

**India: Financial Sector Assessment Program—Detailed Assessments Report on
IOSCO Objectives and Principles of Securities Regulation**

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FINANCIAL SECTOR ASSESSMENT PROGRAM UPDATE

INDIA

INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS
OBJECTIVES AND PRINCIPLES OF SECURITIES REGULATION

DETAILED ASSESSMENT

AUGUST 2013

INTERNATIONAL MONETARY FUND
MONETARY AND CAPITAL MARKETS DEPARTMENT

THE WORLD BANK
FINANCIAL AND PRIVATE SECTOR
DEVELOPMENT
VICE PRESIDENCY
SOUTH ASIA REGION VICE PRESIDENCY

Contents	Page
Glossary	3
Executive Summary	4
I. Introduction	6
II. Information and Methodology Used for the Assessment.....	6
III. Institutional Structure.....	7
IV. Market Structure	8
V. Preconditions for Effective Securities Regulation.....	11
VI. Main Findings.....	12
VII. Recommended Action Plan and Authorities' Response.....	20
VIII. Detailed Assessment	25
 Tables	
1. Corporate Bonds	9
2. Summary Implementation of the IOSCO Principles and Objectives of Securities Regulation.....	14
3. Recommended Action Plan to Improve Implementation of the IOSCO Principles	20
4. Detailed Assessment of Implementation of the IOSCO Principles	25
 Annex	
I. Status of Implementation of the New IOSCO Principles	98

GLOSSARY

AMC	Asset management company
AMFI	Association of Merchant Bankers of India
ANMI	Association of National Exchange Members of India
AUM	Assets under management
BOISL	Bank of India Shareholding Limited
BSE	Bombay Stock Exchange
CCP	Central Clearing Counterparty
CG	Central Government
CIS	Collective investment schemes
CVO	Central Vigilance Officer
FRRB	Financial Reporting Review Board
FSDC	Financial Stability Development Council
GAAP	Generally Accepted Accounting Principles
HLCCFM	High Level Coordination Committee for Financial Markets
ICAI	Institute of Chartered Accountants of India
ICCL	Indian Clearing Corporation Limited
IFRS	International Financial Reporting Standards
IOSCO	International Organization of Securities Commissions
IMSS	Integrated Market Surveillance System
IRDA	Insurance Regulatory Development Authority
LA	Listing Agreement
MB	Merchant banker
MCA	Ministry of Corporate Affairs
MF	Mutual Fund
MoU	Memorandum of Understanding
MMoU	Multilateral Memorandum of Understanding
MCA	Ministry of Corporate Affairs
MoF	Minister of Finance
NACAS	National Advisory Committee on Accounting Standards
NBFC	Non bank financial companies
NISM	National Institute of Securities Markets
NSCCL	National Securities Clearing Corporation Limited
NSE	National Stock Exchange
PM	Portfolio manager
QRB	Quality Review Board
RBI	Reserve Bank of India
RoC	Register of Companies
RSEs	Recognized Stock Exchanges
SAT	Securities Appellate Tribunal
SE	Stock Exchange
SEBI	Securities and Exchange Board of India
SRO	Self Regulatory Organization
WTM	Whole time member

EXECUTIVE SUMMARY

India exhibits significant progress in the implementation of the IOSCO Principles vis-à-vis the assessment concluded in 2000. In particular, the legal authority of Securities and Exchange Board of India (SEBI) has been strengthened, and SEBI has now broad regulatory, licensing, investigation, supervision, and enforcement powers. Based on such strong legal framework SEBI has also developed robust regulations for different types of market participants, including issuers, collective investment schemes (CIS), brokers, portfolio managers, underwriters, and recognized stock exchanges (RSEs)—although in the medium term its approach to capital requirements should be revisited. Finally efforts made by SEBI during the last years to build a robust market surveillance system and separate investigation and enforcement departments have translated into effective enforcement of unfair trading practices, such as market manipulation, and insider trading. That has allowed SEBI to build a reputation of a credible enforcement agency. It is important that such commitment to enforcement continues to exist, including in the form of dedicated human and technological resources, as well as through the strengthening of the supervision function—as will be further described below.

SEBI faces three main challenges which altogether impact the effectiveness of the supervisory programs for issuers and securities intermediaries: strengthening the supervision approach toward securities intermediaries, including fund managers and the funds they administer; improving mechanisms to ensure compliance of issuers with reporting requirements; and mechanisms to ensure compliance with accounting and auditing requirements.

SEBI is aware of such challenges and some measures are currently being implemented to address them. In the first case, starting in FY 2011–2012 SEBI has implemented a risk-based supervisory approach for fund managers and the funds they administer, as well as merchant bankers. In regard to the two latter challenges SEBI has set up coordination committees with the RSEs and the Ministry of Corporate Affairs (MCA), who are respectively the main authorities currently responsible for reviewing issuers' compliance with reporting requirements and accounting standards. SEBI is also in the process of creating its own unit that will review periodic reports submitted by issuers. Finally the government has created the Quality Review Board (QRB), which will be in charge of reviewing the quality of the work of auditors; although it is not yet operational.

In the long term those challenges involve strategic discussions concerning the role of the RSEs and MCA and SEBI's resources. First, SEBI should review the degree to which it will want to continue to rely on the demutualised exchanges for self-regulation, in particular if they become themselves listed companies. Second, SEBI and MCA should review whether it would be more effective if reviews of information submitted by listed companies are carried out by SEBI only. Finally, the authorities should analyze whether the QRB would meet all the requirements set forth in the IOSCO Principles for independent oversight of

auditors', or whether a different body under the oversight of the securities regulator is necessary. Naturally all such decisions will have an impact on SEBI's resources.

An important challenge, outside of the control of SEBI, is criminal enforcement, which needs to be stepped up. This is a challenge faced by many countries and measures to address it are complex, in particular because they are out of the control of the securities regulator. However, in the past SEBI has been successful in arranging for dedicated designated criminal courts to hear cases related to CIS cases. SEBI could explore whether such type of arrangement could be extended to all types of securities offenses.

I. INTRODUCTION

1. **An assessment of the level of implementation of the IOSCO Principles in the Indian securities market was conducted from June 15 to July 1, 2011 as part of the Financial Sector Assessment Program (FSAP) by Ana Carvajal, Monetary and Capital Markets Department.** An initial IOSCO assessment was conducted in 2000. Since then significant changes have taken place in the Indian market, in terms of market development, upgrading of market infrastructure and of the regulatory framework. Therefore, the need to conduct a new assessment.

II. INFORMATION AND METHODOLOGY USED FOR THE ASSESSMENT

2. **The assessment was conducted based on the IOSCO Principles and Objectives of Securities Regulation and its Methodology adopted in 2003 and updated in 2008.** In June 2010, IOSCO approved a revision to the IOSCO Principles, which mainly resulted in the addition of nine new Principles. However, at the time of the assessment a revised methodology had not been approved yet. As a result this assessment has been conducted based on the Principles adopted in 2003, and their corresponding methodology. Nevertheless the authorities agreed to hold exploratory discussions on the status of implementation of the new principles. A summary of such discussions is included as an Annex to this assessment. As has been the standard practice, Principle 30 is not assessed due to the existence of a separate standard for securities settlement systems. A technical note on payment issues will be delivered during this mission.

3. **The IOSCO methodology requires that assessors not only look at the legal and regulatory framework in place, but at how it has been implemented in practice.** The recent global financial crisis has reinforced the need for assessors to take a critical look at supervisory practices, to determine whether they are effective enough. Among others such judgment involves a review of the inspection programs for different types of intermediaries, the cycle, scope and quality of inspections as well as how the agency follow-up on findings, including the use of enforcement actions.

4. **The assessor relied on:** (i) a self-assessment developed by SEBI; (ii) the review of relevant laws, and other relevant documents provided by the authorities including annual reports; (iii) meetings with the Chairman of SEBI and other members of the Board, staff of SEBI as well as the RBI, and other public authorities, in particular representatives of the Ministry of Finance (MoF) and the Ministry of Corporate Affairs (MCA); as well as (iv) meetings with market participants, including issuers, brokers, merchant bankers, fund managers, stock exchanges, external auditors, credit rating agencies and law firms.

5. **The assessor wants to thank SEBI for its full cooperation as well as its willingness to engage in very candid conversations regarding the regulatory and supervisory framework in India.** The assessor also wants to extend her appreciation to all other public authorities and market participants with whom she met.

III. INSTITUTIONAL STRUCTURE

6. **The regulation and supervision of the securities market in India is mainly a responsibility of the Securities and Exchange Board of India (SEBI).** SEBI has been set up under the Securities and Exchange Board of India Act, 1992 (SEBI Act), with a mandate to protect the interest of investors, to regulate and to promote the development of the securities market. The responsibilities of SEBI have been stated by law, and they stem from various statutes, in particular (i) the SEBI Act; (ii) the Securities Contract (Regulation) Act, 1956 (SC(R) Act); (iii) the Depositories Act, 1996; and (iv) and the companies Act, 1956 in respect of listed companies and companies proposed to be listed on the Recognized Stock Exchanges (RSEs). Based in all such statutes SEBI regulates the public offering of equity, debt and asset backed securities, as well as collective investment schemes (CIS) and the trading of securities and derivatives in recognized stock exchanges (RSEs). Finally it regulates and supervises all intermediaries in the securities market as well as infrastructures providers, including exchanges, central clearing counterparties and central securities depositories.

7. **The Ministry of Corporate Affairs (MCA) and the Reserve Bank of India (RBI) have certain responsibilities in the regulation and supervision of securities markets.** SEBI reviews prospectus of listed issuers and regulate listed companies in respect of issue, transfer of securities and nonpayment of dividend. The MCA has authority to register and regulate all companies (except, listed companies in respect of issue, transfer and nonpayment of dividend), and it is currently the main authority in charge of reviewing the annual financial reports (including financial statements) that all companies, including listed issuers, are required to submit pursuant to the Companies Act. The RBI has regulatory responsibility over contracts on government securities, gold related securities and money market securities and securities derived from those securities and repo contracts in debt securities. However, the execution of those contracts on exchanges is under the responsibility of SEBI.

8. **Several channels have been created to foster coordination.** Many of them are recent developments, and therefore are still evolving. There are coordination committees between SEBI and the RBI, and between SEBI and MCA. In addition, two committees have been constituted for purposes of dealing with financial conglomerates, with representation from SEBI, RBI and the Insurance Regulatory Development Authority (IRDA). The Financial Stability Development Council (FSDC) was created in 2010, with representation from the MoF as well as the three regulatory authorities to foster coordination on financial stability issues, as well as developmental issues. A subcommittee on inter-regulatory coordination has also been set up within the umbrella of the FSDC. Finally a joint mechanism to solve any potential difference of opinion regarding the nature of a product was created in 2010.

9. **The RSEs play a key role in self-regulation.** In India, RSEs are the listing authorities, and thus are in charge of monitoring issuers' compliance with disclosure obligations. Under the listing agreement, they also operate as the primary regulator and supervisor for brokers. Finally they are in charge of real time surveillance of the markets that they operate. In practice such functions have mainly rested in the two nationwide RSEs, the Bombay Stock Exchange (BSE) and the National Stock Exchange (NSE). SEBI has established several mechanisms to ensure robust oversight of the RSEs in the discharge of their self-regulatory functions. Such mechanisms include periodic reporting, as well as regular meetings on market developments, and annual on-site inspections. More recently a committee on non-compliance with listing obligations was constituted.

IV. MARKET STRUCTURE¹

Equity markets

10. **Equity markets in India have achieved an important size relative to GDP.** As of June 2011, there were 5,025 listed companies in the BSE,² and market capitalization amounted to roughly 100 percent of GDP. However, as in many other markets, market capitalization is still concentrated. As of 2011, the top 10 companies represented 31 percent of total market capitalization.

11. **New listings continued to take place.** During 2011, 23 new companies were listed in the BSE, compared to 80 in 2010. Fifty-eight IPOs have taken place during 2010–2011, compared to 39 in 2009–2010. Private sector companies represented the bulk of new listed companies and IPOs. A fourth of the issuances amounted to Rs. 500 crores (roughly US\$108,157,135) or more.

12. **Trading frequency has increased; although it is still concentrated.** For 2009-2010, 3,371 shares were traded in the BSE and 1,401 at the NSE. Out of such number 2,986 and 1,301 shares were traded above 100 days. Such number of shares represented roughly 89 percent and 93 percent of the total number of shares traded in the BSE and the NSE respectively. The top 10 shares amounted to 26 percent and 23 percent of the annual cash market turnover for the NSE and the BSE respectively. For that same year, the percentage share of securities traded for less than 10 days was 4.1 percent at the BSE and 0.9 percent at the NSE

¹ All the information in this section has been taken from documents submitted by SEBI in connection with the FSAP mission, and SEBI's Annual Report 2009–2010.

² The bulk of companies listed in the NSE are also listed in the BSE. Thus for purposes of measuring the importance of equity markets this assessment uses only the number of listed companies and market capitalization of the BSE. On the other hand secondary market trading is concentrated in the NSE.

Bond markets

13. **Corporate bond markets are less developed, although growing.** The bulk of the debt offerings are issued as private offerings. Data is available for privately placed issues which are listed on exchanges under The Debt Regulations. In addition data is available on corporate bonds issued in dematerialized form from the depositories-CDSL and NSDL.

Table 1. India: Corporate Bonds

(Data for 2011–2012)								
Month	Listed only on NSE		Listed only on BSE		Listed Both on NSE and BSE		Total	
	No. of Issues	Amount (Rs Crores)	No. of Issues	Amount (Rs Crores)	No. of Issues	Amount (Rs. Crores)	No. of Issues	Amount (Rs Crores)
Apr-11	88	10322.30	67	8316.49	0	0.00	155	18638.79
May-11	51	7405.27	61	1542.64	2	4650.00	114	13597.91
Jun-11	74	17508.05	45	1513.62	0	0.00	119	19021.67
Jul-11	84	15127.25	60	7557.48	1	100.00	145	22784.73
Aug-11	78	16690.33	47	3778.87	1	1500.00	126	21969.20
Sep-11	106	15725.17	60	4053.52	2	584.00	168	20362.69
Total	481	82778.37	340	26762.62	6	6834.00	827	116375.00

Equity derivatives markets

14. **Derivatives markets have grown substantially.** Over the years, the derivatives market segment has generated a turnover substantially higher than that of the cash equity market. Trading in derivatives is dominated by the NSE, which has a share of more than 99 percent of total turnover.

15. **Product composition has changed in recent years.** Futures in general and single stock futures used to dominate derivatives products; however for the last two years the largest share of total derivatives turnover has been contributed by index options with 45.5 percent share. In 2009–2010 index options were followed by single stock futures (29.4 percent) and index futures (22.3 percent).

Mutual funds

16. **As for March 2011 there were 51 mutual funds, compared to 47 as of March 2010.** Assets under management (AUM) amounted to Rs. 592,249.54 crores (US\$123,927.5 million). Roughly, 70 percent of AUM was invested in debt funds—out of which 20 percent were invested in money market funds—32.98 percent in equity funds and 3.11 percent in balanced funds (mixed of equity and debt).

17. **Retail investors represented roughly 97 percent of total investors' accounts; however, they held only 40 percent of the AUM.** As of August 31, 2011, there were a total of 47.07 million investor accounts in mutual funds. Corporations and other institutions on the other hand represented roughly 1 percent of total investors but held 54 percent of AUM. Foreign investors amounted to 2 percent of total accounts and hold 4.5 percent of AUM. Vis-à-vis assets classes retail investors accounted for roughly 90 percent of AUM in equity funds, while institutional investors accounted for roughly 90 percent of AUM in debt funds.

Securities intermediaries

18. **As of March 2010, there were 10,203 brokers³ authorized to trade on an RSE.** The majority of the brokers are licensed in both the NSE and the BSE. As per the Indian legal system, brokers can take the legal form of a corporation or can be individuals. In practice, however corporate brokers constitute 90 percent of brokers at the NSE and 82 percent at the BSE. For 2010 the top 10 brokers represented roughly 25 percent and 23 percent of annual cash market turnover of the NSE and the BSE, respectively. Many brokers engage in proprietary trading. For 2010 proprietary trading represented roughly 26 percent and 23 percent of the annual cash market turnover for the NSE and the BSE respectively. As per information provided by SEBI, brokers fund their proprietary trading activities mostly with own funds, and leverage is not common.

19. **In addition there were 192 merchant bankers and three underwriters registered with SEBI.** In practice most merchant bankers are also registered as underwriters, thus the limited number of “stand-alone” underwriters. Book building is the preferred mechanism for placement, and issues are usually oversubscribed. As a result the exposure of merchant bankers/underwriters is usually limited. Such exposure is further limited by regulations, since qualified institutional investors are not allowed to walk away from their expressions of interest. Thus, in practice the obligation of the underwriters is often limited to (a) a 5 percent portion that they are required to retain by regulation (“skin on the game”); and (b) filling any gap resulting from retail investors who withdraw their applications. As per information provided by SEBI, merchant bankers fund their obligations mostly with own funds, and leverage is not common either.

20. **There were also 267 portfolio managers registered with SEBI.** Portfolio managers are only authorized to manage individual accounts, and they cannot pool the money of investors. The bulk of accounts are discretionary. As of March 2011, AUM by portfolio managers amounted to Rs. 295,435.80 crores compared to Rs. 282,720.75 crores as of March 2010.

³ In the context of this assessment, the term “brokers” encompasses all persons licensed by SEBI to carry out investment services, whether in the corporate form or not.

Market infrastructure

21. **There are 21 RSEs; however, equity markets listing and secondary market trading are concentrated in the BSE and the NSE.** Both RSEs operate anonymous order driven systems and settlement takes place on a t+2 basis.

22. **Clearing in both the NSE and the BSE is done through central clearing counterparties (CCPs).** In the case of the NSE, the National Securities Clearing Corporation (NSCCL), a wholly owned subsidiary of the NSE, performs CCP services. In such capacity it handles the risk management function (including margins and settlement guarantee fund). In the case of the BSE, the Bank of India Shareholding Limited (BOISL) facilitates the settlement process of the equity cash segment and delivery based stock derivatives by coordinating with the clearing banks and depositories as per the directions of the exchange. Accordingly, BOISL process the pay-in and pay-out for such segment based on the input files received from the exchange, the clearing banks and depositories. However, BSE Ltd. acts as the central counterparty and guarantees the settlement for such segments. Thus, BSE Ltd. manages the settlement guarantee fund and handles the risk management functions (collateral management, margins, etc.) and overall settlement process. The Indian Clearing Corporation Limited (ICCL) handles the mutual fund segment and the corporate bond segment of BSE Ltd., and currency derivatives segment of the United Stock Exchange of India Ltd. BOISL is a joint venture company of Bank of India (51 percent holding) and BSE Ltd. (49 percent holding). ICCL is a wholly owned subsidiary of BSE Ltd.

V. PRECONDITIONS FOR EFFECTIVE SECURITIES REGULATION

23. **A few general preconditions for the effective regulation of securities markets requires further strengthening.** There are no significant barriers to entry and exit for market participants. Foreign ownership of securities intermediaries is allowed, but investment by foreign investors in Indian issuers and mutual funds must be done through FIIs, which are required to register with SEBI. Since August 2011, SEBI has allowed foreign investors who meet “know your customer” requirements to invest in equity and debt schemes of mutual funds. The Companies Act contains a basic framework for the constitution and operation of corporations that has served the country well but could usefully be updated. In particular, market participants commented that the insolvency regime requires a major overhaul since protracted insolvency proceedings are mentioned as a key weakness of the system. The authorities informed that a Companies Bill 2011 has already been tabled in parliament. Criminal enforcement in the courts is also a challenge, with protracted procedures mentioned as the main problem. The country is moving toward convergence with (rather than adoption of) IFRS. IFRS equivalent standards have been notified by the central government and ICAI has suggested April 2013 for implementation. Some differences with IFRS remain, and the authorities’ intention is to initiate a dialogue with the International Accounting Standards Board to address such differences. Market participants expressed concerns about the taxation framework, in particular the existence of a securities transaction

tax with different percentages for different asset classes, which can distort the natural development of the markets. The authorities informed that the MoF has initiated a review of such tax with a view toward rationalization of securities transaction tax percentages. Finally, there are general concerns about the level of corruption in the country. The creation of an independent anticorruption agency is currently being discussed in parliament.

VI. MAIN FINDINGS

24. **Principles for the regulator (1–5): SEBI’s responsibilities are clearly established by law.** Several mechanisms have been developed to foster coordination among SEBI and other domestic authorities. Many of them are of recent creation and therefore still evolving. In practice, SEBI has acted with a high degree of independence from both governmental and commercial interest. SEBI has broad licensing, supervision, investigation, and enforcement powers. SEBI faces challenges in regard to the number of staff vis-à-vis the size of the market, as well as its capacity to hire personnel with market experience, especially at the senior level. The development of regulations is subject to public consultation. Licensing requirements are established by regulations which are all available in SEBI’s website. Parties affected by a decision of SEBI have a right to appeal. There is a code of conduct for staff that includes provisions on use of information, transactions in securities, gifts, and cool-off periods. There are separate provisions for Board members.

25. **Principles for enforcement (8–10):** SEBI has broad authority to request information, testimony, and conduct inspections on regulated entities. SEBI also has broad authority to request information and testimony from third parties. SEBI has broad enforcement powers over both regulated entities and third parties. It can impose a wide range of measures and sanctions including cease and desist orders, money penalties, and disgorgement. Onsite inspection plans require further strengthening, in particular for securities intermediaries, and so does enforcement of listing obligations by issuers and of accounting and auditing standards. While the law provides for strong criminal penalties, in practice effective criminal enforcement has focused on CIS cases.

26. **Principles for cooperation (11–13):** SEBI’s Act provides SEBI with the authority to cooperate and share public and nonpublic information with domestic and foreign authorities, without limitations. SEBI is signatory of the IOSCO MMOU and several bilateral MOUs, and has demonstrated that in practice it cooperates effectively with other foreign regulators.

27. **Principle for issuers (14–16):** Public offering of securities is subject to disclosure requirements, mainly in the form of a prospectus the content of which is broadly in line with the IOSCO principles. SEBI reviews all prospectuses of equity issuers, and the RSEs review those of debt issuers. There are periodic requirements on listed companies, including to promptly disclose material events. Mechanisms to ensure compliance with listing obligations, which include periodic reporting, are a responsibility of the RSEs. Such mechanisms have limitations. A committee on noncompliance of listing agreement has recently been set up to

address this issue. Issuers are required to submit their financial statements according to local accounting standards, and auditors are required to conduct their audits based on local auditing standards. Current mechanisms to ensure compliance with accounting and auditing standards including auditors' independence have limitations.

28. **Principles for collective investment schemes (17–20):** There are robust registration requirements for sponsors and the asset management companies that manage mutual funds. Individuals who want to sell CIS are subject to a certification process. Mutual funds and asset management companies are subject to offsite reporting. Starting in 2011/12, SEBI has enhanced its supervisory approach whereby inspections are carried out directly by SEBI staff under a risk-based approach, and thematic inspections are becoming an integral part of the supervisory plan. Asset management companies must submit a prospectus for every mutual fund scheme that they want to manage, the content of which is broadly in line with the IOSCO principles. Assets of mutual funds must be entrusted to an independent custodian. There are clear rules on valuation, including detailed guidelines for valuation of illiquid securities. In the case of debt, assets must be valued using the prices provided by independent third parties. Asset management companies are responsible to investors for errors in valuation.

29. **Principles for market intermediaries (21–24):** There are robust registration requirements for all types of securities intermediaries. However in the case of brokers, the RSEs do not conduct visits in connection with registration. Portfolio managers have not been subject to regular inspections but are subject to inspection every three years upon renewal of registration, and only this year SEBI implemented a more comprehensive inspection program for merchant banks. For all types of intermediaries inspections have been compliance based, and follow up of findings of inspections reports should be strengthened. All types of intermediaries except merchant banks and underwriters must submit semiannual audits of their internal controls and risk management systems. All types of intermediaries must appoint compliance officers. The RSEs have established early warning mechanisms for brokers as well as detailed provisions to deal with their failure.

30. **Principles for secondary markets (25–30):** Only RSEs can operate in India, subject to recognition by SEBI. Recognition requirements are robust and include economic resources and certifications of IT systems, among others. The RSEs have established robust mechanisms for market surveillance, which are complemented by SEBI's own surveillance system. Market manipulation, insider trading, and other unfair practices constitute both civil infractions and criminal offenses. The RSEs have robust mechanisms to monitor large exposures by members. A system of Market-Wide Circuit Breakers and Securities Level Price Bands has been put in place.

Table 2. India: Summary Implementation of the IOSCO Principles and Objectives of Securities Regulation

Principle	Grading	Findings
<p>Principle 1. The responsibilities of the regulator should be clearly and objectively stated.</p>	BI	<p>SEBI is the main authority responsible for the regulation and supervision of securities markets. Its responsibilities are clearly stated in different legal statutes. MCA and RBI have some limited responsibilities stemming from laws and notifications from the central government. The RSEs also have a critical role in self-regulation. Different mechanisms have been set up to foster coordination, including several committees. Many of them are of recent creation, thus still evolving.</p>
<p>Principle 2. The regulator should be operationally independent and accountable in the exercise of its functions and powers.</p>	PI	<p>The possibility that Board members can be removed without cause is a threat to independence, as well as the existence of a very general provision that allows the central government to provide directions to SEBI and supersede SEBI's Board. However in practice SEBI has acted with a high degree of independence from both governmental and commercial interests. SEBI is required to provide annual reports to the central government and parliament, and its accounts must be audited on an annual basis by the Comptroller and Auditor General of India.</p>
<p>Principle 3. The regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers.</p>	BI	<p>SEBI has broad licensing, supervision, investigation, and enforcement powers. SEBI faces challenges in regard to the number of staff vis-à-vis the size of the market and its ability to hire staff with market experience, the latter mainly due to salary limitations. Whole time members carry a critical role of overseeing day-to-day operations of the institution.</p>
<p>Principle 4. The regulator should adopt clear and consistent regulatory processes.</p>	FI	<p>Issuance of regulations by SEBI is subject to public consultation. In addition, SEBI has established consultative committees where the views of different stakeholders are taken into consideration. Requirements for licensing/registration are established by regulations, which can all be found on SEBI's website. Parties aggrieved by a decision of SEBI have a right to appeal before the securities appellate tribunal.</p>
<p>Principle 5. The staff of the regulator should observe the highest professional standards.</p>	FI	<p>There is a code of conduct that applies to all staff. Such code establishes clear guidelines in regard to use of information, transactions in securities, gifts, and cooling off periods. There are separate rules for Board members, which impose further disclosures on them, as well as additional requirements in regard to management of conflict of interest.</p>

Principle	Grading	Findings
Principle 6. The regulatory regime should make appropriate use of SROs that exercise some direct oversight responsibility for their respective areas of competence and to the extent appropriate to the size and complexity of the markets.	Not rated	The RSEs are the listing authorities, the front line regulators and supervisors for brokers, and have also a role in market surveillance.
Principle 7. SROs should be subject to the oversight of the regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities.	BI	RSEs require recognition from SEBI, which can impose conditions to grant such recognition. In practice such conditions have included provisions to ensure that conflict of interest in relation to the self-regulatory role are adequately addressed by, for example, requiring independent members on the Board, as well as specialized committees to discharge self-regulatory functions. All bylaws of the RSEs are subject to SEBI's approval. SEBI has established a robust oversight regime for the RSEs in the performance of their self-regulatory role, which includes offsite reporting, meetings, and onsite inspections, the latter on an annual basis.
Principle 8. The regulator should have comprehensive inspection, investigation and surveillance powers.	FI	SEBI has broad powers to request information, testimony, documents, as well as to inspect all types of regulated entities.
Principle 9. The regulator should have comprehensive enforcement powers	FI	SEBI has broad powers to request information, testimony, and documents from third parties, including bank records. It also has broad civil enforcement powers over both regulated entities and third parties. Such civil enforcement powers include the authority to impose a wide range of measures and sanctions, such as cease and desist orders, money penalties, disbars, and disgorgement.
Principle 10. The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance program.	PI	SEBI has established a system of offsite supervision for all intermediaries. There are important limitations in the system of onsite inspections, in particular for securities intermediaries, although SEBI is in the process of implementing changes that would allow it to have a more comprehensive risk-based approach to supervision. SEBI, along with the RSEs, has established a robust system of market surveillance. The supervision of the RSEs is also robust. SEBI has demonstrated that it is active in civil enforcement, in particular in regard to unfair trading practices. Enforcement of listing obligations, currently mainly a responsibility of the RSEs, requires further strengthening, and so does enforcement of accounting and auditing standards. Criminal enforcement also needs to be stepped up.
Principle 11. The regulator should have the authority to share both public	FI	SEBI Act provides SEBI with the authority to cooperate with domestic and foreign authorities and to share both public and nonpublic information.

