Offline Verification of Aadhar or

c. Passport or

d. Any the official document and mode specified by Central Government,

Maintain records [Section 12]

The bank, financial institutions and intermediary has

A. To maintain records of all transactions and value as prescribed. Such transactions can be of a single transaction or a series of transactions internally connected to each other when such series take place within a month.

B. To inform the director within prescribed time.

C. To verify the identity of its clients in a prescribed manner.

D. To maintain record of documents evidencing identity of its clients and beneficial owners as well as account files and business correspondence relating to its clients.

The records mentioned above should be maintained for 10 years from the date of transaction.

Furnish information [Section 12 A]

Director has the right to access information he can call for any records additional information which is necessary as per this act from any banking company, financial institution or financial intermediary. Every reporting authority has to furnish the required information to the Direction within the prescribed manner and time limit.

Enhanced Due diligence [Section 12 AA]

Every bank, financial institution and intermediary should check the identity of the client prior to commencement of such transaction. This verification can be done under Aadhar. Reporting entities should take additional steps to check ownership, financial position, and sources of funds of clients. If a client fails to fulfill the condition he should not be allowed to carry out such a transaction. Information obtained under carrying out above said due diligence measures should be kept with the reporting entity for the period of five years.

Powers of Director to impose fine [Section 13]

Director can carry out enquiry of banks, financial institutions and intermediaries. While in the course of enquire if director finds that the reporting authorities are not following the provisions of the Act such reporting authority can be penalised by director with the fine of Rs.10,000 to Rs, 1,00,000

No civil or criminal proceedings against reporting entity [Section 14]

Banks, financial institutions and intermediaries provide information to the authority. Employees or directors of such reporting are not liable for any civil proceedings against them for providing such information to the authority.

Procedure and manner of furnishing information by reporting entities [Section 15]

For the purpose of implementation of this act Central Government in consultation with the RBI may prescribe the procedure and the manner of maintaining and furnishing information by a reporting entity

6.4 KYC- KNOW YOUR CUSTOMER

In terms of the provisions of Prevention of Money-Laundering Act, 2002 and the Prevention of Money-Laundering (Maintenance of Records) Rules, 2005, Regulated Entities (REs) are required to follow certain customer identification procedures while undertaking a transaction either by establishing an account-based relationship or otherwise and monitor their transactions..

As per RBI KYC Guidelines *"Customer" means a person who is engaged in a financial transaction or activity with a Regulated Entity (RE) and includes a person on whose behalf the person who is engaged in the transaction or activity, is acting.*

KYC- Know Your Customer guidelines help banks to identify and understand the customers. It prevents banks from being an instrument of money laundering activities.

As per KYC guidelines issued by RBI; KYC policy should be approved by the Board of directors or any committee of board to which power has been delegated.

The KYC policy shall include following four key elements:

1. Customer Acceptance Policy;
2. Risk Management;
3. Customer Identification Procedures (CIP); and
4. Monitoring of Transactions

Customer Acceptance Policy:

Customer acceptance policy gives guidelines for accepting a customer. This policy may include following points

- No account is opened in anonymous or fictitious/benami name.
- No account is opened without applying appropriate Customer Due Diligence measures,
- No transaction or account-based relationship is undertaken without following the CDD procedure.
- The mandatory information to be sought for KYC purpose while opening an account and during the periodic updation, is specified.
- CDD Procedure is followed for all the joint account holders, while opening a joint account.
- Circumstances in which a customer is permitted to act on behalf of another person/entity, is clearly spelt out.

Risk Management:

Regulated Entities should have a risk based approach for managing risk. As per risk assessment and risk perception; the customers should be categorised as

1. Low risk customers
2. Medium risk customers
3. High risk customers

Parameters such as customer's identity, social/financial status, nature of business activity, and information about the customer's business and their location etc. should be considered while categorizing risk.

Customer Identification Procedures (CIP)

Customer Identification is required in certain cases like

- starting an account-based relationship with the customer,
- international money transfer operations for a non account holder of the bank,
- doubtful authenticity or adequacy of the customer identification data,
- Selling third party products as agents, selling their own products,
- payment of dues of credit cards/sale and reloading of prepaid/travel cards and any other product for more than rupees fifty thousand etc.
- Transactions for walk-in customers etc.

Monitoring of Transactions

Ongoing monitoring is an important ingredient of effective KYC procedure. Financial institutions should keep attention on large value transactions. Threshold limit can be prescribed for particular categories of accounts and banks should monitor whether such limit is exceeded by customers or not. Unusual large cash transactions inconsistent with regular pattern of account and balance maintained by customer should attract the attention of banks. Key indicators should be set for such account which considering various factors of background check of a customer. , which may include checking country of origin and sources of fund. Periodic review of risk categorization is needed.

6.5 UNIT END QUESTIONS

Multiple Choice Question

1. Following is not a step of the Money Laundering process.

A. Identification

B. Placement

C. Layering

D. Integration

2. Which of the following is not a element of The KYC policy

A. Customer Acceptance Policy;

B. Risk Management;

C. Portfolio Management

D. Monitoring of Transactions

3. According to …………..The bank, financial institutions and intermediary has to maintain records of all transactions and value as prescribed.

A. Section 11

B. Section 12

C. Section 13

D. Section 14

4. If reporting authorities are failing to comply with the provisions of the Act such reporting authority can be penalised by the director with the fine of …………

A. Rs.10,000 to Rs, 1,00,000

B. Rs.20,000 to Rs, 2,00,000

C. Rs.1,00,000 to Rs, 2,00,000

D. Rs.1,000 to Rs, 10,000

5. "Transfer" includes……

A. Sale, purchase, mortgage,

B. Pledge, gift, loan

C. Transfer of right, lien

D. All of above

6. The Financial Action Task Force is an intergovernmental organization. established in ………. by ……….countries.

A. 1989 , G7 Countries

B. 1989, G20 Countries

C. 1999 , G7 Countries

D. 1999, G20 Countries

7. Which of the following is not a form of The Money Laundering Practices

A. Hawala,

B. bulk cash smuggling,

C. fictional loans

D. Loan Syndication

True or False

1. Prevention of Money Laundering Act was passed in 2000
2. PMLA is applicable only for immovable property.
3. Proceeds of crime means any property obtained directly or indirectly by any person as result of criminal activity
4. Financial Institutions should keep watch on large value transactions.
5. KYC stands for Know Your Code
6. Passport is not an official document to verify the identity of a client.

Write Short Notes

1. Money Laundering
2. UN global programme against Money Laundering
3. Financial Action Task Force
4. Objectives of PMLA
5. KYC

Explain in Details

1. Genesis of PMLA
2. Obligation of Banking Companies, Financial Institutions & Intermediaries
3. KYC- Know Your Customer Policy

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7

REGULATORY FRAMEWORK FOR INTERNATIONAL FUNDS

Unit Structure

7.0 LEARNING OBJECTIVE:

- To know about various sources of raising international fund and respective regulatory framework
- To get deep insight of Foreign Direct Investment Policy of India

7.1 INTRODUCTION

Business operations are not limited to a specific region or country. Globalisation has paved ways for exploring international markets and other opportunities. Business needs finance for growth and expansion as well as carrying day to day operations. Such a need of finance can be fulfilled by using internal as well as external Sources. Internal sources deal with using retained profit or selling asset. Internal Sources of finance are owned by the company itself. whereas external sources deal with raising funds from outside of business.

International Funds are an important source of finance from external sources. There are various ways of raising funds from International Sources. International finance supports cross border transactions of a company. It also promotes financial transactions between two countries.

7.2 SOURCES OF INTERNATIONAL FUND

- Global Depository Receipts
- American Depository Receipts

- Indian Depository Receipts
- Foreign Currency Convertible Bonds
- External Commercial Borrowings
- Inter-Corporate Deposits
- Loans from International Commercial Banks
- Loans from International Agencies
- Loans From International Development Banks

In this chapter we are going to discuss regulatory framework of some of the above mentioned sources of international funds

Global Depository Receipts (GDR)

Global depository receipt is a financial instrument issued to raise funds from international. GDR is an instrument that can be traded in the financial markets. GDR allows issues to raise funds by way of private placement or public offerings. GDRs are issued by depository banks. Depository banks purchase shares of foreign companies and distribute the shares to the investors in the form of Depository receipts.

American Depository Receipts (ADR)

American Depository receipts are issued by American Bank. which allows foreign stocks to be traded in American stock exchanges. American Depository Receipts are listed in the USA therefore Capitan gain on the stocks and dividend is paid in Us Dollars.There are basically two types of ADRs i.e. Sponsored and Unsponsored. Sponsored ADRs are further classified into Level-I , Level-II, Level-III ADR

Indian depository Receipts

Indian Depository Receipts are only applicable to the Indian markets. IDR also operates in the same way as GDR works where shares are transferred to depository and depository convert them into Depository receipts. In this case the depository bank belongs to the Indian Economy and the currency of denomination is Indian Rupee. IDR is a way to raise funds from the Indian market for foreign entities as well as Indians. SEBI acts as a depository in case of IDR. First IDR's were issued by Standard Chartered Bank

7.3 REGULATORY FRAMEWORK FOR ISSUING DEPOSITORY RECEIPTS

1. Companies incorporated and listed in India are allowed to issue Depository Receipts. Such Listed Company should comply with the requirements prescribed under SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 and any amendments thereof.

2. Any of its promoters, promoter group or directors or selling shareholders should not be debarred from accessing the capital market by SEBI, should not be a fugitive economic offender or should not be a willful defaulter.

3. Existing holders shall be eligible to transfer Permissible Securities, for the purpose of issue of DRs, if the Listed Company or the holder transferring Permissible Securities are not debarred from accessing the capital market by SEBI or not a wilful defaulter; or not a fugitive economic offender.

4. In case of an initial issue and listing of DRs, pursuant to 'transfer by existing holders', Listed Company should provide an opportunity to its equity shareholders to tender their shares for participation in such listing of DRs

5. Subsequent issue and listing of DRs, pursuant to 'transfer by existing shareholders' may take place subject to the limits approved pursuant to a special resolution in terms of GDR Rules

6. Listed Company should issue Permissible Securities or transfer Permissible Securities of existing holders, for the purpose of issue of DRs, only in Permissible Jurisdictions and said DRs should be listed on any of the specified International Exchange(s) of the Permissible Jurisdiction.

7. Listing of DRs on specified International Exchange shall meet the highest applicable level / standards for such listing by foreign issuers.

8. Listed Company should comply with extant laws relating to issuance of DRs, which includes

   a. requirements prescribed in this Circular, the Companies Act, 2013,

   b. Foreign Exchange Management Act, 1999 ('FEMA'),

   c. Prevention of Money-Laundering Act, 2002, and rules and regulations made thereunder.

9. Listed Company may also enter into necessary arrangements with Custodian, Indian Depository and Foreign Depository.

10. Companies are allowed to issue DRs only with Permissible Securities as the underlying

11. DR issuing companies should ensure that the aggregate of Permissible Securities which may be issued or transferred for the purpose of issue of DRs, along with Permissible Securities already held by persons resident outside India, shall not exceed the limit on foreign holding of such Permissible Securities under the applicable regulations of FEMA

External Commercial Borrowing (ECB)

External Commercial Borrowing (ECB) means borrowing of funds made by Indian companies from foreign sources. ECB can be made in the form of loans, bonds, or other financial instruments. Funds obtained from External Commercial Borrowing can be utilized for business expansion, acquiring assets, and the repayment of existing debt. Indian companies can borrow funds from foreign banks, international financial institutions, and foreign subsidiaries of Indian companies. Companies can obtain External Commercial Borrowing in rupee-denominated loans, which are repayable in Indian rupees, or foreign currency-denominated loans, which are repayable in a foreign currency. ECB are regulated by the Reserve Bank of India (RBI),ntial impact on their financial position.