Principle	Grading	Findings
and nonpublic information with domestic and foreign counterparts.		
Principle 12. Regulators should establish information sharing mechanisms that set out when and how they will share both public and nonpublic information with their domestic and foreign counterparts.	FI	Several mechanisms to foster coordination and exchange of information have been established at the domestic level. Some of them are of recent creation, thus still evolving. SEBI is signatory of the IOSCO MMOU, as well as other bilateral MOUs, and has been active in providing information to foreign counterparts.
Principle 13. The regulatory system should allow for assistance to be provided to foreign regulators who need to make inquiries in the discharge of their functions and exercise of their powers.	FI	SEBI Act grants SEBI the authority to provide assistance to foreign regulators even if the information requested by them is not currently in its files. SEBI has provided examples that it has done so.
Principle 14. There should be full, timely and accurate disclosure of financial results and other information that is material to investors' decisions.	PI	All public offers are subject to the submission of a prospectus, the content of which is broadly in line with IOSCO requirements. SEBI reviews all prospectuses from equity issuers, while prospectuses from debt issuers are reviewed by the RSEs. Listed companies are subject to periodic reporting, including annual reports, quarterly reports (equity issuers), and semiannual reporting (debt issuers). All listed companies must also inform their RSE immediately of material events. The Listing Agreement provides guidance as to the type of events that should be disclosed promptly. Ensuring compliance with all such listing obligations is mainly a responsibility of the RSEs. However, the current arrangements developed by the RSEs have important limitations. A committee on noncompliance was set up to address this issue.
Principle 15. Holders of securities in a company should be treated in a fair and equitable manner.	BI	SEBI's regulations require disclosure to the public of significant holdings (starting at 5 percent) as well insiders' holdings. They also require a mandatory tender offer for the acquisition of control (after certain thresholds). The acquirer must submit an offering document, which is subject to SEBI's approval. The current regulations do not allow the acquirer to pay promoters a higher price for their shares as used to be the case prior to a recent reform. However a difference remains as the regulations allow agreement with promoters whereby in the event of a partial offer, the acquirer can acquire the complete holding of the promoters.
Principle 16. Accounting and auditing standards should be of a high and internationally acceptable quality.	PI	Issuers are required to submit their financial statements according to Indian accounting standards. The intention of the central government is to move toward IFRS equivalent standards. Auditors are required to carry out their audits

Principle	Grading	Findings
		<p>according to Indian auditing standards. The intention of the central government is to move to international standards. Currently the review of financial statements of listed companies is mainly a responsibility of the MCA. However, information is insufficient to assert whether such review is conducted effectively, nor whether enforcement actions are being taken when necessary. Currently there is no independent mechanism to oversee compliance by auditors with auditing standards. The ICAI has performed a disciplinary role over them. The government created a new institution, the Quality Review Board, to oversee the quality of auditors' work, but such entity is not yet operational and it is not clear whether it would meet the independence requirement of the IOSCO Principles.</p>
<p>Principle 17. The regulatory system should set standards for the eligibility and the regulation of those who wish to market or operate a collective investment scheme.</p>	<p>BI</p>	<p>There are robust standards for the eligibility of sponsors and asset management companies, as well as the individuals who sell the products. Mutual funds and asset management companies have been subject to offsite reporting. Until this year all mutual funds were supervised every two years by external auditors. Starting in 2011/12 SEBI has changed its supervisory approach whereby inspections are to be carried out directly by SEBI staff under a risk-based approach, and the mutual funds that pose the greater risk to the system will be inspected on an annual basis. In addition, thematic inspections are becoming an integral part of the inspection plan. SEBI has used primarily warnings and letters of deficiency to address findings from inspection reports, although in a few cases "harder" measures, such as disgorgement and payment of money under consent proceedings, have been imposed.</p>
Principle	Grading	Findings
<p>Principle 18. The regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client assets.</p>	<p>FI</p>	<p>There are clear rules concerning the legal form and structure of CIS. Currently all CIS are constituted as trusts. There are also clear rules on segregation of assets, including the requirement of an independent custodian.</p>
<p>Principle 19. Regulation should require disclosure, as set forth under the principles for issuers, which is necessary to evaluate the suitability of a collective investment scheme for a particular investor and the value of the investor's interest in the scheme.</p>	<p>FI</p>	<p>The asset management company is required to submit a prospectus to SEBI for each CIS, the content of which is in line with the IOSCO Principles. SEBI reviews all such prospectuses.</p>
<p>Principle 20. Regulation should ensure that there is a proper and</p>	<p>FI</p>	<p>There are clear rules on valuation of assets, including illiquid assets. For illiquid debt securities,</p>

Principle	Grading	Findings
disclosed basis for assets valuation and the pricing and the redemption of units in a collective investment scheme.		the guidelines require that asset management companies value the portfolios using prices provided by an independent party (currently the credit rating agencies). Asset management companies are responsible to cover errors in pricing.
Principle 21. Regulation should provide for minimum entry standards for market intermediaries.	PI	There are robust registration requirements for all types of securities intermediaries. For all cases except brokers, such registration is carried out by SEBI and includes a visit to verify that all systems and controls are in order. In the case of brokers, the registration process is carried out on the recommendation of the RSEs. The RSEs do not conduct visits in connection with such registration. There is a system of offsite reporting for all intermediaries. A comprehensive and regular plan for onsite inspections of portfolio managers has not been in place. Only this year a more comprehensive inspection plan for merchant bankers started to be implemented. Brokers have been subject to annual inspections by the RSEs. Inspections have been compliance based, and thematic inspections have not been a regular part of the supervisory approach.
Principle 22. There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake.	PI	All intermediaries are subject to minimum capital requirements depending on the license they want to hold, which they should keep at all times. There are no additional requirements to adjust capital by risk. However, in practice risks exposures appear to be limited, in light of the current business models of different types of intermediaries.
Principle	Grading	Findings
Principle 23. Market intermediaries should be required to comply with standards for internal organization and operational conduct that aim to protect the interests of clients, ensure proper management of risk, and under which management of the intermediary accepts primary responsibility for these matters.	BI	All intermediaries, with the exception of merchant bankers and underwriters, are required to have independent audits of their internal control and risk management systems, on a semiannual basis. In addition, all intermediaries are required to appoint a compliance officer. All intermediaries are required to have in place a system to address investors' complaints. Intermediaries are required to sign contracts with investors when starting a business relationship, and to provide them with information on the status of their investments on a semiannual basis. Know your customer and suitability obligations apply.
Principle 24. There should be a procedure for dealing with the failure of a market intermediary in order to minimize damage and loss to investors and to contain systemic risk.	BI	The RSEs have established early warning mechanisms and have detailed provisions to deal with the failure of brokers. Such provisions do not exist in the case of other intermediaries. However, there are strong rules on segregation of assets, and SEBI has broad powers to deal with the failure of such intermediaries.

Principle 25. The establishment of trading systems including securities exchanges should be subject to regulatory authorization and oversight.	FI	Only RSEs can operate in India, subject to recognition by SEBI. Recognition requirements include financial resources and certifications by experts of the robustness of their IT systems, among others. All rules of the RSEs have to be approved by SEBI. SEBI has broad powers over the RSEs including suspension, and power to revoke the authorization.
Principle 26. There should be ongoing regulatory supervision of exchanges and trading systems, which should aim to ensure that the integrity of trading is maintained through fair and equitable rules that strike an appropriate balance between the demands of different market participants.	FI	The RSEs have established robust market surveillance systems. They monitor the market in real time. Given the plurality of trading platforms, SEBI has established its own surveillance system to complement the role of the RSEs. SEBI conducts its surveillance on t+1. There is evidence that the RSEs are active in investigations, and so is SEBI.
Principle 27. Regulation should promote transparency of trading.	FI	RSEs are required to have both pre- and post-trade transparency not only vis-à-vis other market participants but also vis-à-vis the public.
Principle 28. Regulation should be designed to detect and deter manipulation and other unfair trading practices.	FI	Market manipulation, insider trading, and other unfair practices are by law both a civil infraction and a criminal offense. Parallel proceedings are allowed. Together with the exchanges, SEBI has established a robust system of market surveillance, which is also helped by the fact that all customers are required to have one single number for purposes of transacting in the securities markets. Criminal enforcement needs to be stepped up.
Principle	Grading	Findings
Principle 29. Regulation should aim to ensure the proper management of large exposures, default risk, and market disruption.	FI	The RSEs, through the CCPs, monitor exposures on a real time basis. They have robust powers to deal with exposures, including setting limits. Brokers are required to post initial and variation margin and to contribute to a settlement fund. A system of Market-Wide Circuit Breakers and Securities Level Price Bands has been put in place.
Principle 30. Systems for clearing and settlement of securities transactions should be subject to regulatory oversight and designed to ensure that they are fair, effective and efficient, and that they reduce systemic risk.		Not assessed.

VII. RECOMMENDED ACTION PLAN AND AUTHORITIES' RESPONSE

Table 3. India: Recommended Action Plan to Improve Implementation of the IOSCO Principles

Principle	Recommended Action
Principle 1.	<p>1) SEBI should continue to strengthen coordination by:</p> <p><i>In the context of coordination with MCA: strengthening mechanisms for cooperation in the review of prospectuses and periodic reporting, including enforcement actions.</i></p> <p><i>In the context of coordination with the RSEs: determining whether additional reporting from the RSEs in connection with listing obligations would be beneficial, including any enforcement action.</i></p> <p><i>In the context of financial groups: determining whether regular exchange of inspections reports should take place, as well as whether there is a need to share on a periodic basis other type of information</i></p> <p>2) The differences in regulatory treatment of NBFCs vis-à-vis regulated entities or intermediaries should be eliminated.</p>
Principle 2.	<p>1) SEBI's Act should be amended to remove the provision on termination of services of Board members of SEBI without due cause as contained under section 5(2) of that Act.</p> <p>2) The central government should clarify that the authority to give directions to SEBI should not be construed as to give the MoF the authority to supersede SEBI's decisions on individual cases, in either licensing, supervision, or enforcement.</p> <p>3) The authorities should review whether participation of the MoF in the joint mechanism to decide on hybrid products could be a threat to independence.</p> <p>4) SEBI should explore whether more detailed provisions to protect Board members and staff should be put in place.</p> <p>5) SEBI might wish to explore whether mechanisms for nonbinding consultation of fees and discussion of the budget with regulated entities would be beneficial.</p>
Principle 3.	<p>1) SEBI should analyze whether current resources are sufficient, in particular in the area of supervision.</p> <p>2) In addition, SEBI should consider whether additional incentives could be put in place to make salaries more competitive at a senior level with the overall objective of bringing more staff with market experience at different levels of the organization, including at the Board level.</p>
Principle 4.	SEBI might wish to explore the creation of an internal audit unit.
Principle 5.	SEBI should consider developing more comprehensive regulations on conflict of interest for its staff, in light of the fact that many regulatory decisions are delegated at levels of the organization different from Board members.
Principle 7.	SEBI should continue to strengthen arrangements to address the conflicts of interest of the "for profit" model of the RSEs vis-à-vis their self-regulatory functions, as discussed in the assessment.
Principle 9.	<p>1) SEBI's Act should be amended to explicitly provide investors with a private right of action.</p> <p>2) The authorities might wish to consider amending SEBI's Act to provide SEBI with the authority to access telephone records, subject to judicial approval.</p>

Principle 10.	<ol style="list-style-type: none"> 1) SEBI should strengthen its current program for the supervision of securities intermediaries as discussed under this Principle. 2) Enforcement of compliance with listing obligations by RSEs should also be strengthened. The committee on noncompliance with listing obligations is a step in such direction. 3) Criminal enforcement needs to be stepped up. In such context, the authorities should explore whether a similar arrangement to that existent for CIS could be extended to other types of securities offenses.
Principle 11.	The authorities might wish to consider amending SEBI's Act to make explicit the power of SEBI to share information with foreign counterparts.
Principle 14.	<ol style="list-style-type: none"> 1) Enforcement of compliance with listing obligations by RSEs should be strengthened. The committee on noncompliance with listing obligations is a step in such direction. 2) SEBI along with the RSEs should review whether current arrangements to review material events should be strengthened.
Principle 15.	SEBI should reform the tender offer regulations in order to ensure that all investors get equal exit opportunity in terms of the percentage of their holding that they can tender.
Principle 16.	<ol style="list-style-type: none"> 1) Coordination with MCA for purposes of ensuring compliance by issuers with accounting standards should be enhanced. The recently created coordination committee is a step in such direction. In the long term the authorities should review whether all functions related to listed companies should be vested in SEBI. 2) Qualified statements should not be permitted. 3) Mechanisms to enforce compliance with auditing standards should be strengthened. The Quality Review Board is a step in such direction. The authorities should examine whether it could be considered independent. 4) The framework for auditor's independence should be expanded. SEBI informed that the Companies bill would address this gap. 5) The authorities should finalize implementation of IFRS equivalent standards.
Principle	Recommended Action
Principle 17.	<ol style="list-style-type: none"> 1) SEBI should continue the implementation of a risk-based supervisory program for mutual funds (and their asset management company) as detailed in this assessment. 2) SEBI might wish to consider whether additional guidance in relation to the definition of CIS is needed.
Principle 20.	SEBI might wish to consider whether price vending activity should be regulated and therefore whether specific regulations should be prescribed on entities currently performing such services.
Principle 21.	<ol style="list-style-type: none"> 1) SEBI should strengthen its current program for the supervision of securities intermediaries as discussed under Principle 10. 2) SEBI should consider directing the RSEs to conduct onsite visits in connection with the registration of new members (either during the registration process, or within a short period after the license is granted). SEBI should also review whether current resources allocated by the RSEs to inspection of broker-dealers are sufficient.

Principle 22.	<ol style="list-style-type: none"> 1) SEBI should consider moving to a risk-based capital system. 2) In tandem, SEBI should review prudential requirements reporting for intermediaries different from brokers.
Principle 23.	<ol style="list-style-type: none"> 1) The requirement of an independent verification of internal controls and risk management on a periodic basis should be extended to merchant banks and underwriters. 2) SEBI should incorporate more directly the review of internal controls and risk management as part of its inspections program. In addition, more comprehensive guidelines on internal controls and risk management would be beneficial, especially if SEBI moves to a risk-based capital. 3) SEBI should continue to provide incentives for the reduction of the backlog by intermediaries in regard to investors' grievances.
Principle 24.	<ol style="list-style-type: none"> 1) The RSEs along with SEBI should make operational and test current default procedures. 2) SEBI should consider developing a plan to deal with the failure of entities other than brokers.
Principle 28.	Criminal enforcement of market manipulation and other unfair practices should be strengthened.

Authorities' response to the assessment

31. **SEBI would like to appreciate the effort and time that is put in by IMF and World Bank team to assess the Indian securities markets.** The IMF and World Bank assessment recognizes that the regulatory and supervisory regime for securities market is well developed and largely in compliance with international standards. We see from the report that assessor has also applied higher standards than which is given in IOSCO Principles. We are grateful for the opportunity to provide the following comments regarding the FSAP report.

32. **The report recognizes that SEBI has built the reputation of a credible enforcement agency.** In the report, it has been suggested that the SEBI should focus on the strengthening of the supervision of securities market intermediaries including fund managers. One of the challenges faced by the authorities is the sheer number of the intermediaries operating in the securities market such as brokers (19,557), sub-brokers (78,228), foreign institutional investors (1,767), merchant bankers (199), portfolio managers (246), custodians (19), depository participants (823), etc., as on December 2011. Onsite inspections of brokers are primarily a responsibility of the RSEs. The RSEs have developed a risk based approach to determine the intensity of the inspections. To this end, brokers have been divided in three categories based on a set of criteria that includes among others trading volume, number of clients, funds settled and number of complaints. The enforcement actions taken by regulator are very high compared to other jurisdictions. During 2010–2011 the total numbers of enforcement actions initiated were 958 and the total number of enforcement actions

disposed was 1,803. Further, the total number of half-yearly internal audit reports by the brokers that have to be submitted are 979 for BSE and 1,212 for NSE as on March 31, 2011.

33. **In respect of mutual funds, SEBI has laid down two-tier supervision system.** At the first level by the trustees of mutual funds which supervise the day-to-day operations of mutual funds and compliance with the regulations, investment restrictions and objectives in the scheme document by the asset management company. The comprehensive guidelines for mutual funds are issued by SEBI (i.e., SEBI (Mutual Fund) Regulations, 1996 and circulars issued there under) to provide that mutual funds shall be authorized and registered for business by SEBI. The asset management company has to keep minimum net worth not less than Rs 10 cores. The asset management companies are required to periodically report regarding its operations/activities and make such disclosures to SEBI as may be called upon. As per the extant policy of SEBI regarding inspection of mutual funds, a more risk-based approach has been adopted. The inspections are undertaken based on assets under management and other factors including number of complaints received against the mutual fund. Inspections are also done on discretionary basis based on issues identified in previous inspection reports or regulatory filings.

34. **The assessment also suggests for developing better mechanism to ensure better auditing and accounting standards.** The provision of the Companies Act and Chartered Accountants Act provide a framework to maintain objectivity and integrity of accounting and audit. The government has created Quality Review Board for reviewing the quality of auditors which is already in operation. During the Satyam scam in 2009, SEBI also conducted peer review on the audits of top 50 companies. The new Companies Bill, 2011 placed before the parliament on December 14, 2011 contains provisions for establishment of an independent agency, National Financial Reporting Authority, to oversee the functions of Auditors (Clause 132 of the Bill). National Financial Reporting Authority (NFRA) will ensure scrutiny and compliance of accounting and auditing standards. NFRA is independent of audit professionals. It will also ensure quality of service of professionals associated with compliance and monitoring of corporate financial management. NFRA will have quasi-judicial powers to levy penalty for misconduct on auditors, etc. It can order investigation, levy penalty, and bar professionals from practice in case of their indulgence in professional or other misconduct. A review of the compliance of the corporate governance norms was carried out based on the reports filed by the listed companies, during the period January 2006 to March 2007, at BSE and NSE. Based on the identified criteria adjudication proceedings were initiated against five public sector undertakings and 15 private sector companies.

35. **India is one of the first countries in the world where the first demutualised exchanges were set up.** The NSE started functioning as demutualised stock exchange in November 1994. Subsequently, the BSE was also demutualised in the year 2004. These exchanges are managed by professionals who are independent of members as well as shareholders. The demutualised and for-profit exchanges have their own challenges such as

discharging regulatory functions in respect of members and market by exchanges that are commercial entity and may be listed in stock exchanges. Normally surveillance is conducted by the exchanges. However, in India SEBI has also setup Integrated Market Surveillance System, which generates alerts arising out of unusual market movements. The Integrated Market Surveillance System provides assistance to SEBI in monitoring the market and in discharging its regulatory functions effectively. The system is being used for detecting aberrations, analyzing them and identifying the cases for investigation and for taking further action, wherever warranted. It is also being used for monitoring the activities of market participants as well as issuing suitable instructions to stock exchanges and market participants. Wherever required, findings enabled by the Integrated Market Surveillance System are shared with stock exchanges for appropriate action ensuring that stock exchanges continue to act as the first level regulator for proactively detecting and examining abnormal trading pattern. SEBI has constituted a committee under the chairmanship of Dr. Bimal Jalan, former Governor of RBI, on February 8, 2010 to examine issues arising from the ownership, governance and listing of stock exchanges. The committee submitted its report on November 23, 2010 which is under consideration of SEBI.

36. **As regards criminal enforcement, India being a democratic country follows criminal justice system where a person is treated as innocent till he is proved guilty.** The enforcement agency has to prove the guilt of the person beyond reasonable doubt and the standard of proof is very high. The civil/criminal courts cases pending are 59 as on March 31, 2011.

37. **The Principle 10 assesses the effective and credible use of inspection or enforcement powers.** It is observed that the assessor while assessing the overall effective and credible use of inspection and enforcement powers has given their rating in Principle 10. In addition, it is observed that the element of inspection and enforcement powers has also been again taken into consideration while giving rating for purpose of Principles 14, 16, 17, 21, and 28. It is for consideration whether the Principles such as 14, 16, 17, 21, and 28 should be primarily assessed as per the principle on the key questions for each of such principle or need to be rated or judged on basis of adequacy or effectiveness of enforcement for which a separate principle has been earmarked.

38. **All the intermediaries who operate in the Indian securities market are mainly engaged in fee-based activities.** These are intermediaries or pass-through entities and the risk is mainly borne by the investors. SEBI has specified both initial and continuing minimum net worth requirements for the various intermediaries. In case of trading by any client or fund-based activity by an intermediary such as broker who engages in proprietary trading, they have to bring margins (i.e., initial margins, extreme loss margins, and mark-to-market losses) or additional deposit depending on exposure or risk and are subject to monitoring and risk management by the stock exchanges. The observations that there is no additional requirement to adjust by risk fail to take into account the business model and the risk management system adopted by the stock exchange. SEBI has specified a

comprehensive risk management framework to be followed by the stock exchanges the salient provisions of which include categorization of securities for imposition of margins into groups based on liquidity and volatility of the scrip, as also adjustment of margins from the liquid assets deposited by members. Detailed Assessment

Table 4. India: Detailed Assessment of Implementation of the IOSCO Principles

Principles Relating to the Regulator	
Principle 1.	The responsibilities of the regulator should be clear and objectively stated.
Description	<p>Responsibilities</p> <p>The regulation and supervision of the securities market in India is mainly a responsibility of the Securities and Exchange Board of India (SEBI). SEBI has been set up under the Securities and Exchange Board of India Act, 1992 (SEBI Act), with a mandate to protect the interest of investors, to regulate and to promote the development of the securities market.</p> <p>The responsibilities of SEBI have been stated by law, and they stem from various statutes, in particular (i) the SEBI Act; (ii) the Securities Contract Regulation Act, 1956 SCR Act; (iii) the Depositories Act, 1996; and (iv) and the Companies Act, 1956. Based on all such statutes SEBI regulates the public offering of equity, debt and asset backed securities, as well as collective investment schemes (CIS) including mutual funds (MF) and the trading of securities and derivatives on recognized stock exchanges (RSEs). Finally it regulates and supervises all intermediaries in the securities market as well as infrastructures providers, including exchanges, central clearing counterparties and central securities depositories.</p> <p>The Central Government (CG) via the Ministry of Corporate Affairs (MCA) and the Reserve Bank of India (RBI) have certain responsibilities in the regulation and supervision of securities markets.</p> <p>Pursuant to Section 55A of the Companies Act, SEBI has responsibility over the issue and transfer of securities and non-payment of dividends in the case of listed public companies and public companies which intend to get securities listed on any exchange. Given that Section 73 of Companies Act requires that all companies making a public offering be listed, in practice SEBI is the main competent authority for purposes of the principles on issuers. However due to its overall responsibility to ensure compliance with the Companies Act, MCA does retain certain responsibilities via-à-vis listed companies. In particular, listed companies are required to register their prospectuses with the Registrar of Companies (RoC), and the Registrar has statutory powers to review such prospectuses and request changes to them, even after SEBI has reviewed them. Furthermore staff from MCA highlighted that the RoCs have in fact used such powers and requested changes to prospectus even after SEBI has reviewed them. In addition, MCA also is currently the main authority conducting reviews of the annual reports prepared by listed companies pursuant to the Companies Act.</p> <p>In addition, the SC(R) Act provides the CG with regulatory powers over exchanges and the regulation of contracts. However, via various Notifications of the CG the CG delegated regulatory powers over exchanges to SEBI.</p>

	<p>Notification dated January 3, 2000 made pursuant to Section 16 of the SRCA provides the RBI with regulatory responsibility over any contracts in government securities, money market securities, gold related securities and in securities derived from these securities and in relation to ready forward contracts in bonds, debentures, debenture stock, securitized debt and other debt securities. Such contracts entered into on the recognized stock exchanges shall be entered into in accordance with</p> <ul style="list-style-type: none"> • the rules or regulations or the by-laws made under the SCRA or SEBI Act or the directions issued by SEBI under the said Acts; • the rules made or guidelines or directions issued under the RBI Act or the Banking Regulation Act, 1949 or the Foreign Exchange Regulation Act, 1973 by the RBI; and • the provisions contained in the notification issued by the RBI under the SCRA. <p>Finally under the current regulatory arrangements the RSEs have regulatory and supervisory responsibilities in the areas of listing, licensing and supervision of broker dealers and market surveillance.</p> <p>Interpretation of the Acts that SEBI administers</p> <p>Paragraph 5 (ii) of the SEBI Informal Guidance Scheme, 2003 states that an informal guidance may be sought in regard to a specific provision of any Act, Rules, Regulations, Guidelines, Circulars or other legal provision being administered by SEBI in the context of a proposed transaction in securities or a specific factual situation. Under paragraph 8, SEBI may not respond to a request where the applicable legal provisions are not cited and under paragraph 11, such request shall be available to the public together with SEBI's response with or without ensuring confidentiality requirements, where applicable.</p> <p>Gaps or inequities</p> <p>There are currently no regulations for the provision of "pure" investment advisory services, that is, intermediaries who only provide advice but do not deal on behalf of clients, nor have the custody of their assets. There are no regulations either for hedge funds; the authorities mentioned however that there are currently no hedge funds operating in India.</p> <p>The authorities have raised concerns about differences in the regulatory treatment of financial companies (NBFC) vis-à-vis regulated activities and regulated intermediaries. In connection with securities markets such differences mainly relate to the exemption that Section 67 of the Companies Act affords to NBFCs in the context of private placements which do not need to abide by the threshold applicable to public companies. They also relate to margin trading, since NBFCs are not required to comply with the regulations applicable to brokers. The authorities informed, however, that the exemption provided to NBFCs regarding private placements is removed in the Companies Bill, currently placed before the parliament, and that the issue of margins is being examined by RBI.</p> <p>Coordination</p> <p>The authorities have highlighted the existence of several arrangements aimed at fostering coordination.</p> <p>First, they have highlighted the fact that both the RBI and MCA have one representative in SEBI's Board, which helps to ensure coordination at the high level.</p>
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<p>The consultative process developed by SEBI ensures also that in its rulemaking function, the opinions of other regulators are also taken into consideration.</p> <p>In addition, certain committees have been constituted to foster discussion and coordination on issues of common interest.</p> <p>There is a standing committee between SEBI and RBI since 1994. The authorities have mentioned as an example of good coordination the introduction of products such as currency and interest rates futures for trading on the exchanges. They also mentioned active cooperation with RBI during the licensing process, in particular related to reviews of fit and proper requirements.</p> <p>In June 2011 a similar coordination committee was established with MCA. In the past, ad-hoc committees have dealt with specific issues, such as for example the use of issue proceeds.</p> <p>There are two committees to deal with financial conglomerates (one technical and one high level), where SEBI, RBI and the Insurance Regulatory Development Authority (IRDA) are represented. There are no formal arrangements regarding the frequency of the meetings of the technical committee, but the authorities informed that they usually meet on a quarterly basis. The authorities informed that it is not the practice to share inspection reports. However, whenever in the course of investigation, it is found that the entities would have probably violated the provisions of any statute falling under the jurisdiction of or regulations framed by, some other regulator, orders of SEBI has been forwarded to the concerned regulatory authorities. SEBI has provided examples to that effect. Joint inspections are not conducted either. Nevertheless a standardized template to gather information on financial groups has been developed. The high level committee meets on a semiannual basis to discuss with the CEOs of the financial groups any regulatory concern that they might have.</p> <p>A High Level Co-ordination Committee for Financial Markets (HLCCFM) has operated since 1995. Such Committee consisted of the Finance Secretary—Ministry of Finance (MoF), the Governor of the RBI, the Chairperson of SEBI, and the Chairperson of the IRDA. Via Notification of the CG of December 2010, a Financial Stability Development Council (FSDC) was established to institutionalize and strengthen the mechanisms for maintaining financial stability, financial sector development and inter-regulatory coordination, and without prejudice to the existing mandates and autonomy of the regulators. The FSDC is assisted by a subcommittee which has replaced the HLCCFM. The FSDC is chaired by the Union Finance Minister. The Capital Markets Division of the Department of Economic Affairs, MoF acts as the Secretariat of the Council. The FSDC is still at an early stage, but the authorities mentioned that their objective is that only high level issues be discussed there and more operational issues should be dealt at the level of the subcommittee mentioned below. There are no formal arrangements regarding the frequency of the meetings of the FSDC. The authorities emphasized that the FSDC meets as and when deemed necessary by the Chairperson. Further, as far as possible, the Council takes all decisions on unanimous basis. Since its constitution it has met twice. When an issue is decided, the agenda for the next meeting includes a follow up on actions taken.</p> <p>Within the umbrella of the FSDC a subcommittee on inter-regulatory coordination has been set up. It is integrated by the heads of the regulatory agencies (RBI, SEBI, IRDA, and PFRDA), and chaired by the RBI. The Central Government is represented by the Finance Secretary and/or Secretary—Department of Economic Affairs, Secretary—Department of Financial Services, Director General (Directorate of Currency)—DEA</p>

	<p>and Joint Secretary—Capital Markets, and Department of Economic Affairs. As in the case of the FSDC, there are no formal arrangements regarding the frequency of the meetings of the subcommittee. The authorities informed that it meets also when and as necessary. The subcommittee of FSDC endeavors to meet at least once in three months or as necessary. Since its creation it has met four times. FSDC subcommittee, in its meeting on August 28, 2011 constituted an Inter Regulatory Technical Group to address issues related to risks to Systemic Financial Stability and inter regulatory coordination and to provide essential inputs for meetings of subcommittee. The group includes representatives of the four regulators at the level of Executive Directors.</p> <p>Finally a joint mechanism was also created by Ordinance in 2010 to solve potential differences among regulators in respect to the nature of any hybrid or composite instrument. The committee is integrated by the Union Finance Minister, the RBI Governor, the Finance Secretary, the Secretary-Financial Services, the Chairperson of the IRDA, the Chairperson of SEBI, and the Chairperson of PFRDA. The opinion of the committee is binding. This Committee was created after differences between SEBI and the IRDA surfaced in regard to the nature of certain products that were being sold by the insurance companies (the ULIPS), in particular whether they constituted securities and should therefore be under the jurisdiction of SEBI. In such particular case, a law came to decide the issue and assign jurisdiction to the IRDA.</p> <p>In regard to the RSEs, SEBI has established reporting obligations (discussed under Principles 7 and 26) to oversee how the RSES are performing their self-regulatory functions. In addition, weekly meetings take place between SEBI and each of the national RSEs (NSE and BSE) to discuss market developments. Similarly meetings are also held with depositories on a monthly basis to discuss market developments. This year SEBI also instituted a committee on non compliance with listing obligations, with the participation of NSE and BSE, which developed a detailed list of recommendations as to how the RSEs should deal with non-compliance with listing obligations.</p>
Assessment	Broadly implemented
Comments	<p>The grade mainly stems as a result of an evaluation of the current framework vis-à-vis questions 3a) and c) of the Methodology. To a lesser degree the grade is also a result of an evaluation of question 2b) of the Methodology vis-à-vis the current framework, in particular in regard to the treatment of NBFCs.</p> <p>As stated in the description of this Principle, the public authorities have established several avenues to foster coordination. Through them all it seems that coordination at a high/policy level is well covered; although many of those mechanisms are of recent creation and thus still evolving.</p> <p>In addition, such mechanisms would probably have a positive effect on coordination at an operational level. In this regard for example, under the umbrella of the recently constituted coordination committee, SEBI and MCA could agree on a mechanism/format for regular updates on reviews and any follow up actions needed from MCA or SEBI. In the long term SEBI and MCA should review whether it would be beneficial that all reviews related to listed companies were carried out by SEBI only.</p> <p>A similar positive effect can be expected also from the committee on non-compliance with listing obligations, recently constituted with the RSEs. In fact such committee is already bearing the first results by requiring the RSEs to set up a plan of action to deal with noncompliance issuers. As a result of the work of such committee SEBI might</p>

	<p>wish to consider whether there is a need for some form of regular reporting on listing obligations. Finally, in the context of the committees on financial groups, the authorities should consider sharing their inspections reports as a matter of course. In addition, the authorities could review whether there is other type of information that should be exchanged on a regular basis.</p> <p>According to the information provided by the authorities the size of issuances by NBFCs has diminished over time, and thus at present does not pose a significant concern. The same applies to the margin lending. Nevertheless, the assessor recommends that the differences in regulatory treatment of NBFCs be reexamined. As indicated above staff informed that the exemption provided by Section 67 of the Companies Act is eliminated in the Companies bill, pending in Congress and that the RBI is currently examining the issue of margins.</p> <p>The IOSCO Principles do not require the regulation of hedge funds or other types of alternative funds as long as they are not offered to the public. They do not require either the licensing of investment advisory services, provided that the advisor does not deal on behalf of the client, nor has the custody of the clients' assets; as long as the intermediaries on whose services the advisor advice are adequately licensed. Therefore the absence of regulations in these areas has not been taken into consideration for the grade. The revised methodology will however require the regulation of hedge funds and/or hedge fund managers. In any case, it is important to note that the SEBI Act provides SEBI with sufficient authority to bring new intermediaries into the perimeter of regulation via regulations, and without the need for changes in the law.</p>
Principle 2.	The regulator should be operationally independent and accountable in the exercise of its functions and powers.
Description	<p>Independence</p> <p><i>Matters that require consultation</i></p> <p>SEBI does not have to consult with any governmental authority to carry out the licensing/ registration, surveillance, investigation and enforcement functions granted to it by the SEBI Act, the SCR Act and the Depositories Act, or Section 55A of the Companies Act. In addition, SEBI has the power to issue regulations in connection with the SEBI Act, the Depositories Act and the SCR Act Such regulations need to be tabled in parliament for 30 days, and parliament can make modifications to them.</p> <p><i>Terms of appointment of the Board</i></p> <p>SEBI is a statutory body established under the SEBI Act. SEBI is governed by a Board. The constitution of the SEBI Board, terms and conditions of service of the members are governed by sections 3 to 5 of SEBI Act. According to Section 4 the Board consists of nine members: a Chairman, two members from the MoF and the MCA, one from the RBI, and five additional members, three of which must be whole-time members. All members are either appointed/nominated by the CG, except for the RBI representative who should be nominated by the RBI.</p> <p>SEBI Act does not specify a fixed term of appointment for the Chairman or Board members. The current rules prescribe a five-year term appointment that can be renewed.</p> <p>Section 4 also prescribes minimum fit and proper requirements for Board members.</p>

As per section 6 a member of SEBI's Board can be removed for due cause, which includes: insolvency, incapacity declared so by court, conviction, or abuse of power. In all such cases the member should be afforded a reasonable opportunity to be heard. In addition, section 5(2) gives the right to the CG to terminate the services of the chairman or member of the Board at any time by giving a notice of three months. SEBI informed that such power has never been exercised.

Section 16 of SEBI Act empowers the CG to issue directions on questions of policy. Decisions of the CG on whether a question is one of policy or not is final. Furthermore, under Section 17 the CG has been given power to supersede the Board, on account of grave emergency where the Board is unable to discharge the functions and duties imposed on it under the SEBI Act, on the ground of persistent default in complying with any directions issued by the CG under that Act or in the discharge of functions and duties imposed on it by/under that Act as a result of which financial position/administration of the Board has deteriorate and where circumstances exist, which render it necessary in public interest to do so. SEBI informed that this power has never been used.

Funding

SEBI is not dependent on government or any authority for its funds. Section 11k of SEBI Act authorizes SEBI to levy fees and other charges for carrying out the purpose of that section. SEBI does not have to consult any authority to set up the level of fees applicable to market participants. Fees are charged as per regulations which are approved after a consultation process with the regulated entities. SEBI has a general fund to which all grants, fees and charges received by it under the SEBI Act are credited.

Legal Protection

Section 23 of SEBI Act provides legal protection from suits, prosecution or any legal proceedings to the CG, SEBI's Board or any officer of the CG or any member, officer or other employee of the Board for anything, which is in good faith done or intended to be done under the SEBI Act, rules or regulations made There have not been suits against SEBI staff for actions taken in the exercise of SEBI's responsibilities. However SEBI's legal staff believes that such provision would allow SEBI to pay for the defense of staff in the case of a suit. In addition their position is that such provision would apply even if the person no longer works for SEBI provided that the actions for which the staff is sued took place during employment by SEBI.

Independence from commercial interests

Section 4 of the SCR Act provides SEBI with the authority to appoint government representatives in the Board of RSEs. SEBI has informed, however, that after the demutualization of the exchanges such power has not been used.

Accountability

Main means of accountability to the government

SEBI is accountable to the government for the use of its powers mainly through the MoF. In this regard, section 18 of SEBI Act requires SEBI to submit to the CG annual reports on its activities and programs within 90 days after the end of each financial year. A copy of such reports must also be submitted to each house of parliament.

	<p>Parliament also conducts oversight over SEBI's activities. First, as indicated above SEBI's regulations must be tabled before parliament, and such regulations are also reviewed by the Committee on Subordinate Legislations. Second, the activities of SEBI are reviewed by the Standing Committee on Finance. SEBI informed that such Committee has exercised active "oversight" over it. In fact roughly four times a year, SEBI authorities are called to answer questions to this Committee.</p> <p>In regard to financial accountability, Section 15 of SEBI Act requires SEBI's accounts to be audited by the Comptroller and Auditor General of India (CAG). SEBI's accounts are also tabled at the Table of Lok Sabha (the lower house of parliament) and reviewed by a parliamentary committee.</p> <p>Transparency</p> <p>As any other authority, SEBI is subject to the Right to Information Act, 2005 (RTI), which subjects SEBI to a high standard of transparency in its actions, as will be further explained under Principle 4. In addition, the SEBI Act also requires it to provide reasons for enforcement decisions.</p> <p>Judicial Review</p> <p>The power of SEBI to suspend or cancel a license/certificate of registration or impose monetary penalties are subject to procedural rules such as those incorporated in the SEBI (Intermediaries) Regulations, 2008 or Adjudication Rules, 1995; or Adjudication Rules, 2005 which overall require a due process, including the opportunity to be heard. As per Section 15 T of SEBI Act any person aggrieved by an order of the Board or by an order of an adjudicating officer under that Act has the right to appeal such order before the Securities Appellate Tribunal (SAT). Appeals should be filed within 45 days from the day of receipt of order by the person aggrieved. Under Section 15Z of the SEBI Act decisions of the SAT can be appealed to the Supreme Court within 60 days of communication of the decision, but limited to points of law.</p>
Assessment	Partly implemented
Comments	<p>The grade mainly stems from an evaluation of the current framework vis-a-vis question 5 of the Methodology.</p> <p>As in many other countries, the line between independence and accountability is difficult to draw. The provisions that allow the CG to terminate the services of the chairman or member of the Board at any time by giving a notice of three months, provide directions to the Board and supersede the Board when such directions are not followed, are a threat to SEBI's independence. Furthermore even if not used, they could have a "chilling" effect in the way the regulatory agency carries out its functions. Also, while it can help to ensure coordination, the representation of MCA and the MoF in the Board could be construed as limiting SEBI's independence vis-à-vis the Government, and so does the fact that the CG is part of the committee to solve differences regarding the nature of products. In practice it appears that SEBI has acted with a high level of independence vis-à-vis the government. Such level of independence has been recognized by market participants. It has also been demonstrated for example by the stance that it took regarding the nature of unit linked insurance policies (ULIPS), whereby it explicitly claimed jurisdiction over such product in spite of the different opinion of the MoF.</p>

	<p>As regard to commercial interests, the provision of the SRCA that allows SEBI to appoint representatives on a RSE could create a conflict of interest. However, as indicated above, this authority has not been used by SEBI since the demutualization of the exchanges. Thus the existence of this provision does not pose a material concern. Furthermore, market participants also highlighted SEBI's independence vis-à-vis commercial interests, as demonstrated by SEBI's stance in enforcement.</p> <p>Accordingly, the assessor recommends that the provision on termination of services without due cause as contained under Section 5(2) of the SEBI Act be removed. The assessor also recommends the CG to clarify that the authority to provide orders should not be construed as to give the MoF the authority to supersede SEBI's decisions on individual cases, either in licensing, supervision or enforcement. The participation of the MoF in the joint mechanism to solve jurisdictional disputes should also be reviewed. The assessor also recommends that SEBI explores whether more detailed provisions to protect Board members and staff should be put in place.</p> <p>The current mechanisms of accountability are considered sufficient vis-à-vis the IOSCO Principles. Other countries where the regulator is funded by levies on market participants have enhanced accountability in the use of resources, by establishing mechanisms of non-binding consultation of fees, as well as for discussion of the use of funding, with the industry. As explained in the description of the principle, the fees to be charged must be established by regulation which is subject to consultation with regulated entities. Thus, without affecting the grade, the assessor encourages SEBI to evaluate whether establishing the latter type of mechanism would also be beneficial for SEBI.</p>
Principle 3.	The regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers.
Description	<p>Powers</p> <p>SEBI has been given broad licensing, surveillance, investigation, and enforcement powers, as described in the relevant Principles. It has also been given the power to make regulations pursuant to the SEBI Act, the Depositories Act and the SRCA.</p> <p>Resources</p> <p><i>Human resources</i></p> <p>SEBI has currently 583 staff, out of which 110 are support staff. It has recently added 90 professional staff. There are two career streams: the general stream mainly composed of business administrators recruited from a variety of universities, who amount to roughly 70 percent of the staff, and the legal stream, recruited from the top legal schools.</p> <p>SEBI's recruitment policy is to recruit at entry level and "groom" the staff. As a result, the percentage of staff with direct market experience is low. Staff with market experience is mainly concentrated at the Executive Director level, although there is also staff with market experience at other levels of the organization. For the general career stream there is also a policy of rotation, roughly every three to five years.</p> <p>Salaries are better than those offered to other public employees, and are competitive enough at the entry/junior level. However SEBI cannot compete with private sector salaries in what relates to senior positions. Attrition varies depending on economic cycles. It is currently less than 5 percent, but has been higher (roughly 10 percent) in the past.</p>

	<p>Internal controls</p> <p>Under Regulation 3(i) of the SEBI (Procedure for Board Meetings) Regulations, 2001, meetings of the Board shall be convened at least once in each quarter of the year by the Chairman or in his absence, by any member nominated by the Chairman, in this behalf. The SEBI Act confers to the Board both the policy function (translated mainly into the power to approve regulations) as well as the day-to-day management (license/registration, supervision, investigation and enforcement actions). Overall, as allowed by Section 19 of SEBI Act, all functions except for policy have been delegated at different levels of the organizations (chairman, whole time member, executive director) depending on the nature of the function. In particular whole time members (WTMs) carry a critical role in overseeing day to day operations. Each WTM has been assigned oversight responsibilities over particular departments. In addition, there is a system of periodic reporting to the Board as a whole, and the Executive Director in charge of Legal Affairs must provide an annual report of compliance of the institution with the relevant Acts and regulations. SEBI also highlighted the existence of an audit committee which consists of independent Board members.</p> <p>Technological resources</p> <p>SEBI has committed significant resources to the development of technology to allow it to better fulfill its mandate. Key projects underway include an upgrade to the Integrated Market Surveillance System, the development of an automated system to consolidate all information related to investors' complaints, and an automated system to consolidate all the information (reports) that issuers and intermediaries are required to submit to SEBI.</p> <p>Training</p> <p>SEBI is committed to training. Competency building of SEBI staff is one of the key activities of the National Institute of Securities Markets (NISM). The NISM was set up by SEBI in 2006 for imparting training to SEBI staff and also persons associated with securities market. All staff recruited at entry level are required to attend an induction program that lasts about two months. There are also a wide variety of courses available at the NISM for continuous learning. Training abroad is also available to staff at different levels of the organization.</p>
Assessment	Broadly implemented
Comments	<p>The grade stems from an evaluation of the current framework vis-a-vis question 3 of the Methodology.</p> <p>SEBI authorities believe that the organization has sufficient resources (both in quantity and skills) to fulfill its mandate. In particular the authorities have highlighted the fact that SEBI leverages from the resources of the RSEs for listing, market surveillance and supervision of brokers. Furthermore SEBI is in the process of implementing a risk based approach to supervision that would allow it to make a better use of its resources.</p> <p>Indeed no regulator has infinite resources and thus it is essential that they leverage their resources. However, in the end the approach chosen needs to ensure that the system of supervision is robust and effective. SEBI faces two challenges to achieve such objective. One is the number of staff vis-à-vis the size of the market. As explained under the relevant Principles, additional resources appear to be needed to ensure effective off site supervision of periodic disclosures by issuers, as well as</p>

	<p>more effective supervision of securities intermediaries. In addition the revised IOSCO Principles will require a system of independent oversight of auditors which in many countries has fallen under the remit of the financial regulators, as well as more intensive supervision of credit rating agencies. The second challenge is SEBI's ability to hire and retain qualified personnel, in particular at the senior level, given the gap in salaries vis-à-vis the private sector. In particular it is important that SEBI be able to attract staff with market experience at all levels of the organization, including at the Board level. Those two challenges have been the main considerations for the grade.</p> <p>As described above SEBI has certain oversight mechanisms in place aimed at ensuring that the different departments carry their functions in an effective manner. The assessor considers those mechanisms sufficient vis-à-vis the IOSCO Principles. However, without affecting the grade, SEBI might find beneficial to consider the creation of an internal "audit" unit in charge of conducting reviews of whether the different departments and divisions are adequately discharging their functions. SEBI highlighted that there is already an audit committee which consists of independent Board members; further it is examining the necessity of setting up an internal audit department and its scope.</p>
<p>Principle 4. The regulator should adopt clear and consistent regulatory processes.</p>	
<p>Description</p>	<p>General obligations</p> <p>As indicated in Principle 2, SEBI is bound by the RTI Act. Such Act requires every public authority to publish/disclose information, including among others (i) the particulars of the organization, functions and duties; (ii) the powers and duties of its officers and employees; (iii) the procedure followed in the decision making process, including channels of supervision and accountability; (iv) the norms set by it for the discharge of its functions; (v) the rules, regulations, instructions, manuals and records, held by it or under its control or used by its employees for discharging its functions except when otherwise confidential; (vi) a statement of the categories of documents that are held by it or under its control; and (vii) the particulars of any arrangement that exists for consultation with, or representation by, the members of the public in relation to the formulation of its policy or implementation thereof.</p> <p>Such provision also requires every public authority to publish all relevant facts while formulating important policies or announcing the decisions which affect the public; and provide reasons for its administrative or quasi-judicial decisions to affected persons.</p> <p>Rule making</p> <p>SEBI has established a consultation process for rulemaking. Policy issues are discussed via specialized consultative committees integrated with different stakeholders, including industry representatives and investors' associations. In addition, draft regulations are posted for comments in SEBI's website.</p> <p>Licensing</p> <p>Licensing requirements have been established via regulations, which are all available in SEBI's website. In many cases SEBI has also issued circulars and guidelines which are also available in the website.</p>

	<p>Enforcement</p> <p>The power of SEBI to suspend or cancel a license/certificate of registration or impose monetary penalties are subject to procedural rules such as those incorporated in the SEBI (Intermediaries) Regulations, 2008 or Adjudication Rules, 1995 or Adjudication Rules, 2005. Such rules and regulations require SEBI to make available the findings of an investigation to the person against whom the proceeding was initiated. The procedures also require that a person be given the opportunity to be heard. SEBI has to give written reasons and pass a reasoned order. Similar obligations apply in the case of refusal to give a license or to revoke a license.</p> <p>An aggrieved person, can file an appeal before the Securities Appellate Tribunal (SAT), challenging the order of SEBI both on merit of the decision and also on procedural fairness. The current regulatory practice is that enforcement actions are public once a decision has been reached by SEBI.</p> <p>Confidential information</p> <p>Section 8 of the RTI Act exempts from disclosure information that has been provided to a public authority due to its fiduciary duty. In connection to this obligation the Employees Service Regulation requires SEBI staff to maintain secrecy as well as not to make use of any information which has come to their knowledge in discharge of their official duties, nor communicate any such information to any other persons except in the course of their official duty.</p> <p>Investor education</p> <p>SEBI plays an active role in investors' education such as through conducting workshops, disseminating investor education materials through advertisements, radio and television, and a dedicated website for investor education. SEBI also grants financial assistance to 33 recognized investor association for investor education. In addition SEBI has certified 150 people as resource people to help in disseminating knowledge. Finally financial market has been included as one of the subjects for secondary education by CBSE.</p>
Assessment	Fully implemented
Comments	Other regulators have found it to be in the public interest to disclose enforcement cases once "charges have been filed", rather than when a decision has been taken. Without affecting the grade the assessor encourages the authorities to consider whether such policy would further strengthen SEBI's enforcement efforts.
Principle 5.	The staff of the regulator should observe the highest professional standards including appropriate standards of confidentiality.
Description	<p>Obligations</p> <p>SEBI (Employee Service) Regulation, 2001 (Service Regulation) lays down conduct standards for SEBI employees. Such Regulations contain provisions aimed at addressing conflicts of interest, in particular:</p> <p><i>Prohibition to use information. Such regulations require SEBI staff to maintain secrecy and not to make use of any information which has come to their knowledge in discharge of their official duties, nor to communicate any such information to any other persons except in the course of their official duty.</i></p> <p><i>"Cool-off periods." During two years after leaving SEBI staff must get prior approval from the Board to take on work on a regulated entity.</i></p>

	<p><i>Restrictions on holding and trading in securities. SEBI employees are prohibited from dealing in equities. All other trades are permitted but must be reported immediately if they exceed roughly \$100.00. In addition, staff is subject to annual reporting of their assets and liabilities, including their dependents. Such reports must be submitted to the Chief Vigilance Officer (CVO).</i></p> <p><i>Prohibition of receiving gifts except if of minimum value.</i></p> <p>Pursuant to Regulation 79 the violation of these standards is subject to penalties, including criminal liability. Under the Insider Trading regulation SEBI staff are considered insiders and as such subject to the provisions (and sanctions) imposed under such Regulations.</p> <p>There is also a separate Code of Conduct for Board members. Overall such code requires them to disclose any interest which may conflict with their duties, and excuse themselves from deciding cases when they have a conflict of interest. Board members are required to disclose their holdings of shares and holdings of shares of their family within 15 days of assumption of their position and later on, on an annual basis, within 15 days of the close of the financial year. They are also required to disclose any employment of fiduciary position held during the previous five years with a regulated entity, as well as any other significant relationship with a regulated entity.</p> <p>Additional obligations are placed on whole time members. In particular they must disclose substantial transactions. They are also subject to more strict rules concerning employment, as they are not allowed to hold any other office of profit, nor engage in any other professional activity that entails a salary or professional fees.</p> <p>Oversight mechanisms</p> <p>The Central Vigilance Officer (CVO) is the main authority responsible for ensuring staff compliance with conflict of interest regulations. Currently the CVO has three staff in charge of checking compliance with such reporting, and identifying whether potential acts of corruption have taken place. The CVO reports directly to the Central Vigilance Commission, which is a body of the CG in charge of combating corruption.</p>
Assessment	Fully implemented
Comments	Given that many functions have been delegated to staff at a level lower than a Board member, the assessor encourages SEBI to develop a more comprehensive regulation on conflict of interest for staff, including disclosure of conflict of interest and excusing themselves from participating in regulatory decisions when such conflicts are present.
Principles of Self-Regulation	
Principle 6.	The regulatory regime should make appropriate use of Self Regulatory Organizations (SROs) that exercise some direct oversight responsibility for their respective areas of competence, and to the extent appropriate to the size and complexity of the markets.
Description	<p>There are a total of 21 RSEs including two nationwide exchanges the Bombay Stock Exchange (BSE) and National Stock Exchange (NSE). In practice trading activity carried out in RSEs, excluding the two nationwide RSEs is minimal or non-existent. Thus for practical purposes in this assessment the reference to RSEs should be construed as referring to the BSE and the NSE.</p> <p>The RSEs perform both market regulation and member regulation functions. Membership of a RSE is mandatory to act as stock broker as per Regulation 6A(1)(a) of Stock Broker Regulations issued by SEBI.</p>

	<p>The depositories also perform a self-regulatory role vis-à-vis depository participants. Given that the oversight over depositories is covered by another standard (CPSS-IOSCO), issues related to depositories are not covered in this assessment.</p> <p>There are also other organizations such as the Association of National Exchanges Members of India (ANMI), Association of Mutual Funds of India (AMFI), Association of Merchant Bankers of India (AMBI) and Financial Planning Standards Board of India (FPSBI). They all function mostly as industry associations.</p>
Assessment	Not rated
Comments	As per the IOSCO Methodology, under this Principle an assessor only needs to verify whether there is any entity in the jurisdiction performing self-regulatory functions and if that is the case, then Principle 7 must be graded.
Principle 7.	SROs should be subject to the oversight of the regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities.
Description	<p>Exchanges as self-regulatory organizations</p> <p>Eligibility</p> <p>Section 19 of the SRC Act prohibits the operation of a stock exchange (SE), unless prior recognition has been given by SEBI. Section 3 requires a SE that wants to be a recognized stock exchange (RSE) to file an application with SEBI.</p> <p>Pursuant to Section 4 SEBI can impose conditions for recognition, including relating to (i) the qualifications for membership; (ii) the manner in which contracts shall be entered and enforced; (iii) the representation of the CG on the exchange Board by a maximum of three members; and (iv) the maintenance of accounts of members and their audit. Section 4A requires that stock exchange be demutualized. A more detailed description of recognition criteria is provided in Principle 25.</p> <p>Section 9 empowers a RSE to make rules, but subject to approval from SEBI on different aspects related to the operation of a trading facility, including:</p> <p><i>hours of trade;</i></p> <p><i>clearinghouse;</i></p> <p><i>number and class of contracts in which settlements will be made;</i></p> <p><i>terms and conditions of contracts, including margins;</i></p> <p><i>listing of securities;</i></p> <p><i>settlement of claims or disputes;</i></p> <p><i>levy and recovery of fees, fines and penalties;</i></p> <p><i>regulation of dealing by members for their own account; and</i></p> <p><i>limitations on volume of trading, information obligations by members.</i></p> <p>Powers of SEBI</p> <p>The SCRA provides SEBI (via notification from the CG) the following powers vis-à-vis RSEs</p> <p><i>Direct a RSE to make rules or changes to existing rules, within a period of two months from the order. If the RSE fails to do so, SEBI can directly make the rules (Section 7).</i></p>

Make rules in any of the areas where RSE can make by-laws or amend them. (Section 10).