Important Element of ECB Regulation

Currency of borrowing	A. Any freely convertible foreign currency B. Indian Rupee C. Any other currency as specified by the Reserve Bank in consultation with the Government of India.
Forms	• As prescribed by the Reserve Bank in consultation with the Government of India. • Certain hybrid instruments, such as optionally convertible debentures,
Eligibility of borrowers	• All entities eligible to receive foreign direct investment, in terms of Foreign Exchange Management
Maturity	• Minimum average maturity will be 3 years
Lenders	• Resident of Financial Action Task Force or international Organization of Securities Commissions Compliant country • Multilateral and Regional Financial Institutions where India is a member country • Lender specified by Reserve Bank, in consultation with the Government of India
All-in-cost	A. For ECBs raised in foreign exchange • The maximum spread over the benchmark of 6-month LIBOR or • Applicable benchmark for the respective currency will be 450 basis points per annum or • as prescribed by the Reserve Bank in consultation with the Government of India.

	B. For ECBs raised in Indian Rupees • The maximum spread will be 450 basis points per annum over the prevailing yield of the Government of India securities of corresponding maturity or • as prescribed by the Reserve Bank in consultation with the Government of India
End-uses	• For all purposes except for those activities prescribed in the negative end-use list by the Reserve Bank in consultation with the Government of India.
Borrowing Limit	• up to USD 750 million or equivalent per financial year. • For Startups up to USD 3 million or equivalent per financial year.
Security	• as specified by the Reserve Bank • may also provide corporate and / or personal guarantee

7.4 FOREIGN DIRECT INVESTMENT REGULATIONS

Foreign Direct Investment (FDI) regulations are rules and policies established by a country's government to control the inflow and outflow of foreign investments into their economy. The regulations aim to create a favourable investment climate for foreign investors while balancing the interests of domestic businesses and the country's economic development goals.

<u>Examples of FDI regulations that countries may impose:</u>

Investment Approval: Countries may require foreign investors to obtain prior approval from the government before investing in certain sectors or industries. This is to ensure that the investment aligns with the country's economic goals, doesn't; it threatens national security, and is consistent with environmental regulations.

Equity Caps: Governments may impose limits on the percentage of equity ownership that foreign investors can hold in certain industries or companies. For example, a government may allow foreign investors to hold no more than 49% of a company's equity in certain sectors.

Performance Requirements: Governments may require foreign investors to meet certain performance criteria, such as export targets, job creation, and technology transfer, to encourage them to contribute to the country's economic development.

Taxation: Countries may impose different tax rates for foreign investors compared toDomestic investors. For example, they may offer tax incentives to encourage foreign investors to invest in certain sectors or regions.

Currency Controls: Governments may impose restrictions on the repatriation of profits or capital by foreign investors to control the flow of foreign currency out of the country.

FDI regulations vary by country and can change over time. It is important for foreign investors to understand and comply with the regulations in the countries where they plan to invest to avoid any legal or financial repercussions.

The Foreign Direct Investment (FDI) policy and the Securities and Exchange Board of India (SEBI) regulations are two distinct regulatory frameworks that govern foreign investment in India. brief overview of each segments is given below

Foreign Direct Investment (FDI) Policy:

The FDI policy is a set of guidelines and regulations issued by the Department of Industrial Policy and Promotion (DIPP), Ministry of Commerce and Industry, Government of India. The policy regulates foreign investment in various sectors of the Indian economy, including manufacturing, services, and infrastructure.

The FDI policy is regularly reviewed and updated to ensure that it remains relevant to the changing economic conditions and business environment. The latest FDI policy was released on 28th August 2017, which consolidates all the previous regulations and guidelines on FDI.

The FDI policy outlines the sectors where foreign investment is permitted, the entry routes for foreign investors, and the conditions and limitations for foreign investment. The policy also specifies the sector-specific caps on foreign investment, which may vary depending on the strategic importance of the sector to the Indian economy.

7.5 SEBI (FOREIGN PORTFOLIO INVESTORS) REGULATIONS - 2014:

The SEBI (Foreign Portfolio Investors) Regulations - 2014 is a set of guidelines issued by the Securities and Exchange Board of India (SEBI) to regulate foreign portfolio investments in India. The regulations provide a framework for foreign investors to invest in Indian securities, including equities, debt securities, and derivative instruments.

The SEBI (Foreign Portfolio Investors) Regulations - 2014 replaced the earlier SEBI (Foreign Institutional Investors) Regulations - 1995, and introduced a more liberalized and streamlined framework for foreign portfolio investments in India.

The SEBI (Foreign Portfolio Investors) Regulations - 2014 classify foreign portfolio

investors into three categories - Category I, Category II, and Category III - based on their level of regulation and risk. The regulations also provide for the registration process for foreign portfolio investors, the investment limits for each category of investors, and the operational and compliance requirements.

SEBI (Alternate Investment Fund) Regulations – 2012:

The SEBI (Alternate Investment Fund) Regulations - 2012 is a set of guidelines issued by the Securities and Exchange Board of India (SEBI) to regulate alternate investment funds (AIFs) in India. The regulations provide a regulatory framework for private equity funds, hedge funds, and other types of AIFs that invest in India.

The SEBI (Alternate Investment Fund) Regulations - 2012 replaced the earlier SEBI (Venture Capital Funds) Regulations - 1996, and introduced a more comprehensive and flexible framework for AIFs in India.

The SEBI (Alternate Investment Fund) Regulations - 2012 provide for the registrationprocess for AIFs, the investment restrictions and conditions for AIFs, the valuation and reporting requirements, and the obligations of the fund manager and custodian. The regulations also classify AIFs into three categories - Category I, Category II, and Category III - based on their investment strategy, level of regulation, and investor eligibility.

Foreign Direct Investment (FDI) policy in India is a set of guidelines issued by the Department of Industrial Policy and Promotion (DIPP), Ministry of Commerce and Industry, Government of India. The FDI policy regulates foreign investment in various sectors of the Indian economy, including manufacturing, services, and infrastructure. The aim of the policy is to attract foreign investment to promote economic growth, employment, and technology transfer in India.

7.6 FEATURES OF THE FDI POLICY IN INDIA:

Sectors where FDI is permitted: The FDI policy in India allows foreign investment in various sectors, subject to certain conditions and limitations. Some sectors are fully open to foreign investment, while others are subject to sector-specific caps and restrictions.

Entry routes for foreign investors: The FDI policy allows foreign investors to enter the Indian market through various routes, including automatic route, government route, and approval route. The entry route depends on the sector, the level of foreign investment, and the strategic importance of the sector to the Indian economy.

Sector-specific caps on FDI: The FDI policy specifies the sector-specific caps on foreign investment, which may vary depending on the strategic importance of the sector to the Indian economy. For example, the FDI limit in the defense sector is 74%, while it is 100% in most other sectors.

Conditions and limitations for FDI: The FDI policy specifies the conditions and limitations for foreign investment, such as minimum capitalization requirements, technology transfer requirements, and performance requirements.

Investment promotion measures: The FDI policy includes various measures to promote foreign investment in India, such as single-window clearance, fast-track approvals, and tax incentives.

The FDI policy in India is regularly reviewed and updated to ensure that it remains relevant to the changing economic conditions and business environment. The latest FDI policy was released on 15th October 2021, which consolidates all the previous regulations and guidelines on FDI.

7.7 UNIT END QUESTIONS

Multiple Choice Question

1. Depository banks purchase shares of foreign companies and distribute the shares to the investors in the form of ……….
   A. Convertible Bonds
   B. Foreign Company Shares
   C. International Funds
   D. Depository receipts.
2. Minimum average maturity is …….. For ECB
   A. 1 Year
   B. 2 Years
   C. 3 Years
   D. 4 Years
3. For Startups up to USD………… or equivalent per financial year.
   A. 3 million
   B. 4 million
   C. 5 million
   D. 6 million
4. External Commercial Borrowing can be done in
   A. Any freely convertible foreign currency
   B. Indian Rupee
   C. currency as specified by the Reserve Bank
   D. All of the above

5. Which of the following is not a FDI regulation
   A. Taxation
   B. Performance Requirement
   C. Investment Cap
   D. Nome of the above

True or False

1. American Depository Receipts can be listed in India.
2. Companies incorporated and listed in India are allowed to issue Depository Receipts in India.
3. The FDI policy regulates foreign investment in various sectors of the Indian economy.
4. The FDI policy is a set of guidelines and regulations issued by the Department
5. International Affairs
6. Governments cannot impose limits on the percentage of equity ownership that foreign investors can hold in certain industries or companies.
7. Countries may impose different tax rates for foreign investors compared to domestic investors.

Write Short Notes

1. International Sources of Fund
2. Features of FDI Policy in India
3. GDR v.s ADR
4. ExternalCommercial Borrowings
5. Examples of Foreign Direct Regulations

Explain in Details

1. Regulatory Framework to issue Depository Receipts
2. Regulatory Framework to raise fund by issuing External Commercial Borrowings
3. Foreign Direct Investment Policy in India

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8

REGULATORY FRAMEWORK RELATED TO CREDIT RATING AGENCIES

Unit Structure

8.0 LEARNING OBJECTIVE:

- To know about various sources of raising international fund and respective regulatory framework
- To get deep insight of Foreign Direct Investment Policy of India

8.1 INTRODUCTION

SEBI (Credit Rating Agencies) Regulations, 1999 is the regulatory framework in India related to Credit Rating Agencies. These regulations were enacted by the Securities and Exchange Board of India (SEBI) to regulate and oversee the functioning of Credit Rating Agencies (CRAs) operating in India.

8.2 KEY PROVISIONS OF THE SEBI (CREDIT RATING AGENCIES) REGULATIONS, 1999:

Registration of CRAs: The regulations require CRAs to register with SEBI before they can provide credit rating services in India. Toobtain registration, CRAs must comply with certain eligibilitycriteria, including a minimum net worth requirement.

Disclosure norms: The regulations mandate CRAs to disclose all information related to the credit rating process, including the methodology used, key rating assumptions, and any limitations or qualifications in the rating process. The CRAs are also required to make certain disclosures in their rating reports, including their track record of rating performance.

Code of Conduct: The regulations prescribe a code of conduct that CRAs must follow while providing credit rating services. This includes maintaining independence, avoiding conflicts of interest, and maintaining confidentiality of information.

Monitoring and Enforcement: The regulations empower SEBI to monitor the performance of CRAs and take appropriate action against non-compliant CRAs. This includes imposing penalties, suspending or cancelling registration, or taking legal action against the CRA and its officials.

Overall, the SEBI (Credit Rating Agencies) Regulations, 1999 provide a comprehensive regulatory framework for CRAs in India. The regulations aim to promote transparency and accountability in the credit rating process and protect the interests of investors and other stakeholders.

Credit Rating Agencies (CRAs) are companies that assess the creditworthiness of corporate and government entities by evaluating their ability to meet their financial obligations, including the timely repayment of debt. CRAs provide credit ratings on various types of debt instruments, such as bonds, loans, and commercial paper.