Issue directions to exchange or clearing corporation, to any company whose securities are listed (Section 12A).

Supersede the governing body of a RSE, provided that the RSE is given an opportunity to be heard (Section 11).

Suspend the business of a RSE for not more than seven days, by notification in the gazette, but such period can be extended via a new notification (Section 12).

Withdrawal of recognition (Section 5).

Levy penalty up to Rs. 25 crores for failure to furnish periodical returns, failure to make or amend bylaws or failure to comply with directions issued by SEBI (Section 23G).

Furthermore, as per Sections 11, 11B, and 11C of SEBI Act, SEBI retains full authority to inquire into any matter affecting investors or the market. Also, self-regulatory functions have been assigned to the exchanges via regulations and circulars of SEBI; thus SEBI can any point amend such regulations and circulars in the way it sees necessary.

Resources dedicated to self regulatory functions by the nationwide RSEs.

Area	Number of Staff	
	BSE	NSE
Listing	28	30
Market Surveillance	8	8
Supervision of brokers	25	62
Investigation	10	25

Off-site supervision

RSE are required to submit a wide array of periodic reports to SEBI. Some of these reports deal directly with the operation of the trading platforms and their robustness. Other reports allowed SEBI to oversee how the RSEs are performing their self-regulatory functions. In addition, SEBI has used periodic meetings and more recently also constituted a committee to complement such reporting.

Robustness and integrity of the systems

Risk management certification of RSEs subsidiaries (Smaller stock exchanges have floated subsidiaries which act as brokers on stock exchanges having nationwide trading terminals. These smaller stock exchanges submit risk management certificates of their broking subsidiaries to SEBI), on a half yearly basis:

compliance reports regarding inspection observations, on a quarterly basis;

system audit reports on an annual basis;

oversight of listing obligations;

in February 2011, a committee on noncompliance with listing obligations was set up, with the participation of the BSE and the NSE;

market surveillance;

monthly (for four exchanges, NSE, BSE, MCX-SX, and USE) or quarterly development reports (for the remaining exchanges);

SEBI also holds weekly meetings with the NSE, and RSE to discuss market developments;

supervision of brokers;

monthly reports on investors complaints; and

findings of on-site inspections Consolidated reports regarding the audit reports that brokers are required to submit, along with the actions taken by the RSE.

On-site supervision

The RSEs are subject to periodic inspections by SEBI. SEBI inspections cover a wide range of aspects, including issues related to the robustness of the trading infrastructure as well to the SEs role as SROs.

Record keeping

Section 6 of the SCRA requires RSE to keep records for five years.

Conflict of interest

Section 4 of the SRCA provides SEBI with the authority to impose conditions for the recognition of a RSE. Based on such powers SEBI has imposed certain minimum rules in regard to the integration of the Boards of RSEs. In particular not more than 25 per cent of the Board can represent trading members and 25 percent must be public interest directors and the shareholders directors should constitute the balance. There are detailed rules concerning whom to consider a director, a trading members' director, a shareholders' director and a public interest director. In particular, public interest directors shall be selected by the governing Board from a SEBI constituted panel. SEBI has mandated the stock exchanges to form standing committees such as ethics committee, membership selection committee and audit committee. Further, SEBI has mandated that not more than 20 percent of members of the statutory committees such as disciplinary committee, defaulters committee, arbitration committee and investor services committee shall be trading members.

SRO

Section 11(2)(d) of SEBI Act explicitly empowers SEBI to promote and regulate SROs; however, currently there are no SROs constituted under this Section.

SRO Regulation, Regulation 4, establishes a minimum set of requirements that a company needs to meet to be recognized as a SRO, including:

Minimum net worth of Rs. 1 crore (US\$0.21 million).

Adequate infrastructure.

The directors must be fit and proper. As per regulation 12 the Board should consist of nine members, five appointed by SEBI and four by the SRO. At least four directors must be independent.

Regulation 5 provides SEBI with the authority to impose conditions for the recognition, which can relate to (i) qualifications for membership; (ii) representation of SEBI in the Board; and (iii) maintenance of accounts of members and their audit by chartered accountants whenever such audit is required by SEBI.

	Regulation 15 provides the SRO with authority to make governing norms or articles on (i) eligibility criteria; (ii) reporting by members; (iii) arbitration mechanisms for resolving disputes; (iv) disciplinary proceedings; (v) internal control standards; and (vi) code of conduct.
Assessment	Broadly implemented
Comments	<p>The grade mainly results of an evaluation of the current framework vis-à-vis question 4 of the Methodology.</p> <p>As explained under Principles 10, 14, 21, 25, 26 and 28 SEBI has relied heavily on the RSEs for listing, the regulation and supervision of brokers as well as for market surveillance—although in the latter area SEBI is increasingly taken a more active role given the plurality of platforms available.</p> <p>SEBI has imposed certain conditions aimed at addressing the inherent conflict of interest between the for profit business of the demutualized RSEs and their self regulatory function; which have been described above. Indeed such conditions, along with the oversight regime also discussed above, have helped to create a satisfactory oversight framework.</p> <p>However, in the opinion of the assessor it is important that SEBI continues to further strengthen such arrangements with the aim to ensure that the RSEs dedicate sufficient resources to their self-regulatory role, and discharge such function in an active/vigorous manner. SEBI's recent actions, including the constitution of a committee on noncompliance with listing obligations and the sampling of on-site inspections carried out by the RSEs to determine the quality of such inspections, indicate that SEBI is moving in such direction.</p> <p>Countries have developed different arrangements aimed at ensuring sufficient independence of the self-regulatory function, such as a very strict ring-fencing of the regulatory function vis-à-vis the business side, including on budget issues. In addition to the measures already imposed, SEBI could examine the benefits of requiring the creation of a separate regulatory Board or of a regulatory oversight committee to assist the Board of the RSEs in ensuring that self regulatory functions are appropriately discharged. In the long-term SEBI should consider whether addressing potential conflicts of interest requires a more drastic solution, such as the spin-off of the self-regulatory functions of the SEs in a separate SRO. Some participants have proposed that such role be given to one of the current associations, such as ANMI. However ANMI's current structure would not be supportive of an independent SRO.</p> <p>Finally the assessor acknowledges the existence of special requirements, including a risk management certification for smaller RSEs that have subsidiaries that perform brokerage services. However the assessor recommends that SEBI reviews whether such requirements altogether address the conflict of interest brought by such ownership.</p>
Principles for the Enforcement of Securities Regulation	
Principle 8.	The regulator should have comprehensive inspection, investigation and surveillance powers.
Description	<p>Powers over regulated entities</p> <p>SEBI's enforcement powers both vis-à-vis regulated entities as well as third parties mainly stem from Section 11, 11 A, 11 B, 11 C, and 11 D of SEBI Act. As per Section 11, SEBI can call for information, undertake inspection, conduct inquiries and</p>

audits of stock exchanges, MFs, other persons associated with securities market, intermediaries and SROs. As per section 11(2A), SEBI can undertake inspection of any books, register, or other documents or records where the Board has reasonable grounds to believe that the company has committed insider trading or fraudulent or unfair practices relating to securities market.

To undertake all such actions, Section 11 provides SEBI with the same powers vested in a civil court under the Code of Civil Procedure for the purposes listed below:

discovery and production of books and accounts and other documents at such place and time as specified by the Board;

summoning and enforcing attendance of persons and examining them under oath;

inspections of any books, registers and other documents or records of any person referred to in section 12 (SEBI regulated entities);

listed companies or companies intending to get its securities listed on any recognized stock exchange; and

issuing commissions for the examination of witnesses.

Besides the specific powers of inspection under SEBI Act., Section 209A of the Companies Act, 1956 confers SEBI with the powers to inspect listed public company and those public companies intending to get their securities listed during business hours without any previous notice to the company or any officer of the company. In terms of Section 18 of the Depositories Act, SEBI can call for information and make inquiry from any issuer, depository, depository participants or any beneficial owner with regard to securities held in a depository. Regulation 59 of the SEBI (Depositories and Participants) Regulations, 1996 empowers SEBI to take inspection of any issuer, depository, depository participants, any beneficial owner, issuer or its agent. Besides it, different regulations governing the intermediaries and other registered entities empowers SEBI to conduct inspection and call for information from such intermediaries or registered entities. Section 7 of the SCRA requires every recognized stock exchange to furnish annual report to SEBI.

Record-keeping obligations

As per Rule 10 of the Prevention of Money Laundering (PML) Rules, all intermediaries are required to maintain the records of identity of clients for a period of 10 years from the date of cessation of the transactions between the client and the intermediary. Rule 6 also requires that records of transactions be also maintained for a period of 10 years from the date of transactions between the client and the intermediary. The SEBI Master Circular dated December 31, 2010 reiterates the requirements specified in the PML rules in paragraphs 8.2 and 8.1 respectively of the Master Circular.

Rule 14 and 15 of the Securities Contracts (Regulation) Rules, 1957 require every recognized stock exchange and every member of recognized stock exchange to maintain and preserve books of account and other documents for a period of five years. Regulations 38 and 49 of the SEBI (Depositories and Participants) Regulations, 1996 provides for maintenance of records and documents by every depository and depository participant respectively.

Identity of clients and AML

As indicated above SEBI has the power to request any information from securities intermediaries, which includes the information necessary to identify clients. This is

	<p>facilitated by the fact that pursuant to SEBI Circular MRD/DoP/cir-05/2007 dated April 27, 2007, and AML Master Circular dated December 31, 2010, a permanent account number (PAN) granted by the Income Tax Authorities is mandatory for transactions in the securities market.</p> <p>Section 12 of the Prevention of Money Laundering Act, 2002 (PMLA) requires every banking company, financial institution and intermediary to (i) maintain a record of all transactions, the nature and value of which may be prescribed; (ii) furnish information of transactions to the director within such time as may be prescribed; and (iii) verify and maintain the records of the identity of all its clients, in such manner as may be prescribed. Records shall be maintained for a period of 10 years from the date of cessation of the transactions between the clients and the banking company or financial institution or intermediary, as the case may be.</p> <p>SEBI has issued Guidelines in connection with such obligations. Section 3.2.1-3.2.2. of SEBI Guidelines requires registered intermediaries to have a system in place for identifying, monitoring and reporting suspected money laundering or terrorist financing transactions to the law enforcement authorities. The Registered Intermediaries should:</p> <p><i>issue a statement of policies and procedures, on a group basis where applicable, for dealing with money laundering and terrorist financing reflecting the current statutory and regulatory requirements;</i></p> <p><i>ensure that the content of these Guidelines are understood by all staff members;</i></p> <p><i>regularly review the policies and procedures on prevention of money laundering and terrorist financing to ensure their effectiveness. Further in order to ensure effectiveness of policies and procedures, the person doing such a review should be different from the one who has developed such policies and procedures;</i></p> <p><i>adopt customer acceptance policies and procedures which are sensitive to the risk of money laundering and terrorist financing; and</i></p> <p><i>undertake customer due diligence (“CDD”) measures to an extent that is sensitive to the risk of money laundering and terrorist financing depending on the type of customer, business relationship or transaction; and develop staff members’ awareness and vigilance to guard against money laundering and terrorist financing.</i></p> <p>Outsourcing of inspections</p> <p>Regulation 24 of the SEBI (Stock Brokers and Sub-Brokers) Regulations states, inter alia, that SEBI may appoint a qualified auditor to investigate into the books of account or the affairs of the stock-broker, provided that, the auditor so appointed shall have the same powers of the inspecting authority as mentioned in regulation 19 and the obligations of the stock broker in regulation 21 shall be applicable to the investigation under this regulation. Similar provisions have been provided in other intermediaries Regulations also. Staff informed however that SEBI has not used such powers since 2009.</p> <p>When such powers were used, SEBI appointed auditors who were in the Reserve Bank panel as Statutory Central Auditors. The auditors were given detailed guidance note for the inspections as well as a format for the preparation of the inspection reports. The guidance notes have included instructions on maintenance of confidentiality and avoidance of conflict of interest. SEBI also has held pre-inspection meeting with the auditors.</p>
Assessment	Fully Implemented

Comments	
Principle 9.	The regulator should have comprehensive enforcement powers.
	<p><i>Block one or more bank accounts for a period not exceeding one month, provided that there is approval of the judicial magistrate.</i></p> <p><i>Direct any intermediary or any person associated with the securities market in any manner not to dispose or alienate an asset forming part of any transactions which is under investigation.</i></p> <p><i>Imposition of “civil” sanctions.</i></p> <p>Breaches to SEBI Act, the Depository Act, the SRC Act and the corresponding regulations constitute a “civil” infraction. In all three cases SEBI is the competent authority to impose sanctions in connection with such breaches. The three Acts provide SEBI with the power to impose a wide range of sanctions, including:</p> <p><i>directions to any regulated entity or any person associated with the securities market (Section 11B);</i></p> <p><i>cease and desist orders (Section 11 D); and</i></p> <p><i>suspension or cancellation of certificate of license/certificate of registration by initiating enquiry proceedings against intermediaries (Section 12.3).</i></p> <p>Monetary penalties (Sections 15A to–HB): the penalties vary depending on the violation. In the case of insider trading and market manipulation the penalty could go up to 25 crores (US\$5.23 million) or three times the benefit obtained. In case of breaches of the Acts or the corresponding regulations for which the Act does not establish a specific penalty, the money penalty could go up to one crore rupees (US\$0.21 million).</p> <p>In addition, SEBI is allowed to require disgorgement of illicit gains. Such authority is not explicitly included in SEBI’s Act; however there is settled jurisprudence from the Supreme Court supporting it on the basis that it is not technically a sanction.</p> <p>“Civil” sanctions different from money penalties are imposed by a WTM. Monetary penalties are to be imposed by an adjudicating officer who should be any officer of SEBI, not below the rank of a Division Chief. Section 15I explicitly provides adjudicating officers with the power to summon and enforce the attendance of any person, or to produce any document. Pursuant to section 24B CG can grant immunity on recommendation of SEBI. Orders by a WTM or an adjudicative officer are subject to appeal before the Securities Appellate Tribunal, as per section 15T of the SEBI Act. According to 15L, SAT shall consist of a presiding officer and two other members, appointed by the CG and as per section 15N the presiding officer and other members shall hold the office for a period of five years and shall be eligible for re- appointment. Section 15M provides minimum qualification for appointment of members of the SAT. Section 15U establishes that the SAT shall not be bound by the procedures of the Code of Civil Procedure, 1908 but shall be guided by the principles of natural justice. The SAT is empowered to regulate its own procedures. The SAT shall have the powers vested in a civil court under the Code of Civil Procedure, including:</p> <p>(i) summoning and enforcing attendance of any person and examining them under oath; (ii) requiring the discovery and production of documents; (iii) receiving evidence on affidavits; and (iv) issuing commissions for the examination of witnesses. As per Section 15U any proceeding before SAT shall be deemed to be a judicial proceeding.</p>

	<p>Criminal sanctions</p> <p>Breaches to SEBI Act, the Depository Act and the SCRA including rules and regulations made under those Acts also constitute a crime, punishable with imprisonment of up to 10 years or with a fine of up to 25 crore rupees (US\$5.23 million) or both.</p> <p>The failure to pay a penalty imposed by the adjudicating officer or to comply with any of his/her directions or orders also constitutes a crime, punishable with imprisonment of up to 10 years to a fine of up to 25 crore rupee (US\$5.23 million) or both.</p> <p>SEBI can file a criminal complaint for violations to the statutes it administers (SEBI Act, Depositories Act and SCR Act).</p> <p>Under the Indian legal system parallel proceedings are allowed; and there is clear jurisprudence in this regard. There is also clear jurisprudence in regard to the differences in the burden of proof of “civil” proceedings (preponderance of the evidence) versus criminal proceedings (beyond reasonable doubt).</p> <p>Other statutes</p> <p>Under Section 209A of the Companies Act SEBI has power to inspect any book or record of a public company in connection with the functions afforded to it by Section 55A. Further, SEBI is also empowered to initiate criminal action in respect of offences under the Companies Act relating to the provisions administered by it. (Sec 621 of the CA).</p> <p>Private right of action</p> <p>As per sections 15Y and 20A of SEBI Act only SEBI is empowered to take action for violation of such statutes and their regulations. Such sections explicitly bar the jurisdiction of civil courts in the matters which are within the purview of Adjudicating Officer, SAT or SEBI.</p> <p><i>However, private persons can seek remedies such as compensation for deficiency of services against an intermediary before the Consumer Forum, pursuant to the Consumer Protection Act, 1986 or for any claim against a broker before an arbitrator under the by-laws of the RSEs. Further under the Companies Act, 1956 private right of actions, i.e., civil as well as criminal is specifically available.</i></p>
Assessment	Fully implemented
Comments	<p>While there is not an explicit recognition of a private right of action, individuals do have the right to file suits to get redress in connection with financial services pertaining to securities market based on the Consumer Protection Act. As a result the assessor considers that this principle has been fully implemented. Nevertheless, it would be useful that an explicit right of action be explicitly recognized in the statutes.</p> <p>The Principles do not require that a securities regulator has “direct” access to telephone records. In practice, however, the authority to access such records can become critical, in particular for the investigation of the more egregious cases, such as market manipulation or insider trading. Thus the assessor recommends that, for purposes of civil enforcement, consideration be given to providing SEBI with the authority to access telephone records, under similar conditions than the blocking of bank accounts (i.e., with approval of a judicial magistrate). In many countries wiretapping would be allowed only within a criminal investigation.</p>

Principle 10.	The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance program.
Description	<p>Supervision of securities intermediaries and MFs</p> <p>Overall SEBI has used a supervisory approach that focuses heavily on institution-based supervision. SEBI's supervisory strategy has varied depending on the type of intermediary. In the case of brokers the RSEs have acted as the front-line supervisors, while SEBI is the front-line supervisor for the remaining categories of intermediaries, including MFs and the AMCs that administer them.</p> <p>Off-site supervision</p> <p>Three off-site mechanisms have been used by SEBI to supervise regulated entities:</p> <p><i>Off-site reporting. In particular securities intermediaries are required to submit annual audited financial statements and semi-annual unaudited financial statements.</i></p> <p><i>Use of third-party/independent experts as "gatekeepers." Since 2009, brokers and PMs are required to have a semiannual audit on their operations conducted by an accountant paneled by the RBI. In the case of MFs the trustee is required to be the front line supervisor of compliance and in such role is required to submit an annual report to SEBI. Brokers and MFs are also required to have their IT systems certified by experts.</i></p> <p><i>A system of redress for grievances. Intermediaries are required to have systems in place to address investors' complaints; complaints that are more than 30 days old need to be reported to SEBI.</i></p> <p><i>Off site supervision has been complemented with on-site inspections. In the past SEBI used auditors paneled by the RBI to conduct on-site inspections. In 2006 it started to change such approach. In the case of brokers, SEBI now relies on the RSEs to conduct the on-site inspections, while in the case of the remaining intermediaries SEBI has started to directly conduct such inspections.</i></p> <p>On-site supervision</p> <p>Brokers are subject to regular on-site inspections. As further explained in Principle 21 pursuant to SEBI's circular all active members must be inspected on an annual basis by the RSEs of which they are members. The RSEs have developed criteria to determine the intensity/scope of the inspections. In the last couple of years SEBI has also conducted its own inspections on brokers ("<i>purpose-driven</i>" inspections). <i>In 2008–2009 SEBI conducted 38 of such inspections, while in 2009–2010 it conducted 36 inspections.</i></p> <p>In addition, during the inspections of the RSEs SEBI has reviewed a sample of the inspections conducted by the RSEs as a mechanism to oversee their quality. SEBI is still in the process of analyzing the results of such inspections; however staff indicated that the findings show that there is room for improvement.</p> <p>As explained in Principle 21, SEBI has not established a regular program of on-site inspections for portfolio managers (PMs) but has used the renewal process—for which it conducts on-site visits—as a way to check on going compliance with entry requirements.</p>

In the case of merchant bankers, prior to 2011, SEBI did not have a comprehensive program of on-site inspections; and only a few inspections were conducted on a yearly basis (for example for 2007–2008 two inspections were conducted, none for 2008–2009, and two for 2009–2010). It must be highlighted, however, that this year SEBI shifted its approach, and introduced risk-based criteria to decide on the inspections to carry out. As a result this year SEBI conducted inspections on the top 10 MBs by number of issues.

Finally, as explained in Principle 17 AMCs and the MFs they administer have been subject to inspections on a two year cycle by accountants paneled by the RBI. SEBI provided terms of reference for such inspections, which included the need for auditors to look at compliance issues as well as internal controls and risk management. Starting in FY 2011–2012 SEBI has changed its supervisory approach whereby inspections are to be carried out directly by SEBI under a risk based approach and MFs that pose the greatest risk to the system will be inspected on an annual basis.

On the other hand the supervisory approach has not included mechanisms to allow for a systematic identification of problems/risks that exist in a plurality of intermediaries, and thematic inspections aimed at monitoring such risks have not been systematically used. In the case of brokers, SEBI conducts “purpose driven” inspections as described under Principle 21, which are a first step in such direction. Also, SEBI highlighted that it increased the number of inspections that it conducted on brokers during the current year. In the case of AMCs and the MFs they administer, as part of the new supervisory approach, thematic inspections are becoming an integral part of SEBI’s inspection plan.

Supervision of RSEs

As explained under Principles 7 and 26, the RSEs are subject to a comprehensive system of off-site supervision via reports, regular meetings with the nationwide RSEs to discuss market developments and more recently also the constitution of a committee focused on compliance with listing obligations. In addition, SEBI conducts annual inspections on the nationwide RSEs.

Market surveillance

As explained under Principles 26 and 28 the RSEs perform real time surveillance of the markets. Given the existence of multiple markets SEBI has developed an Integrated Market Surveillance System that allows it to monitor the markets across exchanges, and across segments. SEBI conducts its market surveillance functions on a t+1 basis. SEBI is currently in a process of upgrading the capabilities of such system.

Investors’ complaints

SEBI has required both issuers and intermediaries to have in place mechanisms to address investors’ complaints. Thus, when complaints are received directly at SEBI, SEBI routes them to the corresponding intermediary. Intermediaries are required to inform SEBI the way they dealt with the complaints and it is expected that they will be dealt with within 30 days. In the case of brokers, SEBI also received reports from the RSEs.

Through such reports SEBI can identify the brokers that concentrate most complaints, as well as whether there are recurrent topics. SEBI has used such information to conduct meetings with the top 10 brokers and depository participants by numbers of complaints in the year 2010–2011. It has also held meetings with senior officials from

other intermediaries to discuss redress of complaints. As a result the backlog in the attention of investors' complaints by intermediaries has diminished from 18,602 in 2009 to 9,879 in 2010 to 7,132 in 2011.

SEBI does not have the authority to settle monetary disputes but can impose disciplinary actions on issuers and/or securities intermediaries if the laws and regulations have been breached. As per the RSEs by-laws brokers have to abide by system of arbitration. Thus, if an investor is not satisfied with the way an intermediary has dealt with a complaint, it can go to mediation and then to arbitration. Staff informed that the arbitration system of the RSEs has worked well; and that cases are usually completed within six months.

Staff informed that SEBI is in the process of upgrading its system to handle complaints so that via website investors will be able to check the status of their complaints, including any action requested by SEBI or the RSEs.

Systems of compliance

Securities intermediaries are required to appoint compliance officers. The regulations do not explicitly required that the compliance officers be accountable only to the Board of the intermediary. They do require compliance officers to inform immediately to the Board of the intermediary and to SEBI of any material violation.

Investigation

SEBI has established a separate department to conduct investigations of violations of the laws and regulations that SEBI administers. There is approximately 45 staff in such department.