The credit rating is a measure of the issuer's creditworthiness, and it reflects the likelihood of default on the debt instrument. CRAs use a variety of factors to assess creditworthiness, including the issuer's financial health, past credit history, management quality, and market conditions.

The three major global CRAs are Standard & Poor's (S&P), Moody's, and Fitch Ratings. These agencies dominate the credit rating industry and hold significant influence in financial markets. There are also several smaller CRAs that operate in different regions or specialize in specific industries.

CRAs play a critical role in the financial markets by providing investors with independent and objective assessments of credit risk.Investors rely on credit ratings to make informed investment decisions and to manage their portfolio risk. CRAs also help issuers by providing them with a credible credit rating, which can help lower borrowing costs.

However, CRAs have been criticized for their role in the 2008financial crisis, when they assigned overly optimistic credit ratings to mortgage-backed securities that turned out to be much riskier than initially thought. This has led to increased regulatory scrutiny and reforms to improve the quality and transparency of credit ratings.

Credit Rating Agencies (CRAs) play an important role in the Indian financial markets by providing independent credit assessments of corporate and government entities. There are several CRAs operating in India, including the three major global CRAs, namely Standard & Poor's (S&P), Moody's, and Fitch Ratings, as well as several domestic CRAs.

In India, the primary regulator of CRAs is the Securities and Exchange Board of India (SEBI). SEBI regulates the functioning of CRAs through the SEBI (Credit Rating Agencies) Regulations, 1999, which provides a framework for the registration, disclosure, and code of conduct for CRAs. SEBI also monitors and enforces compliance with these regulations, including imposing penalties or revoking registration for non-compliance.

Some of the prominent domestic CRAs in India include CRISIL, ICRA, CARE Ratings, and Brickwork Ratings. These agencies have developed expertise in assessing credit risk across various sectors of the Indian economy and provide credit ratings for a wide range of debt instruments, including bonds, loans, and commercial paper.

The role of CRAs in India has grown significantly in recent years, as the Indian economy has expanded and diversified. Credit ratings provided by CRAs are widely used by investors, financial institutions, and issuers to evaluate credit risk and make informed investment decisions. However, like in other markets, CRAs in India have also faced criticism for their role in the 2008 financial crisis and have since been subject to increased regulatory scrutiny to improve the quality and transparency of credit ratings.

8.3 IMPORTANCE OF CREDIT RATING AGENCIES: IN INDIA

Credit Rating Agencies (CRAs) play a crucial role in the Indian financial markets, providing independent and objective assessments of credit risk for corporate and government entities. Some of the key importance of CRAs in India are:

Facilitating access to credit: CRAs provide credit ratings that help issuers of debt securities to access credit at competitive interest rates. High credit ratings indicate low credit risk, making it easier for issuers to access credit at lower interest rates.

Enhancing transparency and credibility: Credit ratings provide transparency and credibility to the creditworthiness of issuers. Credit ratings are based on a rigorous and transparent methodology that considers various factors, including financial health, past credit history, and management quality.

Managing risk: Credit ratings are used by investors to assess credit risk and make informed investment decisions. Investors use credit ratings to manage risk by diversifying their portfolios across different credit ratings.

Promoting accountability and good governance: CRAs have a significant influence on the financial markets, and their credit ratings can affect the cost of borrowing for issuers. This puts pressure on issuers to maintain good governance practices and financial discipline to maintain a high credit rating..

Promoting investor protection: Credit ratings provide valuable information to investors, enabling them to make informed investment decisions. The SEBI (Credit Rating Agencies) Regulations, 1999, also provide investor protection by requiring CRAs to disclose all information related to the credit rating process, including the methodology used, key rating assumptions, and any limitations or qualifications in the rating process.

Overall, the importance of CRAs in India cannot be overstated, as they play a critical role in promoting financial stability, market transparency, and investor protection. By providing independent and objective credit assessments, CRAs help issuers to access credit at competitive interest rates and enable investors to manage risk and make informed investment decisions.

Advantages of Credit Rating Agencies?

Credit Rating Agencies (CRAs) provide a number of advantages to various stakeholders in the financial markets, including investors, issuers, and regulators. Some of the key advantages of CRAs are:

Independent and objective credit assessment: CRAs provide an independent and objective assessment of credit risk, enabling investors to make informed investment decisions. Credit ratings are based on a rigorous and transparent methodology that considers various factors, including financial health, past credit history, and management quality.

Facilitate access to credit: CRAs provide credit ratings that help issuers of debt securities to access credit at competitive interest rates. High credit ratings indicate low credit risk, making it easier for issuers to access credit at lower interest rates.

Market transparency: CRAs provide transparency to the credit worthiness of issuers, which promotes market transparency. The credit rating process requires CRAs to disclose all information related to the credit rating process, including the methodology used, key rating assumptions, and any limitations or qualifications in the rating process.

Enhance credibility: Credit ratings provide credibility to the creditworthiness of issuers, which is particularly important for smaller or less established issuers. Credit ratings from reputable CRAs can help enhance the credibility of issuers and make them more attractive to investors.

Promote financial stability: CRAs play a critical role in promoting financial stability by providing an independent assessment of credit risk. Credit ratings help investors to manage risk by diversifying their portfolios across different credit ratings. This promotes financial stability by reducing the likelihood of systemic risk in the financial markets.

Encourage good governance: The credit rating process puts pressure on issuers to maintain good governance practices and financial discipline to maintain a high credit rating. This promotes good governance practices and financial discipline among issuers, which is beneficial for the financial markets as a whole.

Overall, the advantages of CRAs are significant, as they promote transparency, credibility, financial stability, and good governance in the financial markets.

limitations of Credit Rating Agencies?