SEBI collects statistics in regard to the number of investigation open, the number of investigations completed as well as the nature of the investigations. Such statistics showed that SEBI has been active in the investigation of unfair trading practices, such as market manipulation and insider trading. Furthermore in recent years SEBI has been able to reduce the backlog that it had.

SEBI has also constituted a separate department to take on enforcement proceedings. Such department is composed of approximately 25 staff.

	INVESTIGATIONS			
	Taken up		Finalized	
	2008-2009	2009-2010	2008-2009	2009-2010
Market Manipulation	52	44	62	46
Capital Issue related to Manipulation	2	2	1	7
Insider Trading	14	10	12	10
Takeover	3	2	1	5
Others	5	13	7	6
Total	76	71	83	74

Source: "Civil" enforcement.

SEBI does not have a written strategy toward enforcement; however its staff shows a clear understanding of the deterrent effect of an enforcement program. On an aggregate the statistics included below showed that SEBI has made both used on “soft” measures such as deficiency observations, and warnings, to “harder measures” ranging from directions to suspensions and monetary penalties. The comparison of such data against additional data provided by SEBI on enforcement actions by type of intermediary for 2009-2010 lead to conclude that harder measures are concentrated in misconducts linked to market surveillance. Such stance in regard to unfair trading practices has allowed SEBI to build a reputation as a strong enforcement agency which has not hesitated to impose sanctions on high profile individuals and companies. Staff also indicated that SEBI has roughly a 75–80 percent success rate, when cases are appealed to the SAT.

The same data, as well as data provided by SEBI in connection with findings from inspections reports of AMCs and the MFs they administer lead to conclude that softer actions (such as letters of deficiency and warnings) have been preferred to deal with findings from inspections on regulated entities.

Year	Monetary Penalties			Debarments, Suspension, ** Cancellation, A/c Freezing, Warning, Censure, Winding-up, Cease & Desist		Disgorgement			Prosecutions	
	No. of Orders	No. of Entities	Amount (Rs.Lakh)	No. of Orders	No. of Entities	No. of Orders	No. of Entities	Amount (Rs. Lakh)	No. of Cases Upheld	No. of Entities Convicted
2005	195	298	733.63	79	144				1	4
2006	95	166	3571.75	142	242				34	157
2007	91	115	1448.15	181	599				15	57
2008	118	181	1898.00	119	508	4	5	174.55	10	37
2009	532	563	3338.54	180	1222	6	18	1648	10	34
2010	581	638	4465.21	94	948	5	5	3368.5	10	45
Total	1612	1961	15455.28	795	3663	15	28	5191.1	80	334

SEBI also makes use of consent orders (settlement powers). Consent orders have allowed it to be more efficient in the discharge of its enforcement function. SEBI has issued guidelines for the use of such authority; which among others restrict the type of cases which could be subject to a consent order. In addition, there are procedures in place to check the use of such authority by SEBI, including the need for approval by a committee of the consent order and the amount paid.

Data relating to Disposal of applications under the Consent Scheme as on March 2011, obtained from <http://www.sebi.gov.in/consentdata.pdf> is provided below:

Year	Applications received	Applications disposed by way of		Amount collected (' crore)
		Acceptance	Rejections	
2007-08	617	54	25	2.17
2008-09	666	428	164	45.71
2009-10	680	359	317	68.57
2010-11	333	171	237	72.14
Total	22,961	1,012	743	188.592

1) Of these, 284 applications have been treated as withdrawn/infructuous.

2) As a part of settlement process, apart from the amount collected, the settlement in 132 cases included debarment from dealing in securities market/suspension of certificate of registration for varying period of time.

The amount of `188.59 crore received through consent mechanism comprises `28.97 crore toward disgorgement, `158.53 crore toward settlement charges and `1.09 crore toward administrative and legal charges.

As described under Principles 14 and 16 enforcement with listing obligations (which includes periodic and ongoing reporting) has been mainly a responsibility of the RSEs; while MCA has been the main authority responsible for reviewing compliance of financial statements with accounting principles. As indicated under Principle 14 in the past the RSEs have suspended companies for breaches to listing obligations. However compliance with listing obligations remains an important challenge. This year through the committee on non-compliance with listing obligations SEBI instructed the nationwide RSEs to develop a plan of action to deal with non-compliance, including initiating the corresponding enforcement actions. A limited number of money penalties have been imposed by SEBI as a result of breaches to listing obligations, in particular those included in clause 49 of the LA. On the other hand there is no information on the findings of MCA's review of financial statements or on enforcement actions resulting from such reviews. Findings from on-site inspections carried out by MCA on listed companies are shared with the RSEs, but there is no information that the RSEs have taken enforcement actions as a result of such reports.

Criminal enforcement

Overall market participants believe that SEBI has been active filing criminal cases and SEBI provided information that supports such assertion. Convictions have taken place, as shown in the chart above. During the last years, however, such cases have mostly focused on frauds related to CIS, as SEBI was able to secure dedicated tribunals to deal with such cases. Protracted procedures have been mentioned as the main area where improvements are needed.

Assessment

Partly implemented

Comments	<p>The grade is mainly a result of an evaluation of the current framework vis-à-vis questions 1 a) and b) and question 11 of the methodology. In the opinion of the assessor—further detailed below—(i) the limitations observed in the supervision of securities intermediaries; (ii) in enforcement of reporting obligations by issuers and accounting and auditing standards; and (iii) in criminal enforcement altogether are material and therefore the grade of partly implemented. The assessor acknowledges however that changes are underway in the approach to supervision of securities intermediaries, as well as enhancements in coordination with the RSEs as well as with MCA which should have a positive effect on enforcement of reporting obligations and accounting standards. Once all such changes are implemented a review of the grade would be warranted.</p> <p>Supervision of securities intermediaries still has important limitations that should be addressed as a matter of priority. First, it would be beneficial if SEBI develops an overall strategy toward resource allocation across the entire organization that takes into consideration the risk that different categories of intermediaries (and their business models) posed to the system. Second, SEBI should consider strengthening thematic inspections by making them a regular component of its supervisory approach for all types of intermediaries, thus complementing its current institution-based approach. To do that SEBI will need to develop mechanisms that allow it to identify clusters of risks across individual participants. Third, SEBI should consider improvements to its institution-based supervisory approach. As a first step there should be an inspection program for all categories of intermediaries. In addition, SEBI should rely more on an identification of the risks posed by each category, as well as each entity individually to determine both the inspection cycles as well as the scope of the inspections. This approach should be used also to develop the inspection plan for brokers, even if it is still carried out by the RSEs. Finally, in addition to a compliance based approach, inspections should include also a more thorough assessment of the quality of internal controls and risk management vis-à-vis the business model of the regulated entity. To implement all such changes SEBI will need to make upgrades to its current off-site monitoring and reporting arrangements. Fourth, better follow-up of findings made on supervisory reports is warranted, including through the imposition of sanctions, when necessary. Fifth, in the case of brokers, SEBI would benefit from a strategic analysis on the extent to which it wants to continue to rely heavily on exchanges for on-site inspections, given the inherent conflicts of interest of their for-profit model with their self-regulatory functions. In the context of such analysis it should discuss what the proper balance should be between inspections by the RSEs and inspections by SEBI. If SEBI continues to rely on the RSEs for such function, a review of resources allocated by the RSEs to it is warranted. Finally SEBI should also discuss with the RSEs mechanisms to ensure proper oversight of sub-brokers.</p> <p>As indicated above, it is important to highlight that SEBI has already embarked in such strategic planning. Furthermore in the case of MFs and the AMC's that administer them the new supervisory approach is broadly compliant with the IOSCO Principles, as further explained in Principle 17.</p> <p>Limitations in supervision can affect the overall efficacy on an enforcement program given that supervision is a key tool to uncover breaches with laws and regulations. In this regard, and as indicated above a breakdown of sanctions imposed during 2009-2010 by type of intermediary provided by SEBI shows that very few sanctions have been imposed in certain specific types of intermediaries, which could be an indication of weaknesses in the supervisory program. SEBI has highlighted that a</p>
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series of measures have been taken for strengthening the follow up of findings of inspection reports, in particular: (i) the findings of SEBI's reports are communicated to intermediaries and discussed thoroughly with them and action is taken commensurate with the seriousness of the violation; (ii) intermediaries are required to report to SEBI corrective steps taken; and (iii) compliance with recommendations is also checked during the subsequent inspection. Similar procedures are required from the exchanges.

With the caveat stated above in relation to the link between supervision and enforcement the statistics collected by SEBI indicate that overall SEBI has given priority to investigation and enforcement, in particular in regard to serious misconducts linked to market surveillance, such as market manipulation and insider trading. This conclusion is also supported by comments from market participants.

In the medium term SEBI should analyze whether the amount of resources that it is currently allocating to investigation and enforcement will be sufficient to keep up with the increased complexities of the market and therefore the increased complexity of the cases that SEBI will be dealing with. In this regard, for example it is critical that SEBI keeps its current commitment toward developing sophisticated surveillance systems that allow it to store and analyze massive amounts of information in an automated manner.

However, the information provided along with consistent comments from many market participants raise concerns about the quality of enforcement by the RSEs in particular in the area of compliance by issuers with reporting obligations. As indicated in Principle 14, a committee recently constituted has already recommended the RSEs to develop a plan of action to deal with such event of noncompliance, and thus these limitations should be addressed soon. In addition, as indicated in the description of this Principle, not enough information has been provided to support the conclusion that MCA has been effective in ensuring compliance by issuers with accounting standards. While the recently created coordination committee between SEBI and MCA should bring benefits, in the long term SEBI and MCA should review whether any functions related to listing companies should be vested only in SEBI. In the case of auditors, there are currently no independent oversight mechanisms.

In regard to mechanisms to ensure compliance with listing obligations, SEBI highlighted that in its budget for 2011–2012 it stated that in its endeavor to further enhance the scope of its activities to more comprehensively monitor compliance with listing requirements, to respond to growing investor expectations, inter-alia, proposed to create a forensic account cell to improve quality of financial information disclosed and to assist in detecting financial irregularities so as to serve as an effective early warning mechanisms, Accordingly the cell was set up via Office Order dated February 2012.

Finally, criminal enforcement does not appear to be effective enough, except in the area of unauthorized CIS. The limitations in criminal enforcement are somewhat mitigated by the strong enforcement powers that SEBI has on the civil arena; though in practice it is important for a country to use sanctions such as imprisonment, since they carry a more powerful deterrent effect. The authorities informed that certain amendments have been proposed in the SEBI Act such as empowering the Court of Sessions to take cognizance of and try offences under the SEBI Act, which is expected to bring down the delay in criminal enforcement.

Principles for Cooperation in Regulation	
Principle 11.	The regulator should have authority to share both public and non-public information with domestic and foreign counterparts.
Description	<p>Section 11 (2) (1a) of SEBI Act provides SEBI with the authority to “calling from or furnishing to any such agencies as may be specified by the Board, such information as may be considered necessary by it for the efficient discharge of its functions.” SEBI has interpreted that such provision authorizes it to share both public and non public information with both domestic authorities as well as foreign counterparties, without any limitation. It has also interpreted that information covers both documents as well as testimony.</p> <p>In the case of foreign counterparts, as a matter of practice—not law—SEBI shares such information on condition of reciprocity based on Memoranda of Understanding (MoUs) entered into with such foreign counterparts. Also a matter of practice, SEBI has obtained the consent of CG before entering into any of such MoUs, including the signature of the IOSCO MMoU.</p>
Assessment	Fully implemented
Comments	<p>SEBI’s Act is fairly broad and thus the interpretation that SEBI has made of it appears reasonable. Furthermore, in practice SEBI has used such statute to dispense co-operation to foreign counterparties on a regular basis, and it has never been questioned in the use of such powers—even when it has involved the collection of bank records. Finally, SEBI is currently signatory of the IOSCO MMoU which means that the screening committee of IOSCO has found satisfactory SEBI’s interpretation of the scope of its statute. As a result the assessor has given a fully implemented to this principle.</p> <p>However, the assessor recommends that such section be amended to explicitly refer to cooperation with foreign counterparties, to eliminate any possibility of different interpretations. SEBI staff informed that such reform has been included in a draft bill of amendments to SEBI Act.</p>
Principle 12.	Regulators should establish information sharing mechanisms that set out when and how they will share both public and nonpublic information with their domestic and foreign counterparts.
Description	<p>Domestic cooperation</p> <p>The authorities have established different mechanisms to foster coordination at a domestic level, as further described in Principle 1.</p> <p>International cooperation</p> <p>SEBI is signatory of the IOSCO MMoU. In addition, it has entered into several bilateral MoUs, such as SEC of U.S., SEC of Malaysia, FSC Mauritius, SFC of Hong Kong.</p> <p>SEBI has provided evidence that it has effectively cooperated with foreign counterparties. During the last three years SEBI has received an average of thirty requests per annum. Roughly 70–80 percent of such requests refer to fit and proper information that is already in SEBI’s files. On average such requests are answered within 15 days. Answering requests that involve the collection of information from other entities or authorities, such as bank records has taken longer, usually between 45 -90 days. IOSCO also has a monitoring group that on a periodic basis reviews members “complaints” on cooperation. SEBI staff informed that no complaints have been brought against SEBI.</p>

Assessment	Fully implemented
Comments	Question 7 of the Methodology, which deals with domestic cooperation, has a narrower scope than Question 3 c) of Principle 1 of the Methodology, since the former only requires to assess whether the securities regulator has provided cooperation when required by other domestic authority. Given the narrower scope of this Principle, the assessor has given a fully implemented grade to this Principle.
Principle 13.	The regulatory system should allow for assistance to be provided to foreign regulators who need to make inquiries in the discharge of their functions and exercise of their powers.
Description	<p>As per SEBI's interpretation discussed under Principle 11, Section 11 of SEBI Act provides SEBI with the authority to collect information that is currently not in its files on behalf of foreign regulators.</p> <p>SEBI has provided concrete evidence that it has provided assistance in the terms required by Principle 13. In this regard it has collected information which was not in its files, including bank records. It has also been able to collect answers to questions posed by foreign regulators (akin to testimony). SEBI staff acknowledges some uncertainty as to whether it could compel a person to provide testimony on behalf of a foreign regulator. However staff emphasized that in practice every time that it has gotten a request for "testimony" (answer questions) it has been able to obtain it.</p> <p>SEBI is not entitled to approach a Court to obtain injunction on behalf of foreign regulators.</p>
Assessment	Fully implemented
Comments	The IOSCO Principles do not require that securities regulator be able to "compel" testimony on behalf of foreign regulators, only that they be able to take testimony on a voluntary basis. Also, the Principles only require that where applicable regulators provide assistance in obtaining court injunctions. In practice many regulators do not have such power. Thus these two issues should not be taken into consideration for the purpose of the grade.
Principles for Issuers	
Principle 14.	There should be full, accurate and timely disclosure of financial results and other information that is material to investors' decisions.
Description	<p>Prospectus obligation</p> <p>Section 2 (36) of the Companies Act, 1956, defines "prospectus" as any document described or issued as a prospectus and includes any notice, circular, advertisement or other document inviting deposits from the public or inviting offers from the public for the subscription or purchase of any shares in, or debentures of, a body corporate. Section 56 of the Companies Act requires that every prospectus should state the matters specified in Schedule II to the Act. The contravention of such obligation is punishable with a fine of Rs 50,000. Public offering is defined as any offer of shares or debentures to 50 or more persons as per Section 67. Section 67, however, authorizes NBFCs to issue securities by private placements even if it is directed to more than 50 persons. The authorities informed that said exception to NBFCs is omitted in the Companies Bill placed before the parliament.</p> <p>Schedule II of the Companies Act provides a basic framework for prospectuses, which should include: general information, capital structure of the company, terms of the offer, particulars of the issue, company information; risks and financial information. In</p>

addition, SEBI is authorized under Section 55A of the Companies Act, 1956 and Section 11A of the SEBI Act, 1992 to regulate public issuances and to specify the matters relating to issue of capital, listing, transfer of securities and other matters incidental thereto and the manner in which such matters shall be disclosed by the companies. Further, SEBI is authorized under Section 11A to prohibit any company from issuing a prospectus, any offer document, or advertisement soliciting money from the public for the issue of securities and to specify the conditions subject to which the prospectus, such offer document or advertisement, if not prohibited, may be issued.

SEBI has framed separate regulations for the issue of equity/convertibles, debt and securitized debt; which established further details in relation to each type of offer and the content of the prospectus. All such regulations have general provisions regarding the need for prospectus to be true, fair and accurate.

Pursuant to SEBI's regulations, the issuer of equities/convertibles has one year from the time of the SEBI's observations to open the offer. If during such period significant changes have taken place, the issuer is required to submit a supplement to the prospectus. In addition, financial statements cannot be more than six months old. Once the offer is closed, the regulations do not require the issuer to update the prospectus on a periodic basis.

Listed issuers, both equity and debt, have continuous obligation under the Listing Agreement; in particular they are required to submit a series of periodical and event based reports to the exchange for wider public dissemination, to keep investors up-to-date.

Powers of SEBI in regard to the prospectus

In the case of equity/convertible issues, Regulation 4-6 of SEBI (Issue of Capital and Disclosure Regulations) 2009 require issuers to submit a draft offer document to SEBI 30 days prior to registering the prospectus with the registrar of companies. Such Regulations authorizes SEBI to specify changes and additional disclosures.

In the case of debt issues, regulation 6 of SEBI Issue and Listing of Debt Securities Regulations establishes that no issuer shall make a public issue of debt securities unless a draft offer document has been filed with the designated RSE through the lead merchant banker. The RSEs are authorized to request changes to it.

Responsibility for the prospectus

Section 62 of the Companies Acts specifies civil liability for misstatements in the prospectus. Such liability cover directors, promoters and every person (experts for example) who signed the prospectus. Pursuant to section 63 misstatements in the prospectus also constitute a crime punishable with imprisonment of up to two years or a fine of 50,000 rupees or both. As every Prospectus need to be filed through a SEBI registered merchant banker, SEBI is empowered to take action against the merchant bankers, in case of lack of due diligence on their part under relevant regulations and SEBI Act.

Periodic and ongoing disclosure

Sections 210 to 219 of Companies Act require public companies to submit to their shareholders their annual reports for their annual meetings. Such reports should contain: the balance sheet, and profit and loss accounts, along with the external auditor's report, and a directors' report. The directors' report such include among

others: (i) a statement of the companies affairs, (ii) proposed reserves, (iii) proposed dividend; (iv) material changes and commitments; (v) information on salaries; (vi) a responsibility statement indicating that the financial statements have been prepared in accordance with the applicable accounting standards, and that directors have taken sufficient care to ensure maintenance of adequate accounting records. Such reports should also be filed with the RoCs within 30 days of the shareholders meeting.

Additional periodic reporting obligations exist only for listed companies. However, pursuant to Section 73 of the Companies Act all issuers of public offerings (whether equity or debt) must also request listing in a RSE. As a result, in practice there is no distinction in disclosure requirements between issuers of public offering and listed companies.

Every issuer intending to list their Securities need to enter into a Listing Agreement with the concerned RSEs. SEBI has prescribed the provisions of the Listing Agreement (LA), by way of circular to the RSEs.

Equity issues

Pursuant to clauses 32 and 49 of the LA, listed companies are also required to include as part of their annual reports the following documents:

Consolidated Financial Statements, Cash Flow Statements and Related Party Transactions (Clause 32 of the LA)

Management Discussions and Analysis Report (Clause 49)

Declaration signed by CEO regarding compliance with Code of Conduct by all Board members and senior management personnel (Clause 49)

Separate section on Corporate Governance with a detailed compliance report on various clauses of Clause 49 and extent of compliances of non-mandatory requirements including a certificate from auditors or practicing company secretaries regarding compliance of conditions of corporate governance

Corporate Governance in the Annual report should also contain the additional details prescribed in Annexure I C to Clause 49. Pursuant to Clause 41 LA issuers must submit their audited annual report to the corresponding RSE within 60 days of the end of the fiscal year. Listed companies are also required to publish quarterly financial reports within 45 days of last day of every quarter ended in a financial year (Clause of the LA).

Clause 36 of the Listing Agreement requires listed companies to immediately inform the exchange of all the events which will have bearing on the performance/operations of the company as well as price sensitive information. Material decisions of the Board of directors have to be filed within 15 minutes of the Board meeting.

Clause 35 of the LA requires listed issuers to file with the RSEs their Shareholding Pattern within 21 days from each quarter.

Debt issues

Pursuant to Clause 28 of the Debt Listing Agreement, companies that issue debt are required to include as part of their annual report the following items:

Disclosures of amounts at the year end and the maximum amount of loans/ advances/ investments outstanding during the year for parent and subsidiaries.

Cash flow statement

The annual report has to be submitted to the RSE. The Listing Agreement requires that such report be submitted promptly but does not specify a deadline.

In addition, clause 27 requires them to submit to the exchange and debt holders a half-yearly communication, counter signed by debenture trustee within one month from the end of the half year (September and March) containing, inter alia, the following information: (i) credit rating; (ii) asset cover available; (iii) debt-equity ratio; (iv) previous due date for the payment of interest/ principal and whether the same has been paid or not; and (v) next due date for the payment of interest/ principal.

Pursuant to Clause 29 of the Debt LA they are also required to publish half yearly financial statements within one month from the end of the half year. Such reports have to be subject to limited review by the external auditors.

Clause 19 of the LA requires companies with debt issues to promptly inform the exchange of material events. Such clause provides a list of events that should be notified.

Advertisements

Regulations in relation to advertisement are included in the respective regulations for equity, debt and securitized instruments. Overall the regulations require that any public communication issued by the issuer or research report made by the issuer or any intermediary concerned with the issue or their associates shall contain only factual information and shall not contain projections, estimates, conjectures, etc. or any matter extraneous to the contents of the offer document. Furthermore all public communications and publicity material issued or published in any media during the period commencing from the date of the meeting of the Board of directors of the issuer in which the public issue or rights issue is approved until the issue takes place should be consistent with past practices. In case that such communications are not consistent, then a prominent warning should be made.

Practice***Review of prospectus***

As per the powers afforded to the RSEs in the SCRA and the LA and to SEBI pursuant to SEBI Act and the Companies Act, both the RSE and SEBI review the prospectus of equity issuers. The process has been coordinated so that RSE reviews the prospectus and provides an “in principle approval for listing”, conditioned to any comments that SEBI might make during its own review. SEBI currently reviews all prospectuses for equity offerings. One analyst conducts main review, but there are one/ two levels of oversight depending on the amount of issue. Issues of less than Rs. 100 crores (US\$20.92 million) can be cleared at a level below the ED. There is a check list that analysts use for such review. In addition SEBI is in the process of developing a manual. Prospectuses are also posted on website for a period of 30 days, prior to the clearance by SEBI and any person can send comments during such period.

In order to improve the quality of prospectus, in the past SEBI issued circulars to the market in regard to frequent mistakes, and held meetings with MBs. Staff also informed that ANMI is currently in the process of developing a due diligence manual for MBs which should also have an impact in the quality of prospectuses, as MBs have a role of “gatekeepers” and have to provide “assurances” as to the completeness and accuracy of the prospectuses.

SEBI does not review the prospectuses of debt issuers, but relies on the RSEs to conduct such review. SEBI informed that in practice RSEs do ask for changes, however due to the limited number of debt issues, there may be few instances where such changes are requested. SEBI oversees the RSEs role in reviewing prospectuses through its regular inspections of the RSEs. Prospectus are also posted in the website of the RSEs for a period of seven days.

Review of periodic and ongoing disclosures requirements

SEBI does not conduct reviews of material events posted by issuers, nor of the periodic reports that they are required to submit, unless there is any specific complaint received on such disclosures. Furthermore as indicated above, issuers do not file such reports with SEBI, rather they do it with the RSE where they are listed. Under the current framework such review has been mainly a responsibility of the RSEs. The FRRB and MCA have also had a role in reviewing annual reports, focused on verifying compliance with accounting standards, as described below.

Periodic reports

As indicated above periodic reporting is part of the listing obligations. As such the exchanges are authorized to review compliance with such obligations. Non compliance could lead to suspension or even delisting by the RSEs. In addition, pursuant to section 23E of SCRA, if a company fails to comply with the listing conditions, it shall be liable to a penalty not exceeding 25 crore rupees (US\$5.23 million). SEBI is authorized to appoint an adjudicating officer.

In practice, the RSEs conduct a review of periodic reports, mainly focused on checking whether they are submitted within the deadlines established by the LA, and whether they are complete (vis-à-vis the forms and minimum content prescribed by the regulation or the LA).

In the past the RSEs have suspended companies for failure to comply with listing agreement obligations (143 and 1480 companies by the NSE and the BSE respectively). However based on the results of the meetings, it appears that there has been reluctance from the RSEs to apply such measure given the negative effects that it has on investors. This year SEBI constituted a committee on non compliance with listing agreements with participation from the nationwide RSEs. An important number of active companies (60 in the NSE and 365 in the BSE) were identified as non compliant with listing agreement obligations. As a result the committee recommended that the RSEs develop a plan of action to deal with such con-compliance. To start the committee required the RSEs to issue notice for appropriate action to the non complaint companies. In addition, the committee also recommended changes to the listing agreement, so that the sanctions for noncompliance were clearly spelled out in the agreement, including the possibility of money penalties, as well as additional actions to be taken by the RSEs, such as disclosure in their website of the non complaint companies, and a scoring system to assign weight to the different listing obligations.

SEBI informed that in the past money penalties have also been imposed on issuers which have not complied with listing obligations. SEBI highlighted that after the implementation of the revised provisions of clause 49 of the LA, it advised the RSEs to encourage/exhort the companies to ensure compliance with clause 49. It was also decided that periodic review of the compliance level of clause 49 will be undertaken and a review was carried out by the NSE and the BSE based on the reports filed by

	<p>the listed companies during the period January 2006 to March 2007. Upon review of and based on applying certain criteria (such as market capitalization and repetitive violations), five public sector undertakings (PSUs) and 15 private sector companies were identified and adjudication proceedings were initiated against them, to have a demonstrative effect. All these proceedings were disposed off and the adjudicating officer has levied penalty on six entities. Review of subsequent period is in progress and necessary actions would be initiated against the companies, which are found violating the provisions of clause 49.</p> <p>The FRRB and MCA conduct reviews of annual reports, mainly focused on the financial statements and their compliance with the applicable accounting standards. Thus, such reviews will be further discussed in Principle 16.</p> <p>Material events</p> <p>The RSEs are responsible for reviewing material events. In a few cases (bonus issue or rights issue), the RSEs verify the information before it is sent to the public. For others, such as corporate announcements and Board decisions, such review is done on a periodic basis.</p> <p>The RSEs actively monitor news reported in print and electronic pertaining to traded companies. The RSEs have established pre-determined criteria to filter the news. If necessary, clarifications are sought from the companies concerned, on the accuracy of such news. These clarifications are made available in the website of the RSEs, and also are issued as press releases. Intraday verification of news/ rumors for price sensitive information on leading websites if also carried out by the RSEs. In this regard, for example, 437, 252, and 132 rumor verification actions were carried out for the years 2007–2008, 2008–2009, and 2009–2010, respectively. In the event that a company denies news items referred to it, a letter is sent to the company advising it to take up the matter with the respective media organization. If the company confirms the news, a letter is sent advising it to take precaution to inform exchanges of all matters as required under Clause 36 of the Listing Agreement.</p> <p>The RSEs also have a process to seek clarifications from listed companies when there are significant price/volume variations.</p> <p>Finally, as backed by information provided by SEBI, material events are discussed in the weekly meetings that SEBI holds with the RSEs for purposes of discussing market developments.</p>
Assessment	Partly implemented
Comments	<p>The grade is a result of an evaluation of the current framework vis-à-vis question 6 of the Methodology, in particular in connection with enforcement of periodic reporting—which is part of the listing obligations.</p> <p>The information provided shows that the RSEs review periodic reports. However, such information (for example, the minutes of the committee on noncompliance) leads to conclude that the RSEs have not acted as vigorously as necessary in enforcing compliance by issuers with the listing/reporting obligations. Such information is consistent with the comments that the assessor received from multiple market participants, regarding the need to step up the mechanisms to enforce compliance with periodic obligations. They are also consistent with comments from the RSEs regarding their reluctance to use their suspension powers to deal with noncompliance with listing obligations. The recommendations of the recently created committee on noncompliance with listing obligations are a step in the right direction.</p>

	<p>Without taking it into consideration for the grade, the assessor recommends that SEBI along with the RSEs reviews whether the current arrangements to review material events should be strengthened so that such review is done on “real time” (right after the issuer has communicated the event). Indeed the RSEs would not be expected to review all material events; rather, as it is the case for news, they could develop a set of criteria/alerts to determine the cases that would be subject to review. In addition, the assessor recommends that SEBI considers instructing the RSEs to establish more specific deadlines for the submission of annual reports by debt issuers—as it is the case for equity issuers.</p> <p>Issues related to the reviews conducted by the FRRB and MCA on the financial statements are discussed in Principle 16.</p>
<p>Principle 15. Holders of securities in a company should be treated in a fair and equitable manner.</p>	
Description	<p>Shareholders’ voting rights</p> <p>Shareholders are entitled to vote in the election of directors etc. by virtue of the powers u/s 87 of Companies Act. Sec. 176 of the Companies Act provides for proxy voting. Section 192 A of the Companies Act allows passing of resolution through postal ballots (including e-voting).</p> <p>Members are entitled to cast as many votes as their number of shares. Section 265 of Companies Act provides an option to the company to adopt proportional representation for appointment of director. Section 252(1) also provides large companies an option to have directors elected by small shareholders.</p> <p>A director has to inform the Board of Directors his interest in respect of contracts or arrangement and cannot participate or vote if he is directly or indirectly interested as per Sec. 299/300 of Companies Act.</p> <p>Additional corporate governance requirements</p> <p>The LA imposes additional corporate governance requirements on equity issuers, including the appointment of independent directors as well as the creation of certain specialized committees to assist the Board in meetings its oversight function. In particular listed companies are required to have an audit committee, and a nominations committee.</p> <p>Major changes in structure and control</p> <p>Pursuant to section 391 of the Companies Act fundamental corporate changes such as merger and amalgamations have to be approved by a majority in numbers and $\frac{3}{4}$ in value of shareholders. Section 391 also requires the company to acquire the shares of shareholders dissenting from scheme or contract approved by majority.</p> <p>The SEBI (Substantial Acquisition of Shares and Takeovers) Regulations 2011 (Takeover Regulations, 2011), have become effective from October 22, 2011. The salient features of the Takeover Regulations, 2011 are given below:</p> <p>Regulations 3 to 5 of SEBI of the Takeover Regulations, 2011, requires a mandatory open offer from any person (“acquirer”) who wants to acquire (i) 25 percent; (ii) more than 5 percent in a year if the person is holding 25 percent or more but less than maximum permissible shareholding limit; and (iii) acquisition of control regardless of whether there has been an acquisition of shares or voting rights. Further, Shareholders holding shares entitling them to exercise 25 percent or more of the voting rights in the</p>

target company may, without breaching minimum public shareholding requirements under the listing agreement, voluntarily make an open offer to consolidate their shareholding.

The definition of acquirer covers any person who directly or indirectly acquires or agrees to acquire shares or voting rights, or the control of the target company, either by himself or with any person acting in concert with the acquirer. Control includes the right to appoint a majority of directors or control of management or policy decisions.

As per Regulation 7 of the Takeover Regulations, 2011, the open offer must be made for at least 26 percent of the total shares of the company. The Takeover Regulations, 2011, also provide that uniform price to be payable to all the shareholders, controlling or noncontrolling, irrespective of the fact that acquisition of shares have been made under an agreement or open offer. Thus the concept of paying higher price to promoters has been done away with in the Takeover Regulations, 2011.

Regulation 13 provides that the public announcement shall be made on the same date when the acquisition or agreement to acquire control or shares beyond the threshold limit is taken. The Public announcement with regard to an open offer shall be sent to all the stock exchanges on which the shares of the target company are listed, and the stock exchanges shall forthwith disseminate such information to the public.

Simultaneously, a copy of the public announcement shall also be sent to SEBI. Pursuant to public announcement, a detailed public statement shall be published within five days of the public announcement, in all editions of any one English national daily with wide circulation, any one Hindi national daily with wide circulation, and any one regional language daily with wide circulation. Such announcement has to be simultaneously submitted to SEBI.

Within five working days from the date of the detailed public statement, a draft letter of offer shall be required to be filed with SEBI. SEBI shall give its comments on the draft letter of offer within fifteen working days of the receipt of the draft letter of offer. SEBI is also authorized to require changes, if any, in the offering memorandum.

Regulation 8 provides specific guidance as to the price at which the offer should be made depending upon the trading status of the shares.

Disclosure of insiders and substantial holdings

Regulation 13 of the Prohibition of Insider Trading Regulation requires any director or officer of a listed company to disclose to the company the number of shares and voting rights held by him and his dependents as well as positions in derivatives within two working days from the moment of his/her appointment. Changes must also be disclosed, within the same deadline, even if such change results in shareholding falling below

5 percent, if the change exceeds Rs. 5 lakhs in value or 25,000 shares or 1 percent of total shareholding or voting rights, whichever is lower.

Such same regulation requires any person who holds more than 5 percent shares or voting rights in any listed company to disclose to the company the number of shares or voting rights held by such person, within two working days of the receipt of intimation of allotment of shares; or the acquisition of shares or voting rights, as the case may be. Changes to such positions must also be disclosed, within the same deadline, if they exceed 2 percent of the total outstanding shares or voting rights in the company. In turn, the company is required to disclose such information to the exchanges within two days.

	<p>Regulation 29 of the Takeover Regulations, 2011 requires any acquirer who acquires shares or voting rights that would entitle him/her to more than 5 percent of the shares or voting rights of a listed company to disclose the aggregate of its holdings of voting rights to the company and the exchanges, within two days of the acquisition of shares or voting rights or the receipt of intimation of allotment. Further shareholders holding more than 5 percent are also required to disclose, purchases or sells aggregating to 2 percent or more of the shares capital of the company. The details of such purchases and sale along with the aggregate shareholding after such sale or acquisition shall be made within two days of such acquisition or sale of shares.</p> <p>Regulation 30 requires yearly disclosures of number and percentage of shares applicable to every person who holds more than 25 percent shares or voting rights; and a promoter of a company.</p> <p>The disclosures as stated above shall be made within seven working days from the end of each financial year to (i) every stock exchange where the company is listed; and (ii) target company</p> <p>Enforcement of shareholders' rights</p> <p>Pursuant to Sections 397 and 398 of the Companies Act, the redress for oppression of minority shareholders rights or mismanagement, which stem from the Companies Act should be pursued by the shareholders via a suit brought before the Company Law Board/National Company Law Tribunal which can grant appropriate relief.</p> <p>SEBI does have the power to enforce compliance with the take over and insider trading regulations, as such regulations derive from the SEBI Act. In this regard, regulation 32 allows SEBI to issue a wide range of directions from directing the person to make a public offer to requiring disinvestment, cancellation of shares acquired in contravention to such obligations, and debaring any person involved from dealing in securities markets pursuant an investigation.</p>
Assessment	Broadly implemented
Comments	<p>The grade is a result of an evaluation of the current system vis-à-vis question 3d) of the Methodology, in particular the fact that in the case of a partial offer the acquirer can commit to buy the entire holding of the promoters, although at the same price to be paid to other shareholders. Before the reforms effective in October of this year, the regulations also allowed promoters to be paid a higher price, under certain circumstances. As regards the amount of shares to be bought from promoters vis a vis other shareholders, SEBI staff informed that the Committee set up for review of existing takeover regulations recommended that an offer shall be made for all outstanding shares thereby giving full exit opportunity to all shareholders. Considering the present restriction on banks from financing acquisitions, SEBI Board did not accept such recommendation. It however decided to enhance the minimum offer size from the present 20 percent to 26 percent of the share capital of the target company, thereby indicating the direction in which this policy shall move in future. Over a period of time, the policy will be reviewed based on the availability of bank finance for acquisitions, to ensure that other shareholders get equivalent exit opportunity vis a vis promoters.</p> <p>Overall the assessor considers that the elimination of the non-compete fee constitutes a significant improvement over the regime in existence prior to October 2011. However, eliminating the difference in the percentage of shares that could be acquired from promoters vis-à-vis other shareholders would be needed for full implementation. Such</p>

	elimination could be achieved either by establishing a pro-rata rule applicable to all shareholders or moving to a mandatory offer for the total of the shares. In the meantime the assessor recommends that SEBI conducts active monitoring of these new provisions and amend them as necessary if in practice the end result is that only promoters are getting an exit in the event of a partial offer.
Principle 16.	Accounting and auditing standards should be of a high and internationally acceptable quality.
Description	<p>Obligations of listed companies</p> <p>As indicated in Principle 14 as part of their annual reporting listed companies (whether they issue equity or debt) are required to submit annual audited financial statements. In addition, the listing agreements require equity issuers to submit quarterly financial statements and debt issuers to submit semiannual financial statements which are subject to limited review. As per the Companies Act, such statements must be prepared according to the accounting standards approved by the Institute of Chartered Accountants of India (ICAI), on the basis of the procedures described below. Further, as per the Listing Agreement, the listed companies have to mandatorily comply with all the Accounting Standards issued by Institute of Chartered Accountants of India (ICAI) from time to time. Auditors must conduct their audits of such statements according to the standards approved by ICAI.</p> <p>Accounting and Auditing Standards</p> <p>ICAI is a statutory body established under the Chartered Accountants Act of 1949. It is in charge of establishing accounting and auditing standards. To this end it has constituted separate committees, the Accounting Standards Board (ASB) and the Auditing and Assurance Standard Board (AASB). Both Committees have wide representation of public interest and have representatives of regulators, industry chambers and educationists besides members of Council of ICAI. SEBI is member of both Committees.</p> <p>Accounting standards</p> <p>The formulation of accounting standards is subject to governmental oversight via the National Advisory Committee on Accounting Standards (NACAS), which was constituted in 2001 under the Indian Companies Act, 1956. NACAS role is to review the standards and recommend whether changes need to be made. Based on such recommendation, ICAI makes changes if necessary and the accounting standards are notified by the CG.</p> <p>The current standards that apply to listed companies are Indian GAAP. The opinion of experts is that in a few areas Indian GAAP do not require as rigorous disclosure as other accounting standards, such as IFRS. Two examples given are financial instruments and acquisitions. The authorities also informed that India is in a process of convergence toward (rather than adoption of) IFRS. ICAI has already issued “equivalent” standards and those standards were already notified by the CG in February 25, 2011. Adoption will be done on a gradual basis (a period of three years). It is expected that implementation will be finalized by 2014, but the CG has not officially notified the dates for implementation. While the overall objective is avoid differences vis-à-vis IFRS, in a few areas such differences will remain. The intention of the Government is to initiate a dialogue with the IASB to address such differences.</p>

Auditing Standards

ICAI has adopted local auditing standards. However, under the Clarity Project it is seeking to adopt the International Standards on Auditing (ISA). There is currently no oversight mechanism for ensuring the compliance of auditing standards by the auditors. Though Companies bill placed in the parliament requires mandatory compliance with Auditing Standards.

The current framework allows publication of qualified financial statements. However, Clause 49 of the Equity Listing Agreement contains a non-mandatory requirement stating that company may move toward a regime of unqualified financial statements.

Auditors' independence

Section 226 of the Companies Act contains a few provisions aimed to ensure auditors independence. In particular an internal auditor cannot be the statutory auditor of a company or a person who is indebted to the company or who is holding the shares of the company cannot be appointed as a statutory auditor. ICAI has also issued a Code of Ethics and issued a Guidance Note on Auditor's independence.

Further, the Companies Bill placed in the parliament, has more stringent provisions pertaining to auditors' independence, including qualification, rotation, performance of non-audit services, and liability.

The current listing agreement requires that Audit Committee should recommend to the Board of directors regarding the appointment, re-appointment and, if required, the replacement or removal of the statutory auditor and the fixation of audit fees. Two thirds of the member of the Audit Committee should be independent directors.

Compliance with accounting standards by issuers

A Financial Reporting Review Board (FRRB) was constituted in 2002 to review compliance by issuers with accounting standards; however its nature is that of a non standing committee of ICAI which does not have direct enforcement powers. The FRRB has representatives from ICAI, as well as from different stakeholders including the regulatory authorities.

To perform this function the FRRB has developed certain criteria (mainly net worth, but also industrial class and random sampling) based on which roughly 150–200 companies are selected and their annual financial statements are reviewed.

Given its advisory nature, the FRRB does not have the power to request information from companies nor to take disciplinary actions against them. Thus if it finds deficiencies, it notifies them to MCA or SEBI (in the case of listed companies).

The FRRB had referred 53 cases pertaining to financial year 2003–04 to 2006–07 to SEBI. SEBI analyzed the reports of the FRRB and discuss them in a subcommittee of SEBI Committee on Disclosures & Accounting Standards (SCODA). Out of 53 audit reports, eight audit reports had qualifications. Out of these eight qualified reports, seven audit reports contain "subject to" type of audit qualifications which are considered technical in nature. In respect of three qualified audit reports, the qualifications were recurring in nature and were not rectified by the management.

These findings were discussed by the sub-group , which recommended that a mechanism should be created through which the impact of such audit qualifications can be ascertained on the financial position of the listed entity and action may be taken

against the management of the company, in the interest of the investors. These recommendations are being considered for implementation by SEBI.

Below a table of information with the total number of cases taken up for review and referred to regulatory authorities by FRRB from 2008–09 to 2010–11.

	2010–11	2009–10	2008–09	Total
Total no of reviews commenced during the year	175	136	148	459
Number referred to Ministry of Corporate Affairs and SEBI	4	10	Nil	1

MCA also conducts reviews of the annual financial statements of listed companies. Scrutiny is done based on two parameters. First MCA reviews the statements of companies which have done an IPO since 2001. This involves 20 percent of SEBI' actively traded companies. Second, MCA reviews the financial statements of a number of companies which are selected based on a warning/alert system based on nine parameters as well as complaints received against the company. Such parameters include among others the listed status of the company, balance sheet, and turnover. The system is fairly recent and is being tested for improvements if any. The instruction to the RoCs is to cover as many companies as possible, but in practice the objective is to cover around 20 percent of all companies.

Enforcement actions, if any, would be in terms of the provisions of the Company Act which includes monetary penalties. In addition, if such reports involve violations to SEBI Act, then the RoCs would communicate them to SEBI. However, information was not available as to the results of such reviews, and whether any enforcement action has come out of them. In addition, to the off-site reviews of financial statements, MCA has the power to conduct on-site inspections pursuant to Section 29 A of the Companies Act. As per its Annual Reports, such inspections are mainly carried out as a result of complaints received. As per such reports, the number of companies inspected during last five years is as follows

Year	No. of Inspections
2005–06	253
2006–07	220
2007–08	189
2008–09	207
2009–10	204
.04.2010–31.12.2010	168

Such data includes inspections of unlisted and listed companies. In the case of listed companies, SEBI has been periodically in receipt of abstract of inspection reports from MCA relating to violation of clauses of listing agreement and SEBI Regulations, which were forwarded to the RSEs for necessary action at their end. Recently SEBI created a database of inspection reports forwarded by MCA to SEBI.

Apart from the regular investigations carried out by officials of MCA, certain investigation cases are entrusted to the Serious Fraud Investigation Office (SFIO) on certain grounds/criteria, (one of the grounds being investigation of listed companies). SFIO, set up by Ministry of Corporate Affairs, is a multi-disciplinary investigating agency, wherein experts from banking sector, capital market, company law, law, forensic audit, taxation, information technology etc. work together to unravel a corporate fraud. As per the details in the annual report of MCA, during the period from 1st April 2010 to 31st December 2010, six cases were referred to MCA. So far, 79 cases have been referred to SFIO for investigation. Out of these, SFIO has submitted investigation reports in 52 cases as of 31.12.2010, two cases have been either stayed or dismissed by the courts and the remaining cases are under investigation. As of 31.12.2010, 823 cases of prosecution have already been filed in the different courts against the persons involved in fraudulent activities in the companies.

In addition, after the developments surrounding Satyam Computer Services, SEBI undertook a review of the last quarterly results and the last audited annual financial statements for companies constituting the NSE-Nifty 50, BSE-Sensex and some other listed companies (on a random basis). The sample selected covered companies which comprised 60 percent of total market capitalization. SEBI informed that this exercise is not intended to be a onetime exercise but could be repeated, if alternative mechanisms such as the Quality Review Board (QRB) described below are not fully functional.

According to SEBI the peer review exercise carried out by SEBI for companies constituting the NSE-Nifty 50, BSE-Sensex and some other listed companies did not suggest any significant adverse findings which warrants actions from the regulators.

Compliance with auditing standards and auditors requirements

ICAI established the Peer Review Board in 2002, which undertakes peer reviews of firms with focus on documentation and processes adopted for the engagements to ensure compliance with technical standards. It issues peer review certificates if the compliance, processes and documentation are found to be satisfactory. Such certificate is valid for a period of three years. As per SEBI's circular dated April 05, 2010, in respect of all listed entities, limited review/statutory audit reports submitted to the concerned stock exchanges shall be given only by those auditors who have subjected themselves to the peer review process of ICAI and who hold a valid certificate. Further, SEBI has mandated that financial information disclosed in the offer document need to be signed by auditors holding peer review certificates.

FRRB findings on the reviews discussed above can also form the basis for initiating action against the auditor under the Chartered Accountants Act, 1949.

Under the Chartered Accountants Act, ICAI has disciplinary powers over auditors. Such function is exercised via a Disciplinary Board, the Disciplinary Committee and Appellate Board which has representation of members appointed by the CG, in addition to representatives of ICAI. ICAI informed that it has been active in applying disciplinary measures against auditors. ICAI has initiated action against 306 members in the past 3 years and found 115 members guilty. The List of Persons/Members found guilty under First & Second Schedule is displayed on ICAI website at the following link. http://www.icai.org/new_post.html?post_id=6400.

In addition in 2007, the CG constituted a QRB to review the quality of services provided by chartered accountants to provide guidance to them for improvement in quality of

	<p>services and to make recommendations to the Council of ICAI. The Chairman of the Board is appointed by CG and it has equal representation of ICAI Council members and members appointed by CG. The assessor was informed that such body is currently in the process of devising a strategy to fulfill its mandate.</p>
Assessment	Partly implemented
Comments	<p>The grade is mainly a result of an evaluation of the current framework vis-à-vis Questions 9 a) and b) of the Methodology, question 8b ii) and question 6 of the Methodology.</p> <p>The assessor acknowledges that currently two entities review compliance by issuers with accounting standards, one is the FRRB and the other is MCA—though limited to the annual financial statements. However a comprehensive analysis of all the information provided cast significant doubts as to whether proper follow up, including enforcement actions, is taken place, as further explained below.</p> <p>The review carried out by the FRRB has some inherent limitations given the advisory nature of such body, and thus the fact that it cannot request information from issuers. Furthermore the information provided does not allow the assessor to conclude that referrals by the FRRB have led to enforcement actions—although SEBI highlighted that is currently in the process of implementing certain recommendations derived from the analysis of referrals made by the FRRB.</p> <p>In the case of MCA, there is no information available regarding the outcome of the annual off-site reviews of financial statements, and whether enforcement actions have been taken as a result of such reviews. The assessor acknowledges that there is information on the number of on-site inspections conducted by MCA on companies (both unlisted and listed) and SEBI highlighted that an abstract from the inspections of listed companies has been made available to the RSEs for the corresponding actions. However, the minutes of the committee on non-compliance lead the assessor to conclude that the RSEs have not been active enough in ensuring compliance with listing obligations, including those related to financial statements.</p> <p>Thus, the assessor recommends that the current framework to ensure compliance by issuers with accounting standards be strengthened. The recent review performed by SEBI is a step on such direction. Further SEBI informed that it is planning to create a unit for such purpose. In such context, SEBI should review whether the current framework provides it with the authority to request restatements. Also, the recently created committee between SEBI and MCA should also have a positive effect in coordinating matters related to listed issuers, including enforcement matters. In the long term SEBI and MCA should review whether any functions related to listed companies should be discharged by SEBI only. The assessor also acknowledges that ICAI currently performs a role of ensuring compliance by auditors with technical standards. The website of ICAI shows that ICAI has pursued sanctions against auditors, although processes appear to be slow—as for example the Satyam case indicates. However, oversight by ICAI falls more on the nature of oversight by a professional body rather than “independent” oversight—although the assessor acknowledges that its creation by statute has given ICAI somewhat of a hybrid nature. Thus, the assessor recommends that the system be strengthened. The authorities are moving in such direction with the creation of the QRB; however it is not yet operational. In any case, the assessor encourages the authorities to review whether its composition would allow to consider the QRB as an independent mechanism for oversight of auditors.</p>

	<p>SEBI highlighted that the new Company Bill placed before parliament contains provisions for the establishment of an independent agency, the National Financial Reporting Authority, to oversee the functions of auditor, In addition, in its budget for 2011–2012 SEBI had stated that in its endeavor to further enhance the scope of its activities to more comprehensively monitor compliance with listing requirements, to respond to growing investor expectations, inter-alia, proposed to create a forensic account cell to improve quality of financial information disclosed and to assist in detection of financial irregularities so as to serve as an effective early warning mechanisms, Accordingly the cell was set up via Office Order dated February 2012.</p> <p>Finally, the current framework for auditor’s independence is limited. As mentioned in the description, the changes in the Companies Act would address such limitations.</p> <p>The IOSCO Principles do not require that financial statement be prepared according to IFRS; rather they require that financial statements be prepared in accordance of principles of “high international quality”. Thus, the fact that a country has not adopted the IFRS does not automatically lead to a downgrade. The authorities have emphasized that current Indian GAAP are fully consistent with the International Accounting Standards effective before IFRS were adopted, and thus should be considered of high quality. However the assessor strongly recommends that the IFRS equivalent standards be implemented as soon as possible. The ICAI has suggested April 1, 2013 for implementation of convergence with IFRS for listed companies.</p> <p>The assessor also recommends that a similar system of oversight be developed for the formulation of auditing standards. SEBI authorities informed that the CG is contemplating expanding the role of NACAS to cover also auditing standards.</p>
Principles for Collective Investment Schemes	
Principle 17.	The regulatory system should set standards for the eligibility and the regulation of those who wish to market or operate a collective investment scheme.
Description	<p>The Indian legal system recognizes two types of CIS:</p> <p><i>Mutual funds, which covers the majority (if not all) of the CIS that would fall under IOSCO’s definition, including all pools of assets that invest in financial assets, including securities, as well as real state.</i></p> <p><i>Collective investment schemes, which constitute a very narrow category of pools of assets which invest in agricultural projects/assets such as teak plantations.</i></p> <p>The respective regulations as per the regulatory framework are: the Mutual Fund Regulations, 1996 and the Collective Investment Schemes Regulations, 1999. The Regulations for CIS were initially developed to regulate activities such as plantations and agro-bonds. The scope is however extendable from these two activities to any activity that meets the CIS criteria as per the regulations. SEBI has been active in pursuing enforcement actions, including criminal sanctions, against entities that have been found to be conducting such activities without authorization. There are currently no CIS in operation. One Collective Investment Management Company (CIMC) is registered while one CIMC has been given a provisional authorization to operate, but no CIS has been floated. Given the definitions above, as well as the fact that in practice there are currently no CIS in operation. the assessment of the CIS principles focused on MFs. Where important differences exist in the regulatory framework, they will be highlighted in the corresponding Principle.</p> <p>The UTI Act was repealed in 2003, and UTI MF was brought under SEBI registration from January.</p>

Eligibility criteria for those wishing to sponsor or manage a MF

According to Section 11 (1B) of SEBI Act sponsoring or managing a collective investment scheme, including a mutual funds requires registration with SEBI.

As per such regulations, MF must be managed by an asset management company (AMC) The legal framework also requires a sponsor. There are eligibility criteria for both the sponsor and the AMC.

Eligibility requirements for sponsors

Regulation 7 establishes the eligibility criteria for sponsors of a MF which includes fit and proper requirements for the company, in particular a "sound track record". As per such regulation it shall mean:

carrying on financial services for not less than five years;

positive net worth;

the net worth in the immediately preceding year should be more than the capital contribution of the sponsor to the asset management company; and

the sponsor must have profits; and should contribute to at least 40 percent of the net worth of the asset management company.

Eligibility requirements for the AMC

Regulation 21 sets up the eligibility criteria for the AMC, which includes:

Fit and proper requirements for the company, as well as for directors, and proper requirements also for key personnel.

Independence requirements for the Board: a minimum of 50 percent of directors should not be associated with the sponsor or the trustees.

A net worth of not less than Rs. 10 cores (US\$2.12 million). The regulations do not require that such net worth be adjusted by risk. However SEBI highlighted that other requirements imposed on the AMC (in terms of risk management, business continuity, etc) in practice lead to a higher net worth. From the data available with SEBI as on August 31, 2010, it is observed that the top 10 mutual funds based on the average assets under management (AAUM) manage around 80 percent of the total industry AAUM. These AMCs have net worth in the range of Rs 578 million to Rs 10386 million.

AMCs are also required to buy insurance to cover against third party losses arising from errors and omissions. The level and type of cover should be determined by the trustees, subject to a minimum level of Rs 5 cores (US\$1 million). However, MFs with assets of less than Rs.100 cores may take insurance cover for an amount of less than Rs.5 crore (US\$1 million) as determined by their trustees. The premium for this cover may be paid for in accordance with Chapter VII, Section 52 (4) (b) (x) of the Securities and Exchange Board of India (Mutual Fund) Regulations, 1996.