While Credit Rating Agencies (CRAs) provide several advantages, there are also some limitations to their operations. Some of the key limitations of CRAs are:

Potential conflicts of interest: CRAs are paid by the issuers of debt securities to provide credit ratings, which creates a potential conflict of interest. The issuers may pressure the CRAs to provide favorable ratings to make it easier to sell their securities, potentially compromising the independence and objectivity of the credit rating process.

Limited transparency: While CRAs are required to disclose their credit rating methodologies, the information provided may not be sufficient for investors to understand the factors that determine a credit rating. In addition, CRAs may not disclose certain information due to confidentiality agreements or other factors, which limits transparency.

Reliance on historical data: Credit ratings are based on historical data and may not accurately reflect future credit risk. Economic and financial conditions can change rapidly, which can affect the credit worthiness of issuers.

Herding behavior: CRAs may exhibit herding behavior, where they tend to converge on similar credit ratings for issuers. This can create a self-fulfilling prophecy, where the ratings themselves affect the credit worthiness of issuers.

Inadequate coverage: CRAs may not provide credit ratings for all issuers or debt securities, particularly for smaller or less established issuers. This can limit the ability of these issuers to access credit at competitive rates.

Rating downgrades can trigger systemic risks: If multiple issuers are downgraded by a CRA simultaneously, it can lead to a panic in the financial markets, triggering a sell-off and increasing systemic risks.

Overall, the limitations of CRAs need to be considered while using credit ratings as an investment tool. Investors should not rely solely on credit ratings and should conduct their own analysis of the creditworthiness of issuers.

8.4 PROVISIONS OF CREDIT RATING AGENCIES REGULATIONS– 1999.

The Credit Rating Agencies Regulations 1999 are a set of regulations issued by the Securities and Exchange Board of India (SEBI) to govern the operations of Credit Rating Agencies (CRAs) in India. The key provisions of the regulations are as follows:

Registration: The regulations require CRAs to be registered with SEBI to operate in India. The registration process includes a review of the CRA's operational, financial, and management capabilities, as well as a review of its credit rating methodology.

Disclosure requirements: The regulations require CRAs to disclose their credit rating methodologies, rating scales, and key rating assumptions. CRAs must also disclose any conflicts of interest, such as financial relationships with issuers or investors, that may affect the independence and objectivity of the rating process.

Rating process: The regulations require CRAs to have a rigorous and transparent rating process that considers all relevant information. The rating process must be based on a comprehensive analysis of the issuer's creditworthiness, financial health, past credit history, and management quality.

Monitoring and surveillance: CRAs must monitor and review the credit ratings of issuers on an ongoing basis to ensure that the ratings remain accurate and up-to-date. CRAs must also conduct periodic reviews of their rating methodologies to ensure that they remain relevant and effective.

Rating dissemination: CRAs must promptly disseminate their credit ratings to the public and ensure that the ratings are widely available through appropriate channels, such as financial publications or online databases.

Remedial action: The regulations require CRAs to take appropriate remedial action if any deficiencies or weaknesses are identified in their rating process. The CRA must also promptly notify SEBI of any material changes in its operations, management, or financial condition.

Penalties: The regulations provide for penalties and disciplinary action against CRAs that violate the regulations or engage in any fraudulent or unfair practices.

Overall, the Credit Rating Agencies Regulations 1999 are designed to promote transparency, objectivity, and accountability in the operations of CRAs in India. The regulations aim to ensure that credit ratings are accurate, reliable, and independent, and that investors have access to all relevant information to make informed investment decisions.

Penalties for Credit Rating Agencies Regulations– 1999.

The Credit Rating Agencies Regulations 1999 provide for penalties and disciplinary action against Credit Rating Agencies (CRAs) that violate the regulations or engage in any fraudulent or unfair practices. The penalties and disciplinary action that can be imposed on CRAs include:

Monetary penalties: SEBI can impose monetary penalties on CRAs for violations of the regulations, which can range from a small amount to a substantial sum, depending on the severity of the violation.

Suspension or cancellation of registration: SEBI has the power to suspend or cancel the registration of a CRA that violates the regulations. If a CRA's registration is suspended or cancelled, it cannot operate as a credit rating agency in India.

Disciplinary action against key personnel: SEBI can take disciplinary action against key personnel of a CRA, such as directors or senior management, who are found to be involved in any violations of the regulations.

Public censure: SEBI can issue a public censure against a CRA for any violations of the regulations. This can harm the reputation of the CRA and reduce investor confidence in its credit ratings.

Referral to law enforcement agencies: SEBI can refer cases of fraud or other criminal offenses by CRAs to law enforcement agencies for investigation and prosecution.

Any other action as deemed fit: SEBI has the power to take any other action it deems fit in the interest of investors and the capital markets.

Overall, the penalties and disciplinary action available under the Credit Rating Agencies Regulations 1999 are designed to ensure that CRAs operate in a fair, transparent, and responsible manner, and that they provide accurate and reliable credit ratings to investors.

Rules of Credit Rating Agencies Regulations– 1999.

The Credit Rating Agencies Regulations 1999 are a set of rules issued by the Securities and Exchange Board of India (SEBI) to govern the operations of Credit Rating Agencies (CRAs) in India. The key rules under the regulations are as follows:

Eligibility criteria for registration: The rules specify the eligibility criteria that CRAs must meet to be registered with SEBI. This includes requirements related to capital adequacy, track record, and management competence.

Registration process: The rules outline the registration process for CRAs, including the application requirements, the fees payable, and the timeline for approval or rejection of the application.

Disclosure requirements: The rules require CRAs to make various disclosures to the public, including information on their credit rating methodologies, rating scales, and rating criteria. CRAs must also disclose any conflicts of interest that may arise in their rating process.

Rating process: The rules require CRAs to have a rigorous and transparent rating process that considers all relevant information. The rating process must be based on a comprehensive analysis of the issuer's creditworthiness, financial health, past credit history, and management quality.