AMCs are also required to have proper internal controls and risk management.

An AMC is authorized to provide other activities in the nature of portfolio management services, management and advisory services to offshore funds, pension funds, provident funds, venture capital funds, management of insurance funds, financial consultancy and exchange of research on commercial basis, provided that they do not conflict with the management of funds; that the management of funds is adequately

segregated from the other activities, and that the company meets capital adequacy requirements separately for each activity.

Registration process.

The registration process is done in two stages:

First, SEBI reviews that the sponsor meets the fit and proper requirements. Even if the sponsor is a regulated entity by SEBI or IRDA SEBI still conducts a background check that includes track record and complaints. Based on such review it provides an “in principle approval.” The follow up step is the registration of the asset management company. In such stage the sponsor needs to take all necessary steps to make the AMC operational. To register the AMC, SEBI conducts an inspection, and checks whether systems are robust and internal controls are in place.

Eligibility criteria for those selling MFs, and marketing a scheme

As per Section 12(1) of the SEBI Act buying, selling or dealing in securities (which includes units in CIS and MF) requires registration with SEBI.

SEBI has made mandatory for any entity/person engaged in marketing and selling of mutual fund products to pass the National Institute of Securities Markets (NISM) certification test (Advisors Module) and obtain a registration number from AMFI. To obtain such certification the interested person must attend the courses and pass an exam administer by the NISM. In addition, AMFI conducts a fit and proper review that includes a background check (“know your distributor”). Certification is valid for five years, at which point the person must reapply.

Sanctions for unlicensed operation

As indicated on Principle 9, SEBI can take a wide array of measures in order to deal with the operation of CIS without a license. They include directions, cease and desist orders, money penalties, as well as criminal proceedings.

SEBI has been active in pursuing persons/entities that have tried to raise and pool funds from the public without being register with SEBI. Furthermore, as indicated above, SEBI has successfully pursued criminal sanctions.

Off-site supervision

The AMC are subject to periodic reporting, in particular, they are required to submit to SEBI:

annual audited financial statements;

half yearly financial statements, with the aimed to oversee capital adequacy;

an independent systems audit by a CISA certified entity, every two years; and

a compliance report by the trustee on an annual basis. Staff indicated that SEBI has conducted orientation sessions for trustees to improve the quality of the compliance reports that they are required to submit.

Staff indicated that the current practice is to review all periodic reports submitted by AMCs.

On-site inspections

Until recently, an inspection of every active MF was carried out once in two years. These inspections were carried out by outsourced external agencies (chartered

accountants) who had good standing in financial service inspections. The terms of reference developed by SEBI required auditors to look at compliance with laws and regulations, as well as internal controls and risk management. SEBI staff informed that SEBI officials also accompanied them during inspections to ensure that all areas were covered and requisite data/information from AMC was placed before the inspection team on time.

In the past, SEBI had also carried out a limited number of specific purpose inspections of MFs as a result of investors' complaints/specific issues/ reporting of 'non compliance' by MFs in their periodic reporting to SEBI.

Based on the observations in inspection reports, MFs were issued warning letters considering the magnitude and seriousness of violations of SEBI regulations/guidelines. In addition, letters of deficiencies were issued to MFs to strengthen their systems and improve compliance standards. The details of inspection carried out are given below:

Inspection Period	No. of Mutual Funds Inspected	Warnings	Deficiencies
2003 –2005	29	8	12
2005 –2007	29	13	17
2007 –2009	36	22	25

In addition to the measures stated above, in a few cases "harder" measures have been imposed. In this regard, SEBI informed that in two cases where errors were found in valuation, the AMCs were directed to compensate the investors for the amount of loss which was Rs. 200 millions in one case and Rs. 30 million in other case. In addition, this year an AMC, its trustee and CEO were ordered to pay a significant amount of money under consent settlement proceedings.

From this year onwards, SEBI is adopting a risk- based approach for the Inspection of MFs. and shall select following MFs for inspection every year on the following basis:

Leading MFs that contribute at least 75 percent of total assets under management of the entire MF industry.

MFs having highest number of investors' complaints vis-à-vis number of investors records.

MFs where noncompliance was reported in previous inspection reports and during off-site monitoring.

MFs that have not been inspected in the last three years shall be inspected in the fourth year.

In addition, SEBI staff informed that theme-based inspections are becoming an integral part of the supervisory program. In this regard, thematic inspections to verify compliance of certain aspects, such as valuation and inter-scheme transfer (through inspection of top 10 debt fund houses) and reasons for difference in brokerage paid by different fund houses (through inspection of top 10 fund houses, which have paid highest brokerage and transaction cost), are being carried out.

	<p>Record-keeping obligations</p> <p>Regulation 50 of the MF regulations requires the AMC to keep books of accounts and records for a period of eight years. The PMLA regulations require them to keep client information for a period of 10 years.</p> <p>Conflicts of interest</p> <p>There are detailed requirement for avoiding conflict of interests. Trustees act as first level supervisors of schemes of MFs.</p> <p>Delegation of functions</p> <p>There are clear regulations concerning delegation of functions. In particular such regulations prohibit delegation of investment management. SEBI staff indicated that outsourcing is common in relation to certain unit holders' services activities (subscriptions and redemption), fund accounting and NAV calculation. However the regulations clearly establish that the AMC retains responsibility for the services outsourced as outlined in Regulation 25(3).</p>
Assessment	Broadly implemented
Comments	<p>The grade is a result of an evaluation of question 4 and 6 in connection also with question 8 of the Methodology. The new supervisory approach that SEBI started to implement in FY 2011–2012 addresses many of the shortcomings observed in the previous approach. In particular the need to ensure more intensive supervision of MFs that pose greater risk to the system, and the need to complement an institution based approach with thematic inspections. It is important that SEBI follows up in a few issues to achieve full implementation of this Principle. First, inspections themselves should focus more on a critical review of internal controls and risk management of the AMCs vis-à-vis their business model (types of funds, clients, etc). Second, SEBI should continue to enhance follow-up of findings from inspections, including when necessary through the imposition of “harder” enforcement measures. Overtime SEBI might wish to further enrich the criteria that it uses to determine the AMCs and funds that fall under the shorter cycle of supervision. Finally, it is important that SEBI upgrades its off-site monitoring systems, as planned, to allow for better analysis and thus identification of areas of focus for inspection. Once all these changes are fully implemented, a review of the grade would be warranted.</p> <p>The IOSCO Principles require financial capacity in an AMC but does not provide additional specifications (as it has in the context of other intermediaries). Thus, the lack of a risk-based capital should not be considered a deficiency vis-à-vis the IOSCO Principles. Many countries, however, require the adjustment of the capital of AMCs based on the amount of AUM. While SEBI has not formally adopted such type of framework, in practice it appears that AMCs hold more than the statutory capital, and there is also an insurance policy which coverage does differentiate by AUM, as explained above.</p> <p>A current case concerning an enterprise which is pooling resources from the public for real estate development has raised some concerns regarding whether in practice the definition of entities/activities subject to registration as CIS requires further guidance.</p>

Principle 18.	The regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client assets.
Description	<p>Legal form/investors' rights</p> <p>Legal form</p> <p>MF Regulation provides the framework governing the legal form and structure of MFs and the segregation and protection of clients' assets. According to Regulation 14 of MF regulations, a MF shall be constituted in the form of trust. A trust deed shall be executed by a sponsor in favor of the trustees. Contents of the trust deed are also governed by SEBI regulations.</p> <p>As per Regulation 29(1) of MF Regulations a MF has to disclose its legal form, structure of MF, and rights of unit holders in the standard offer document.</p> <p>As per Regulation 2(z) and (zi) MF Regulations, a unit holder holds units, each unit representing one undivided share in the asset of the scheme.</p> <p>Investors' rights</p> <p>Regulation 16(1) and 20(1) of MF Regulations, 1996 requires the appointment of trustees for the protection of the interests of unit holders. No AMC or its officers can be appointed as trustee. Regulation 16 establishes certain fit and proper requirements for any person eligible to be appointed as a trustee. In addition it requires that two thirds of the trustees be independent persons and shall not be associated with the sponsors. Pursuant to Regulation 17 their appointment requires SEBI's approval.</p> <p>Regulation 18 provides the trustees with a general oversight role over the management of the MF. As part of such role they are required to ensure that before the launch of any scheme the AMC has in place adequate systems; appointed key personnel with fit and proper requirements; appointed auditors, compliance officer, and registrar; specified norms for engaging brokers and marketing agents and prepared a compliance manual and developed internal control mechanisms. Furthermore the trustees are required to verify compliance by the AMC with all regulations and submit the corresponding report to SEBI on an annual basis. Regulation 25 establishes specific provision in regard to due diligence by the trustees.</p> <p>Separation of assets</p> <p>Regulation 26 requires that the fund has a custodian. No custodian in which the sponsor or its associates hold 50 percent or more of the voting rights of the share capital of the custodian can act as custodian for a fund constituted by the same sponsor. In practice custody services are concentrated in a few banks.</p> <p>As per Clause 5 of Code of Conduct, Trustees and AMC must ensure scheme-wise segregation of bank accounts and securities accounts. Thus, beneficial ownership of securities is recorded at the individual scheme level, at the CSD.</p> <p>Wind-up of a scheme</p> <p>Pursuant to Regulation 39 a scheme may be wound up:</p> <p><i>on the occurrence of any event, which in the opinion of the trustees requires it so;</i></p> <p><i>if 75 percent of unit holders pass a resolution on that regard;</i></p> <p><i>if SEBI directs it in the interests of unit holders;</i></p>

	<p><i>for this purposes trustees shall give notice to the Board and in two daily newspapers having circulation over India and in a vernacular newspaper; and</i></p> <p><i>pursuant to Regulation 41 the trustees should call a meeting of unit holders who by simple majority have the authority to authorize the trustee or any other person t take the necessary steps to wind-up the scheme. On the completion of the wind-up the trustees is required to submit a report to the Board and unit holders.</i></p>
Assessment	Fully implemented
Comments	
Principle 19.	Regulation should require disclosure, as set forth under the principles for issuers, which is necessary to evaluate the suitability of a collective investment scheme for a particular investor and the value of the investor's interest in the scheme.
Description	<p>Pursuant to Regulation 28 no scheme shall be launched by the AMC unless a such scheme is approved by the trustees and a copy of the offer document has been filed with SEBI.</p> <p>Regulation 29(1) of the MF Regulations, 1996 requires that the offer document contains disclosures, which are adequate in order to enable the investor to make informed investment decision. Further, an abridged form of offer document called 'Key Information Memorandum (KIM)' must be issued.</p> <p>Statement of Additional Information (SAI). In case of changes affecting the matter disclosed in SID and an addendum has to be issued.</p> <p>As per SEBI circular July 28, 2004, Key Information Memorandum (KIM) has to be updated at least once a year and as per SEBI circular SEBI/MFD/CIR/10/ 039/2001 dated February 9, 2001, offer document shall be fully revised and updated at least once in two years.</p> <p>In order to enhance as well as standardize disclosure standards by MFs in their offer documents, SEBI has issued standard observations vide circular dated MFD/CIR/06/275/2001 dated July 9, 2001. Disclosures in offer documents and KIM of schemes need to confirm to standard observations.</p> <p>Power to hold back or intervene in an offering</p> <p>Pursuant to Regulation 28 SEBI has the power to require changes in the offer documents. SEBI reviews all prospectuses. Review is done by an analyst and is subject to one additional level of review. SEBI has developed check lists as well as an operational manual to guide the review of prospectus. Additional guidance on specific aspects that in the past have been problematic has been given via email.</p> <p>Advertisements</p> <p>As per Regulation 30, advertisement in respect of a scheme shall be in conformity with advertisement code as specified in Sixth Schedule. As per clause 1 of advertisement code, advertisement shall be truthful, fair and should not contain untrue and misleading information. Further SEBI has prescribed detailed advertising guidelines vide circulars MFD/Cir/4/51/2000 dated 5th June 2000 and MFD/CIR/6/12357/03 dated 26th June 2003. As per regulation 49(1), the price at which units may be subscribed or sold and the price at which units may be repurchased has to be made available to the investors.</p>

	<p>Periodic and ongoing disclosure</p> <p>Pursuant to the MF regulation the AMC is required to submit to SEBI the following periodic reports:</p> <p><i>An annual report and annual statement of accounts for each MF (Regulation 54 of the MF). The annual accounts must be audited by an auditor who is independent from the auditor who audited the statements for the AMC. Pursuant to Regulation 57 such report must be submitted to SEBI within four months from the date of closure of each financial year. Pursuant to Section 56 should report or an abridged form of it should be mailed to all unit holders.</i></p> <p><i>Half year unaudited accounts (Regulation 58). Regulation 59 requires their publications within one month from the close of each half year.</i></p> <p><i>A quarterly statement of movements in the net asset for each scheme of the fund (Regulation 58).</i></p> <p><i>A quarterly portfolio statement, including changes from the previous periods, for each scheme.</i></p> <p>In addition Section 59A requires the AMC to send to all unit holders a complete statement of its scheme portfolio (unless it is published) within one month of the close of each half year. Staff mentioned that in practice most MFs send monthly statements.</p> <p>Trustees are required to submit to the Board on a half yearly basis:</p> <p><i>a report of the activities of the fund;</i></p> <p><i>a certificate stating that the trustees have satisfied themselves that there have not been instances of self dealing or front running by the trustees or AMC; and</i></p> <p><i>a certificate that the AMC has managed the schemes independently of any other activities.</i></p> <p>Accounting standards</p> <p>SEBI has prescribed the specific accounting policies and standards that MFs have to follow. Such policies and standards require stricter disclosures than those required under Indian GAAP.</p>
Assessment	Fully implemented
Comments	Providing statements to clients on a semiannual basis appears to be too long. Staff and market participants emphasized that in practice statements of account are provided to investors on a monthly basis. As a result this issue is not considered material. However, the assessor recommends that SEBI considers changing the current requirement to a shorter cycle.
Principle 20.	Regulation should ensure that there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units in a collective investment scheme.
Description	<p>Asset valuation</p> <p>As per regulation 47 of MF Regulations, every MF shall compute and carry out valuation of investments in its portfolio in accordance with valuation norms specified in Eighth Schedule and guidelines issued by SEBI.</p>

Frequency

NAV should be calculated daily for both open and close end funds.

Valuation of illiquid securities

SEBI has issued detailed guidelines for valuation of illiquid securities, both equities and debt securities. In the case of debt securities, two firms are required to provide bond valuation metrics (which are based on the government yield curve). AMCs are required to take the mean of the two metrics. If the spread exceeds three percent then the firms must review the prices. Currently two credit rating agencies Cricil and Ecra provide such service to the market.

Pricing and redemption

As per regulation 49 an open end fund must publish the sale and redemption price of units at least once a week in a daily newspaper of all India circulation. The repurchase price shall not be lower than 93 per cent of NAV and sale price not higher than 107 per cent of NAV. The repurchase price of close ended scheme shall not be lower than 95 per cent of NAV. The difference between the repurchase price and sale price of unit shall not exceed 7 per cent calculated on the sale price.

However, SEBI Circulars have further tightened these provisions. In this regard SEBI Circular dated June 30, 2009, has mandated the following:

There shall be no entry load for all mutual fund schemes.

The scheme application forms shall carry a suitable disclosure to the effect that the upfront commission to distributors will be paid by the investor directly to the distributor, based on his assessment of various factors including the service rendered by the distributor.

Of the exit load or Contingent Deferred Sales Charge charged to the investor, a maximum of 1% of the redemption proceeds shall be maintained in a separate account which can be used by the AMC to pay commissions to the distributor and to take care of other marketing and selling expenses. Any balance shall be credited to the scheme immediately.

Thus, the above provisions banned entry load which used to be in the range of 2-2.5 percent and tilted the preferences of the mutual funds toward exit loads of 1 percent or lower, as any higher load would have to be credited to the scheme.

To assess the actual situation with respect to loads, data as of September 16, 2011, was sought from the mutual funds.

The data collected revealed the following trends in charge of exit loads:

Total number of mutual fund schemes	Total number of schemes which charge no exit load	Total number of schemes which charge exit load of 1 percent and below	Total number of schemes which charge exit load above 1 percent
1403	809 (58 percent)	548 (39 percent)	46 (3 percent)

	<p>Thus, the data indicates that 97 percent of the schemes charge an exit load of 1 percent or less. Only 3 percent charge exit loads of more than 1 percent and even for these schemes, any load charged over 1 percent is credited back to the concerned scheme to the ultimate benefit of the investors staying invested in the scheme.</p> <p>In case of the 3 percent schemes that charge over 1 percent exit load, exit loads are the highest in the first year following the investment, and usually decrease to nil over the next two–three years. This has been intended to encourage longer term investment. Thus, a conclusion can be drawn that in a huge majority of the schemes (97 percent), the different between the sale and repurchase price is negligible, if any.</p> <p>As per current regulations all open end funds must redeem participation in t + 10. In practice however, MMF have redeemed in t + ½ and all other funds usually in t + 1.</p> <p>Disclosure</p> <p>Regulations 48 and 49 inter alia lay down provisions for disclosure of NAVs in newspapers and the websites of the AMC and AMFI.</p> <p>As per SEBI circular—SEBI/IMD/CIR No.5/96576/2007 dated June 25, 2007, NAV of the scheme shall be displayed on the Association of Mutual Fund of India (AMFI) website by 9:00 p.m. of the same day and for funds of fund scheme by 10:00 a.m. of the following day.</p> <p>Errors in pricing</p> <p>As per Clause 6 of Eight Schedule, there is a threshold of tolerance of 1 percent in regard to errors in pricing. If the error exceeds such percentage then the AMC must pay the difference to the unit holders from its own capital.</p> <p>Suspension of redemptions</p> <p>The prospectus shall establish the conditions under which suspension of redemptions can be made. In addition SEBI regulations would allow SEBI to direct an AMC to suspend redemptions, or to uplift a suspension.</p>
Assessment	Fully implemented
Comments	As indicated above currently CRAs are providing price vending services in addition to their rating services. In the medium term SEBI might wish to consider whether the provision of valuation services should be a regulated activity, and thus whether a specific set of regulations should apply to CRAs in connection with the provision of these services.
Principles for Market Intermediaries	
Principle 21.	Regulation should provide for minimum entry standards for market intermediaries.
Description	<p>Registration of intermediaries</p> <p>As per Section 12 of SEBI Act no market intermediary who may be associated with the securities market shall buy, sell or deal in securities except in accordance with condition of certificate of registration obtained from SEBI.</p> <p>SEBI has issued Intermediaries Regulation, which sets up basic general framework for the registration of intermediaries as well as a basic set of obligations applicable to all</p>

intermediaries. In addition, SEBI has issued specific regulations for various types of intermediaries including stock brokers, merchant bankers, underwriters, and portfolio managers. Such regulations lay down registration requirements, minimum entry standards and conditions of operating for each type of intermediary. There are no specific regulations for “pure” investment advisors; though the regulations on brokers and the regulations for portfolio managers contain provisions applicable to these two types of intermediaries in relation to advisory services.

Pursuant to Regulation 8(2) of the Intermediaries Regulation separate certificates of registration are needed if a company wishes to be registered in more than one category of intermediary (broker, merchant banker, portfolio manager, or underwriter). However, a registered merchant banker or stock broker may act as an underwriter without obtaining a separate certificate of registration as an underwriter. For all types of intermediaries except brokers the license is subject to renewal usually on a two/three year basis. SEBI informed that a system of permanent licenses has just been approved.

The basic framework applicable to all intermediaries includes “fit and proper” requirements for the applicant, the principal officer and the key management persons. As per Schedule II of the Intermediaries Regulation fit and proper requirements include: integrity, reputation and character, absence of convictions and restraint orders and competence including financial solvency and net worth. Minimum net worth differs according to the services provided, and will be further discussed in Principle 22.

In all cases the intermediary must submit an application, which include among others information on:

General detailed of the applicant and its affiliates (information on incorporation and legal status; activities; names of persons that hold directly or indirectly more than 5 percent of the shareholding or voting rights of the company; details of significant affiliates; details of the compliance officer, principal officers, key management personnel).

Details on arbitration/litigation that could have an adverse effect as well as on investors complaints.

Description of the group, tracing down to the individual persons in control.

Management details (directors, partners, trustees, and promoters).

Financial information (audited financial statements for the past three years and latest net worth of the applicant).

Infrastructure details

Pursuant to Regulation 8 SEBI can reject an application if the applicant does not fulfill the corresponding requirements. The applicant must be given an opportunity to be heard. Pursuant to Regulation 9 of the Intermediaries Regulation SEBI can impose conditions for registration as it may deem fit in the interest of investors or the orderly development of the markets. Section 11 (3) of SEBI Act provides SEBI with the authority to suspend or cancel registration.

The regulations governing merchant bankers, underwriters and registrars to an issue and share transfer agents required them to obtain prior approval of SEBI Board for change in control. In the case of brokers such prior approval is required also from the corresponding RSE. The existence of a license, its category and status is available on SEBI's website.

Brokers

Registration

Pursuant to the Stock Brokers Regulation, stockbrokers must submit their applications to the RSEs, which are the main entity responsible to check that the requirements set forth in the Regulations, as well as the By-Laws of the respective exchange are met.

For this purpose, the RSEs have constituted registration committees. The RSEs do not conduct on-site visits for purposes of granting a license. However, SEBI highlighted that the RSEs conduct compliance visits on newly registered brokers to review infrastructure and “orient the stockbrokers” regarding various operational aspects. The RSEs receive a certification from an auditor in regard to the net worth requirement. SEBI receives requisite documents and declarations from the RSEs.

Brokers are required to obtain pre-approval from the RSEs for changes in control, as well as certain material changes such as changes in Board members.

In addition to fit and proper requirements as defined above, the stock brokers regulations require that the applicant:

be eligible to be admitted as a member of a SE;

has the necessary infrastructure, including equipment and human resources; and

has experience in the business of buying, selling or dealing in securities.

Off-site reporting

Brokers are required to submit to the SE:

on an annual basis, audited financial statements;

semiannual unaudited financial statements; and

on a semi-annual basis, they are required to submit an audit report on their compliance with SEBI’s Act, as well as on the effectiveness of their systems to redress investors’ grievances.

On-site inspections

On-site inspections are primarily a responsibility of the RSEs. In 2009 SEBI instructed the RSEs to conduct on-site inspections of all active brokers on an annual basis. Active brokers are defined as those with a minimum of 50 clients and at least one transaction during the year. Currently there are roughly 1,500 active brokers. The RSEs have developed a risk based approach to determine the intensity of the inspections. To this end, brokers have been divided in three categories based on a set of criteria that includes among others trading volume, number of clients, funds settled and number of complaints.

In addition, staff informed that SEBI started to conduct its own inspections on brokers, which SEBI called “purpose driven.” The criteria to select the brokers to be inspected include the number of complaints, the findings of reports from the RSE as well as previous sanctions imposed. In 2008–2009, SEBI conducted 38 of such inspections, while in 2009–2010 it conducted 36. These inspections are in addition to the inspections explained under Principle 7, which are directly aimed at ensuring the quality of the inspections carried out by the RSE. SEBI also conducts “for cause” inspections based on complaints received against the broker. SEBI staff informed that from time to time

SEBI has also conducted “thematic” inspections (sweeps); but they have not been a regular part of the supervisory approach.

Other intermediaries (Portfolio managers, merchant bankers and underwriters)

Registration

SEBI uses a two step process for the registration of portfolio managers, merchant bankers and underwriters, whereby it provides an “in-principle approval,” and on a second stage it conducts on-site inspections to determine that all necessary infrastructure, human resources and IT are in place and working well.

Off-site reporting

Other intermediaries are subject to the following periodic reporting obligations:

annual audited financial statements;

half yearly un-audited financial statements (regulation 15 for merchant bankers, and 18 for portfolio managers; and

on an annual basis the compliance officer must submit a report stating that the intermediary has complied with all relevant regulations and that the information provided in the applications remains true.

Half-yearly reporting by merchant bankers relating to their merchant banking activities.

On-site inspections

SEBI does not have a regular inspection program for PMs. However licenses for PMs must be renewed every three years. As part of the renewal process SEBI conducts an inspection where it checks on-going compliance with entry requirements, including for example the infrastructure and handling of customers’ complaints.

In the case of merchant bankers, prior to 2011 SEBI did not have a comprehensive program of on-site inspections; and only a few inspections were conducted on a yearly basis (for example for 2007–2008 two inspections were conducted, none for 2008-2009, and two for 2009–2010). It must be highlighted, however, that this year SEBI shifted its approach, and introduced risk-based criteria to decide on the inspections to carry out. As a result this year SEBI conducted inspections on the top 10 MBs by number of issues.

Record-keeping requirements

All intermediaries must keep records for a period of a period of 10 years pursuant to the PML rules.

Eligibility criteria for individuals

Regulation 3 of the Certification of Associated Persons in the Securities Market, 2007 establishes that SEBI can require such categories of associated persons to obtain requisite certificate for engagement or employment with such classes of intermediaries and from such date as may be specified by notification.

SEBI has set up the National Institute of Securities Market (NISM) to implement the certification program, to accredit organizations for administering certification examination and conducting Continuing Professional Education program. NISM also maintains a register of persons who hold valid certificates.