Monitoring and surveillance: The rules require CRAs to monitor and review the credit ratings of issuers on an ongoing basis to ensure that the ratings remain accurate and up-to-date. CRAs must also conduct periodic reviews of their rating methodologies to ensure that they remain relevant and effective.

Rating dissemination: The rules require CRAs to promptly disseminate their credit ratings to the public and ensure that the ratings are widely available through appropriate channels, such as financial publications or online databases.

Remedial action: The rules require CRAs to take appropriate remedial action if any deficiencies or weaknesses are identified in their rating process. The CRA must also promptly notify SEBI of any material changes in its operations, management, or financial condition.

Penalties: The rules provide for penalties and disciplinary action against CRAs that violate the regulations or engage in any fraudulent or unfair practices.

Overall, the rules under the Credit Rating Agencies Regulations 1999 are designed to promote transparency, objectivity, and accountability in the operations of CRAs in India. The rules aim to ensure that credit ratings are accurate, reliable, and independent, and that investors have access to all relevant information to make informed investment decisions.

Eligibility criteria for registration of Credit Rating Agencies under Regulations– 1999.

The eligibility criteria for registration of Credit Rating Agencies (CRAs) under the Credit Rating Agencies Regulations 1999 are as follows:

Minimum net worth: The CRA must have a minimum net worth of Rs. 5 crore at the time of registration.

Promoters: The CRA must have promoters who have a sound track record and are of good repute.

Management: The CRA must have a competent and qualified management team with sufficient experience in the field of credit rating.

Infrastructure: The CRA must have adequate infrastructure, including office space, equipment, and technology, to support its operations.

Board of Directors: The CRA must have a Board of Directors that is composed of at least 50% independent directors, and the Chairperson of the Board must be an independent director.

Credit rating experience: The CRA must have at least three years of experience in rating debt instruments or other securities.

Rating methodology: The CRA must have a well-defined and transparent rating methodology that is based on a comprehensive analysis of the issuer's creditworthiness, financial health, past credit history, and management quality.

Disclosure norms: The CRA must have a policy of full disclosure of its rating process, rating criteria, and any conflicts of interest that may arise.

Code of Conduct: The CRA must have a code of conduct for its employees that is in line with the guidelines issued by SEBI.

Compliance: The CRA must have a system of compliance that ensures compliance with the Credit Rating Agencies Regulations 1999 and any other applicable laws and regulations.

In summary, the eligibility criteria for registration of CRAs under the Credit Rating Agencies Regulations 1999 are designed to ensure that only competent and well-managed entities are registered as CRAs, and that they have adequate infrastructure and systems in place to provide reliable and independent credit ratings.

Registration process for registration of Credit Rating Agencies under Regulations– 1999?

The registration process for Credit Rating Agencies (CRAs) under the Credit Rating Agencies Regulations 1999 is as follows:

Submission of application: The CRA must submit an application in the prescribed format to SEBI along with the required documents and fees.

Initial scrutiny: SEBI will scrutinize the application and documents submitted by the CRA to determine whether the CRA meets the eligibility criteria specified under the regulations.

Inspection: SEBI may conduct an inspection of the CRA's premises and records to verify the information provided in the application and to assess the CRA's infrastructure and systems.

Approval or rejection: Based on the application, documents, and inspection report, SEBI will either approve or reject the CRA's application for registration. If approved, SEBI will issue a certificate of registration to the CRA.

Renewal of registration: The CRA's registration is valid for three years, after which it must apply for renewal of its registration. The renewal process is similar to the initial registration process and requires the CRA to submit an application and documents to SEBI.

Surrender of registration: If the CRA wishes to surrender its registration, it must inform SEBI in writing and follow the procedures specified under the regulations.

Overall, the registration process for CRAs under the Credit Rating Agencies Regulations 1999 is designed to ensure that only competent and well-managed entities are registered as CRAs, and that they have adequate infrastructure and systems in place to provide reliable and independent credit ratings. The process involves a rigorous evaluation of the CRA's eligibility criteria, infrastructure, and systems to ensure that they meet the regulatory standards set by SEBI.

Disclosure requirements of Credit Rating Agencies under Regulations– 1999?

Under the Credit Rating Agencies Regulations 1999, Credit Rating Agencies (CRAs) in India are required to comply with various disclosure requirements. These requirements are designed to ensure transparency and accountability in the rating process, and to provide investors and issuers with accurate and reliable information. Some of the key disclosure requirements for CRAs under the regulations are:

Rating disclosure: CRAs must disclose the rating assigned to the instrument being rated, the date of the rating, and the rating outlook.

Methodology disclosure: CRAs must disclose their rating methodology and the key assumptions used in the rating process.

Rating history: CRAs must maintain a rating history of the issuer, which includes details of all previous ratings assigned by the CRA.

Disclosure of rating limitations: CRAs must disclose the limitations of their rating, including any factors that may have a negative impact on the rating.

Conflict of interest disclosure: CRAs must disclose any conflict of interest that may arise in the rating process, including any financial or other relationship with the issuer.

Annual report disclosure: CRAs must prepare and disclose an annual report that provides details of their operations, rating performance, and any other relevant information.

Timely disclosure: CRAs must ensure that all information related to the rating process is disclosed in a timely manner.

Website disclosure: CRAs must maintain a website that provides details of their rating methodology, rating history, and other relevant information.

Overall, the disclosure requirements for CRAs under the Credit Rating Agencies Regulations 1999 are comprehensive and designed to ensure transparency and accountability in the rating process. By complying with these requirements, CRAs can help to build trust and confidence among investors and issuers, and contribute to the development of a robust credit market in India.

Rating process of Credit Rating Agencies under Regulations– 1999.

The rating process of Credit Rating Agencies (CRAs) in India under the Credit Rating Agencies Regulations 1999 involves the following steps:

Request for rating: The issuer of the debt instrument (or an investor) approaches a CRA to request a credit rating for the instrument.

Analysis of information: The CRA obtains information from the issuer, such as financial statements, industry reports, and other relevant data. The CRA then analyzes this information to assess the issuer's creditworthiness.

Rating committee: The CRA convenes a rating committee consisting of experienced professionals who review the analysis and arrive at a rating based on their collective judgment.

Rating communication: The CRA communicates the rating to the issuer and/or investor, along with the key factors that influenced the rating.

Ongoing monitoring: The CRA continuously monitors the issuer's financial performance, market conditions, and other relevant factors to assess the ongoing creditworthiness of the issuer.

Rating review: The CRA periodically reviews the rating to ensure that it remains accurate and up-to-date. If the CRA determines that the rating needs to be revised, it communicates the revised rating to the issuer and/or investor.

The rating process of CRAs under the Credit Rating Agencies Regulations 1999 is designed to ensure that credit ratings are independent, accurate, and reliable. The process involves a rigorous analysis of the issuer's financial performance and creditworthiness, as well as ongoing monitoring to ensure that the rating remains accurate over time. By following this process, CRAs can provide valuable information to investors and help to facilitate the development of a robust credit market in India.

Monitoring and surveillance on Credit Rating Agencies under Regulations– 1999.

The Securities and Exchange Board of India (SEBI) is the regulator of Credit Rating Agencies (CRAs) in India and is responsible for monitoring and surveillance of CRAs to ensure compliance with the Credit Rating Agencies Regulations 1999. Some of the key monitoring and surveillance activities undertaken by SEBI are:

Inspection: SEBI conducts periodic inspections of CRAs to verify compliance with the regulations, assess the adequacy of their systems and processes, and identify areas for improvement.

Review of rating methodologies: SEBI reviews the rating methodologies and processes used by CRAs to ensure that they are consistent with best practices and are transparent.

Disclosure monitoring: SEBI monitors the disclosures made by CRAs to ensure that they are accurate, timely, and adequate.

Investigation of complaints: SEBI investigates complaints and allegations against CRAs to ensure that they are operating in compliance with the regulations and are providing accurate and reliable credit ratings.

Enforcement action: SEBI takes enforcement action against CRAs for non-compliance with the regulations, such as issuing warnings, imposing fines, and revoking registration.

SEBI's monitoring and surveillance activities are designed to ensure that CRAs operate in compliance with the regulations and maintain the highest standards of transparency, independence, and reliability in their credit rating activities. By promoting good governance and accountability in the credit rating industry, SEBI helps to build trust and confidence in the Indian capital markets and promotes the development of a robust credit market.

Rating dissemination of Credit Rating Agencies under Regulations– 1999.

Credit Rating Agencies (CRAs) are required to comply with specific rating dissemination requirements under the Credit Rating Agencies Regulations 1999 in India. These requirements include:

Rating symbols: CRAs must use a rating symbol to indicate the creditworthiness of the rated entity or financial instrument. The rating symbols used by CRAs must be consistent with the definitions and meanings specified in the regulations.

Disclosure of rating rationales: CRAs must disclose the key factors that influenced the rating, including the strengths and weaknesses of the rated entity or financial instrument.

Timeframe for dissemination: CRAs must disseminate the credit rating within a specified timeframe, which is typically within a few days of the rating committee meeting.

Public dissemination: CRAs must make credit ratings available to the public, either through their own website or through other media.

Confidentiality of information: CRAs must ensure the confidentiality of any information received from issuers and must not disclose such information to third parties without the issuer's consent.

Monitoring and updating of ratings: CRAs must continuously monitor and update ratings as appropriate, including issuing revised ratings if necessary.

The rating dissemination requirements of the Credit Rating Agencies Regulations 1999 are designed to ensure that credit ratings are accurate, reliable, and easily accessible to investors and other market participants. By providing clear and transparent information about the creditworthiness of rated entities and financial instruments, CRAs can help investors to make informed investment decisions and promote the development of a robust credit market in India.

Remedial action on Credit Rating Agencies under Regulations– 1999.

The Credit Rating Agencies (CRAs) Regulations 1999 in India provide for remedial action against CRAs in case of non-compliance with the regulations. Some of the remedial actions that can be taken by the Securities and Exchange Board of India (SEBI) are:

Warning: SEBI may issue a warning to the CRA for minor non-compliance with the regulations. The warning may also specify the corrective action that the CRA needs to take.

Imposition of penalties: SEBI may impose penalties on the CRA for non-compliance with the regulations. The penalties may be in the form of monetary fines or other actions, such as suspension or cancellation of registration.

Suspension of registration: SEBI may suspend the registration of a CRA for a specified period of time if it is found to be in violation of the regulations. During the suspension period, the CRA is not permitted to undertake any credit rating activities.

Cancellation of registration: SEBI may cancel the registration of a CRA if it is found to be in serious violation of the regulations or if it repeatedly fails to comply with the regulations.

Prosecution: SEBI may initiate prosecution proceedings against the CRA in case of serious non-compliance with the regulations.

These remedial actions are intended to ensure that CRAs comply with the regulations and maintain the highest standards of transparency, independence, and reliability in their credit rating activities. By taking strict action against non-compliant CRAs, SEBI can help to protect investors and promote the development of a trustworthy credit market in India.

8.5 UNIT END QUESTIONS

Write Short Notes

1. Credit Rating Agencies
2. Advantages of Credit Rating Agencies
3. Key provisions of the SEBI (Credit Rating Agencies)Regulations, 1999:

Explain in Details

1. Regulatory Framework of Credit Rating Agencies
2. Importance of Credit Rating Agencies
3. Remedial action on Credit Rating Agencies under Regulations– 1999.

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