	<p>Pursuant to notifications of SEBI the following individuals are subject to certification:</p> <p><i>Persons associated with a stock broker/trading member/clearing member involved in (i) asset or funds of investors or clients; (ii) redress of investors grievances; (iii) internal control of risk management; and (iv) activities having bearing on operational risk are required a certification from the National Institute of Securities Markets (NISM).</i></p> <p><i>Distributors, agents or any persons employed or engaged in the sale and/or distribution of mutual fund products. In this case the certificate can be given by AMFI.</i></p> <p><i>Persons associated with a trading member of the currency derivatives segment, and that are approved users and sales personnel.</i></p> <p><i>Persons employed with a registrar to an issue or share transfer agent.</i></p> <p>Dealing or interacting with investors or clients (i) dealing, collecting, or processing applications; (ii) dealing with matters related to corporate actions, refunds, redemptions, and repurchase of securities; (iii) handling redressal of investors grievances; (iv) responsible for internal controls and risk management; (vi) responsible for compliance of securities laws; and (viii) maintenance of book and records.</p>
Assessment	Partly implemented
Comments	<p>The grade is a result of an evaluation of the current framework vis-à-vis question 7 of the Methodology, in particular deficiencies in the supervisory approach. These limitations will be further explained below.</p> <p>The main deficiencies identified in regard to the supervisory approach for intermediaries different from brokers are the lack of a regular/comprehensive inspection plan for PMs, the fact that only this year a more comprehensive inspection plan was conducted on MBs, the need to enhance the quality of inspections by focusing more on an understanding of risks (and controls and risk management). In the case of brokers, the limited resources currently allocated by the RSEs to the annual inspection program raises concerns about the quality of such inspections, even under a risk-based approach. All these deficiencies have been further explained in Principle 10. SEBI is currently in the process of making changes to its supervisory approach that are consistent with the recommendations made in Principle 10.</p> <p>India has the particularity that it allows individuals to be brokers, rather than only corporate bodies. The authorities have highlighted however that the requirements for an individual brokers are substantially the same than for a corporate body, including capital requirements. Furthermore the RSEs have not found significant differences in the level of compliance with regulations of individual versus corporate brokers; nor on complaints, or settlement problems. In such context the assessor does not consider this a material weakness.</p> <p>The Principles do not require a system of licensing/registration of investment advisers provided that they do not deal on behalf of clients or hold investors assets. Thus, the lack of regulations for investment advisers has not been taken into consideration for the grade. Nevertheless staff mentioned that SEBI is currently in the process of developing a framework for investment advisers, which will include mandatory membership in a self-regulatory organization. The assessor welcomes such regulations, in particular because it would also allow to distinguish more clearly tied agents from actual investment advisers (which should be independent).</p>

Principle 22.	There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake.
Description	<p>SEBI regulations establish four categories of intermediaries: brokers, underwriters, merchant bankers and portfolio managers. Each category of intermediary is subject to a minimum capital (net worth) requirement that should be kept at all times. In the case of brokers capital requirements are set forth by the respective SE; while in the case of merchant bankers, underwriters and portfolio managers the requirements have been set up by SEBI regulations. Intermediaries are required to hold the minimum capital of all the categories for which they request a license (i.e., minimum capitals would be added up depending on the licenses requested).</p> <p>Broker dealers</p> <p>Minimum capital differs in each exchange and depending on the segment where the broker is active. The minimum capital for a member of the cash segment in the BSE is Rs 10,00,000 (US\$20,925). Such capital must be kept at all times. There are no requirements to adjust such capital based on the risks of the activities that the broker is undertaken. However, to trade on the exchange the broker is required to make an initial deposit in cash or near cash of Rs100,00,000. Such deposit allows the broker to trade up to certain volume and it is adjusted via margins depending on the exposure that it holds on the exchange. Further explanations in regard to the margins will be given under Principle 29. The By Laws do allow the RSEs to impose additional capital requirements on brokers if necessary.</p> <p>Brokers are also required to contribute to the settlement guarantee fund (with an initial contribution of Rs 10,00,000 (US\$20,925), as well as with the investor protection fund (with an initial contribution of Rs 2,50,000 or US\$5,231).</p> <p>Underwriters</p> <p>Regulation 7 requires a net worth of Rs 20 lakhs (US\$41,850), which must be kept at all times. There are no requirements to adjust capital to the risks undertaken. However, Regulation 15 prescribes that the total underwriting obligations shall not exceed 20 times the net worth of the underwriter.</p> <p>Merchant bankers</p> <p>Regulation 7 requires a net worth of not less than five crore rupees (US\$1 million), which must be kept at all times. Such capital does not have to be adjusted by risks.</p> <p>Portfolio managers</p> <p>Regulation 7 of the Portfolio Managers Regulation requires their net worth to be not less than two crore rupees (US\$0.42 million), which must be kept at all times. There are no requirements to adjust such capital by the actual level of risks/activities undertaken.</p> <p>Compliance with capital requirements</p> <p>The RSE are responsible for monitoring compliance of brokers with their capital requirements. The SE can take a wide array of actions if capital levels deteriorate or the broker fails to pay the margins. Such actions can include suspension of further activity, or enrolling of new clients, or suspension of the membership itself.</p> <p>Monitoring of capital adequacy for all other intermediaries is done by SEBI, via the half yearly financial statements that they are required to submit. SEBI can take different actions if capital levels deteriorate including suspension or cancellation of registration.</p>

	<p>Risks from unlicensed affiliates</p> <p>SEBI regulations require a “no objection” by SEBI of the constitution of a foreign affiliate company by a regulated entity. In the case of domestic affiliates such action is not required; however permission of the corresponding RSE is required by the By Laws of the RSEs. Through such mechanism SEBI or the RSEs can address risk arising from the activities of affiliates, for example by imposing conditions. SEBI provided examples where it has in fact done so.</p> <p>Risks from financial conglomerates</p> <p>As indicated in Principle 1, the regulatory authorities have set up two committees to deal with financial conglomerates. The current approach is based on the identification of a lead supervisor, to whom the conglomerate is required to send periodic information. The technical committee meets on a quarterly basis to discuss issues of concern. The high level committee meets with the CEOs of the financial groups on a semi-annual basis.</p> <p>There are currently 12 financial conglomerates. In eight of them the RBI is the lead regulator, given the existence of the bank in the group, in one SEBI is the lead regulator and in 3 IRDA is the lead regulator.</p>
Assessment	Partly implemented
Comments	<p>The grade is a result of an evaluation of the current framework vis-à-vis questions 2, 3, 4, 6, and 8 of the Methodology.</p> <p>As described above the current legal and regulatory framework does require intermediaries to hold a minimum capital not only at the moment of authorization, but at all times. In addition, intermediaries must hold the minimum capital of all categories for which they hold a license. Arguably such feature involves some adjustment of the capital adequacy framework by risk. However, in the opinion of the assessor the categories are not well segmented in terms of the risks that they involve, in particular in the case of the brokers category, as for example a broker that conducts proprietary trading would have the same minimum capital requirement that one that only conducts trading on behalf of third parties. Thus, these are limitations vis-à-vis question 2 of the methodology.</p> <p>More importantly, once that minimum capital is paid, the framework does not require an adjustment of such capital according to the risks that each intermediary is actually undertaken (whether a broker, an underwriters, a merchant banker or a portfolio manager). Thus, the framework has limitations vis-à-vis question 3 of the methodology. In the case of brokers, arguably there is some adjustment by risks, given that the initial cash deposit with the RSEs allows the broker to trade up to a certain limit, and if the brokers wish to exceed such level of trading activity, it would need to increase the initial deposit. But such adjustment only impacts trading in the RSEs. Thus, for example, the fact that such trading is on behalf of third parties or for proprietary trading, would not end up having an impact in the capital of the broker. In practice this situation has not caused disruptions to the market because settlement risk is managed through CCPs with the corresponding margin requirements and contribution to a settlement fund, brokers conduct their proprietary trading with own funds, and leverage is minimal. Daily monitoring of the capital position by the RSEs also help to limit the risk of disruption.</p>

	<p>A similar problem with the capital formula is present in the case of merchant bankers and underwriters, since they are required to hold the same minimum capital irrespective of the level of exposure taken in the different issues that they commit to underwrite. Current business practices appear to have limited the risk of market disruption, since issues have usually being oversubscribed and thus in the event that some retail customers walk away from their expressions of interest, there have been more investors ready to take their position. However, capital reporting for merchant bankers, as well as for all other intermediaries different from brokers is done on a semi-annual basis which is too long for SEBI to be able to be forward looking. Thus, the framework also has limitations vis-à-vis questions 6 and 8.</p> <p>Accordingly, the assessor recommends that a risk-based capital system be implemented, starting with minimum capital requirements that would already take into consideration the different risks of the activities authorized, and which would need to be adjusted on an on-going basis based on the actual risks that the intermediary undertakes (credit, market, liquidity, operational, etc.). In practice that means, for example, that the minimum capital requirement for a broker that only wants to trade on behalf of third parties would be different (lower) than that of a broker that wants to take proprietary positions. On an ongoing basis the capital that each broker would be required to hold would depend on their actual level of “activity”/risks.</p> <p>In tandem, reporting of capital adequacy for intermediaries different from brokers should be strengthened. In this regard, SEBI could consider, for example, quarterly reporting of financial statements, along with a monthly reporting of capital adequacy (or at least the latter), with an obligation from the intermediary to immediately notify SEBI if the actual capital falls below a certain threshold.</p>
Principle 23.	Market intermediaries should be required to comply with standards for internal organization and operational conduct that aim to protect the interests of clients, ensure proper management of risk, and under which management of the intermediary accepts primary responsibility for these matters.
Description	<p>Adequate management and organizational structure</p> <p>The Code of Conduct for intermediaries require them to have <i>good corporate policies and corporate governance; internal control procedures and financial and operational capabilities which can be reasonably expected to protect its operation, its clients, investors and other registered entities from financial loss arising from theft, fraud, and other dishonest acts; and adequate infrastructure, as well as operating procedures and systems which should be backed by operation manuals.</i></p> <p>In addition, there are also circulars that require specific types of intermediaries to implement specific controls for specific types of activities.</p> <p>Further, as per SEBI Insider Trading Regulations, the intermediary has to lay down systems and procedures to restrict access to confidential information, segregation and Chinese wall, system and procedure for prevention and misuse of price sensitive information. These guidelines require that the employees who have confidential information shall be physically segregated from other employees.</p> <p>Current regulations require all types of securities intermediaries to appoint a compliance officer who is responsible for monitoring the compliance of the entity with legal and regulatory requirements. (Regulation 18A of the Stock Brokers Regulation;</p>

23A of the Portfolio Managers Regulation; 28A of the Merchant Bankers Regulation and 17A of the Underwriters regulation). The compliance officer shall report any material non compliance to the Board of the intermediary, as well as to SEBI. In addition, starting in 2009 securities intermediaries, except merchant bankers and underwriters are required to carry out a complete internal audit on a half yearly basis by an independent qualified Chartered Accountant, Company Secretary or Cost and Management Accountant, who should not have any conflict of interest. The audit shall cover, inter alia,

the existence, scope and efficiency of the internal control system;

compliance with the provisions of the respective laws and regulations;

data security and insurance in respect of operations, and

efficacy of the investor grievance redressal mechanism and discharge of various obligations toward clients.

The internal auditor shall submit the audit report to the member, as well as the respective SE within three months from the end of the half year period.

Redress of investors grievances

Current regulations require intermediaries to make endeavors to redress investors' grievances promptly within 30 days. They are also required to keep records of complaints received and how they have been redressed. On a quarterly basis intermediaries must submit information to SEBI on the complaints addressed and those that remained unresolved beyond three months. And SEBI receives also monthly reports from the RSEs. The statistics collected by SEBI showed that there is an important backlog by intermediaries. However they also showed that such backlog is diminishing, as indicated in Principle 10.

In the case of brokers the By-Laws of the RSE require that an arbitration system be in place. Thus, if the investor is not satisfied with the way the broker handle its complaint, he/she can request to go to mediation. If mediation fails, the case can be submitted to arbitration. Cases are heard by unipersonal arbitrators or a panel depending on the value of the claim. Both parties are allowed to nominate an arbitrator. Decisions of arbitrators can be appealed before the civil courts within 90 days, but in the case that the arbitrator required that compensation be given to the investor, the amount must be deposited with the RSE, irrespective of the appeal. Overall a case submitted to arbitration is finalized within six months. In SEBI's opinion the arbitration system developed by the SE has worked well. On average cases are finalized in six months.

Pursuant to the Master Circular on Oversight of Members the RSE must keep all complaints in the website.

SEBI staff informed that SEBI is currently in the process of developing a centralized system that will consolidate all complaints received from clients against regulated intermediaries, along with the actions taken. Investors would be able to consult at any point in time the status of their complaints.

Segregation of assets

The Code of Conduct for Intermediaries require them to segregate each client's funds and securities separately from their own.

Regulation 15 of the Portfolio Managers Regulation requires discretionary portfolio managers to individually and independently manage the funds of each client in accordance with the needs of clients. In the case of non-discretionary managers the same obligation of separate accounting applies; in such case the portfolio manager should manage the portfolio according to clients' instructions.

Such Regulation also requires portfolio managers to keep the funds of all clients in a separate account to be maintained in a commercial bank regulated by RBI. In the case that assets under management amount to Rs 500 crores (US\$105 million) or more the portfolio manager is required to appoint a custodian in respect of securities.

Conflict of interest

The Code of Conduct for Intermediaries requires them to avoid conflict of interest, and to put in place mechanisms to resolve any conflict of interest that may arise. Furthermore, an intermediary shall make appropriate disclosure to clients of potential areas of conflict

Suitability obligations

The Code of Conduct for Intermediaries contains a general obligation for all types of intermediaries to protect the interest of clients and render the best possible advice having regard to the investors' needs.

Regulation 14 of the Portfolio Managers Regulation requires portfolio managers to gather information about the client on the investment profile of the client as well as his/hers detailed investment objectives, and document it.

Information to clients

The Code of Conduct for Intermediaries requires them to ensure that adequate disclosures are made to the clients in a comprehensive and timely manner to enable them to make a balanced and informed decision.

Regulation 21 of the Portfolio Manager Regulation requires them to provide statements of account to clients at least on a half-yearly basis, as well as when required by the clients. Such reports should contain information on the composition and value of the portfolio, transactions undertaken in the period, beneficial interest received in the period, expenses incurred and details of risks foreseen by the manager.

Regulation 14 of the Portfolio Managers require them to enter into an agreement with clients, which should define rights, liabilities and obligations relating to the management of the clients' funds. SEBI has prescribed a minimum content for such contract, which should include issues such as areas of investment and restrictions if any, procedures of settling clients' accounts, fees, custody of securities, type and frequency of reports to clients.

Such regulation also requires them to provide clients with a disclosure document prior to entering into an agreement with them. SEBI has prescribed a minimum content for such document, which should include information on fees, portfolio risks, disclosures in related to related party transactions and performance of the portfolio manager. Current regulations require that such statements be given at least every six months.

	<p>Investment advice</p> <p>As stated in Principle 21 there is no specific regulation for investment advisors. The Regulations for brokers and portfolio managers do include general obligations in regard to the provision of investment advice by these two types of intermediaries. In general such obligations require them not to provide advice unless they have ground to believe that the recommendation is suitable to the client. Investment advice in publicly accessible media shall include a disclosure of interest of the broker as well as the specific employee responsible for it. SEBI on September 9, 2011, has issued a concept paper proposing a framework for regulation of investment adviser through a SRO. The entities who give personalized investment advice for consideration are prepared to be regulated under this framework.</p>
Assessment	Broadly implemented
Comments	<p>The grade is a result of an evaluation of the current framework vis-à-vis question 1b) in connection also with question 2 of the Methodology.</p> <p>The requirement of a semi-annual audit has come to strengthen the oversight of internal controls and risk management. However, as indicated in the description it does not apply to MBs or underwriters. SEBI has highlighted that for both intermediaries, the regulations do prescribe the need for them to having adequate internal controls. In addition, SEBI indicated that while there is no explicit requirement that an objective assessment of internal controls be carried out, compliance officers must report to SEBI instances of non-compliance. The assessor acknowledges the important role played by compliance officers, however vis-à-vis the Principles it is important that an explicit periodic objective assessment be in place, along with reporting on its results.</p> <p>In any case, as indicated under Principle 10, inspections carried out on intermediaries should more explicitly deal with internal controls and risk management. Finally the development of more comprehensive guidelines in regard to internal controls and risk management—rather than circulars that address specific types of controls—would be beneficial, especially if SEBI moves to a risk-based capital system.</p>
Principle 24.	There should be a procedure for dealing with the failure of a market intermediary in order to minimize damage and loss to investors and to contain systemic risk.
Description	<p>Plan to deal with the failure of an intermediary</p> <p>The by-laws of the SEs contain detailed procedures to deal with the event of default of a broker, which are further explained in Principle 29. SEBI has not developed similar procedures for other types of intermediaries. However staff does not consider them critical given that in practice all other intermediaries are mostly “fee-based” and the risks to clients are addressed through separation of accounts and the power of SEBI to transfer clients’ accounts.</p> <p>Early warning mechanism</p> <p>For intermediaries other than brokers SEBI oversees their financial solvency via the half-yearly financial statements.</p> <p>The RSEs have taken primary responsibility for overseen capital adequacy of brokers. They do so on a daily basis. In addition, as will be further explained under Principle 29, the RSEs have established a system of alerts (cash market) and position limits (derivatives market) to manage the exposures of brokers.</p>

Powers of the regulator

As indicated in Principle 21, Regulation 9 of the Intermediaries Regulations provides SEBI with the authority to impose any condition on registration. In addition, SEBI has the power to issue interim orders to any intermediary. Finally, pursuant to SEBI Act SEBI can suspend an intermediary and based on such suspension impose any action in relation to the custody of money or securities of clients.

In the case of portfolio managers, as per circular 11.05.07 SEBI can order a portfolio manager to transfer their business to another SEBI registered portfolio manager.

In the case of brokers, the RSEs can request members to reduce exposures, order them not to take new positions, or even ask for additional and/or special margins. They can also deactivate the terminal of a member if the member fails to pay margins, settle transactions, or on apprehension of financial difficulties or detection of serious irregularities or for frequent violations of trading restrictions placed on them.

The by-laws of the RSEs contain default procedures that apply both to individual and corporate brokers. A declaration of default by the SE must be communicated to all other members, and SEBI. Pursuant to SEBI circular default in one exchange, automatically triggers default of the broker in any other exchange of which he is a member. Upon declaration of default by a SE all the deposits, assets or collateral shall be vested on the RSE. A defaulters committee is in charge of assessing and paying claims. The Defaulters' Committee is empowered to (a) initiate any proceedings in a court of law either in the name of the Exchange or in the name of the defaulter against any person for the purpose of recovering any amounts due to the defaulter (b) to initiate any proceedings in a court of law either in the name of the Exchange or in the name of the creditors (who have become creditors of the defaulter as a result of transactions executed subject to Byelaws, Rules and Regulations of the Exchange) of the defaulter against the defaulter for the purpose of recovering any amounts due from the defaulter. SEBI staff indicated that this power was contested in court, and the Supreme Court upheld it.

Investor protection

Current regulations applicable to brokers and portfolio managers require proper segregation of clients' money and securities in accounts different from the accounts of the broker or the portfolio manager. In the case of securities, beneficial ownership is kept at the CSD at the individual level. Such segregation of assets works as the first line of defense for clients.

In addition, brokers are required to "square-off" any money that they owe to clients at least once in a calendar quarter or month, depending on the preference of the client, as per circular MIRSD/SE/Cir-19/2009 on "Dealing between a client and a stock broker". Also, in the case of portfolio managers, SEBI's regulations require the appointment of a separate custodian when assets under management amount to Rs 500 crores (US\$105 million) or more.

Brokers are required to contribute to an investor protection scheme. Investors' claims are processed by the defaulters committee. If the defaulters committee grants an award, then it instructs the trustee of the IPF to pay the investors. There is no similar investor protection fund for other securities intermediaries.

	<p>Coordination in the event of default</p> <p>There is a crisis management contingency contact comprising of SEBI, RBI, RSEs and clearing banks, mainly aimed at addressing market disruption. In the context of financial conglomerates, the regulators have constituted two committees where issues of common concern can be discussed. Conglomerates are required to submit a standard set of data to their lead supervisor. In addition, SEBI can also coordinate with regulators through the FSDC. SEBI has MoUs for cooperation with foreign intermediaries.</p> <p>Practice</p> <p>SEBI staff informed that the last cases of default by a broker occurred in the late 90s. After that there have not been instances of default.</p> <p>Furthermore the authorities have provided concrete examples of actual coordination in the context of “crisis” situations, for example in connection with the failure of Lehman Brothers subsidiaries in India, and redemptions pressures for money market funds.</p>
Assessment	Broadly implemented
Comments	<p>The grade is a result of the evaluation of the current framework vis-à-vis question 1 of the Methodology.</p> <p>It is important that the procedures contained in the By-Laws of the RSEs be made operational through a default plan and that such plan be tested. As for the other intermediaries, the assessor concurs with SEBI staff assessment that the default of other types of intermediaries should not cause disruption to the markets—given their business models—nor to investors/ clients—given current requirements on asset segregation and SEBI’s powers to transfer clients’ assets/accounts to other intermediaries. However, it would be beneficial if SEBI requires more frequent reporting on capital adequacy from such intermediaries, and develops a basic plan to deal with their failure. In addition, in the context of the technical committee on financial conglomerates the regulators should seek to develop a basic framework for coordination to deal with the failure of entities in the group.</p>
Principles for the Secondary Market	
Principle 25.	The establishment of trading systems including securities exchanges should be subject to regulatory authorization and oversight.
Description	<p>Recognition (authorization) of exchanges</p> <p>Section 19 of the SCRA prohibits the operation of an exchange, unless prior recognition has been given by SEBI. Section 3 requires a RSE that wants to be a RSE to file an application with SEBI.</p> <p>The SCRA does not recognize any other market operator different from a RSE. Section 13A allows a RSE to establish additional trading floors with prior approval from SEBI, on terms and conditions stipulated by SEBI as per Section 13A of SC(R) Act. Derivative Exchanges or separate derivative segment of an existing exchange also require approval from SEBI. The composition of governing body of the SEs should be as specified by SEBI. The appointment of executive director or the managing director of the SEs also require prior approval of SEBI.</p> <p>Pursuant to Section 4 SEBI can impose conditions for recognition, including relating to (i) the qualifications for membership; (ii) the manner in which contracts shall be</p>

entered and enforced; (iii) the representation of the CG on the exchange Board by a maximum of three members; and (iv) the maintenance of accounts of members and their audit. Section 4A requires that stock exchange be demutualized, and authorizes SEBI to impose conditions for such demutualization/corporatization.

Requirements for recognition

SCR Regulations establish general criteria that an entity needs to meet for purposes of recognition. Other basic criteria for new stock exchanges include financial capacity (minimum of Rs 100 crores of net worth) as well as fit and proper requirements. Given the use of CCPs SEBI has required also that proper risk management policies and procedures be in place. In the case of the NSE and the BSE such risk management includes real time basis measurement of exposures; initial and variation margins and contribution to a settlement fund; access criteria for members and haircut of collateral. SEBI has also required RSEs to conduct stress testing and back testing on a regular basis.

In order to assess whether a SE meets such basic criteria SEBI requires that a set of documents be presented along with the request for recognition, including a business plan, a business continuity plan and technology infrastructure proposed, proposed organizational structure, details on clearing and settlement, an appraisal of the SE done by an independent accountant (RBI approved panel).

As in the case of securities intermediaries, the registration is conducted in a two step approach. First SEBI reviews the application along with the information detailed above, and conducts an initial visit. If the documentation is found satisfactory SEBI provides an “in principle approval”, subject to the condition that the SE puts in place all the infrastructure detailed in its plan, including both the trading facilities as well as the clearing and facilities, and submits the by-laws and regulations to SEBI for their approval. A second inspection takes place to check whether all infrastructure is in place.

Supervision

As indicated above the current recognition process requires that SEBI assess the robustness of the trading platform, including clearing and settlement facilities. Furthermore as will be further explained in Principle 26, SEBI requires an annual certification of risk management systems as well as an annual audit on the IT of the SE. In addition, as part of the conditions for the “final approval” SEBI requires that the bylaws and regulations of the SE be submitted for approval by SEBI. SEBI has issued “model” bye- laws that may be referred by all SEs while framing their bylaws. In addition, the regulations must deal with the following issues: hours of trade; Clearing house, Number and class of contracts in which settlements will be made; Terms and conditions of contracts, including margins; Listing of securities; Settlement of claims or disputes; Levy and recovery of fees, fines and penalties; regulation of dealing by members for their own account; and limitations on volume of trading, information obligations by members. The bylaws (which are supported by detailed regulations) also contain the principles to deal with breaches to the Bylaws and regulations. SEs regulations also contain conditions for trading halts (as will be further explained in Principle 29).

	<p>Fairness of access</p> <p>Via the approval of by-laws and regulations SEBI can oversee that the rules of the exchanges provide for fair treatments of members.</p> <p>SEBI has issued detailed instructions in regard to order matching. In particular, it has required that exchanges put in place anonyms automated order driven systems, whereby trades are matched automatically (based on an algorithm) based on time and price. Such rules are complemented with prohibitions on front-running.</p> <p>Furthermore SEBI has constituted a Technical Advisory committee to discuss and address challenges posed by recent technological developments that could have an impact of fair access, as well as on the integrity of trading platforms. Issues such as co-location and high frequency trading are being discussed on that committee. SEBI has already issued regulation allowing direct market access. Under such regulations “naked” DMA is not permitted.</p> <p>Operational information</p> <p>All by-laws and rules of the exchanges are available in their websites, and thus all members have similar access to market rules and procedures. SEBI has also provided specific rules concerning transparency of SEs, as detailed in Principle 27.</p> <p>Every Trading Member is required to preserve the following reports produced from the Trading System for a period of five years: (i) activity log; (ii) orders cancelled today; (iii) new orders today; (iv) outstanding orders today; and (v) trades done today. The surveillance mechanisms of the SEs have access to the trading information of the members and their clients and they can have audit of all their transactions. The system maintains a log of all events from order entry to execution. A perfect audit trail by logging in/ the trade execution process in enterprises is also provided.</p> <p>As for confidentiality, the exchanges have adopted anonymous order matching system. A single consolidated order book for each stock displays, on a real time basis, buy and sell orders originating from all over the country. The Open Electronic Consolidated Limit Order Book (OECLOB) ensures full anonymity by accepting orders, big or small from members without revealing their identity.</p>
Assessment	Fully implemented
Comments	
Principle 26.	There should be ongoing regulatory supervision of exchanges and trading systems, which should aim to ensure that the integrity of trading is maintained through fair and equitable rules that strike an appropriate balance between the demands of different market participants.
Description	<p>Market surveillance by the RSE</p> <p>The RSE monitors day-to-day operation and trading in the exchanges under the oversight of SEBI.</p> <p>The nationwide SEs have a facility to generate on-line alerts, in real time, based on certain preset parameters like price and volume; variations in securities; members taking unduly large positions not commensurate with their financial position or having large concentrated position(s) in one or few securities. They are responsible for real time surveillance.</p>

The RSEs have established surveillance departments which analyzed such alerts. An alert would be followed by a short investigation aimed at determining whether there is an issue of concern. If it is, then the RSE conducts a “full-fledge” investigation, which can end up in sanctions for the brokers. The RSEs do not have power to impose sanctions on third parties. Thus, in many cases, in particular involving insider trading, the RSE would submit the results of its investigation to SEBI, so that SEBI can initiate any disciplinary proceeding against a third party. Details on investigations carried out by the RSEs are provided in Principle 28.

Market surveillance by SEBI

SEBI has developed an Integrated Market Surveillance System (IMSS) to monitor surveillance activities across exchanges. Through the system SEBI receives data from the exchanges on all transactions carried out, in all segments, including also currency. The information is received intraday, but SEBI conducts its analysis on a t+1 basis as real time surveillance is done by the RSEs. SEBI also receives information from the depositories on all transfer of securities, by the end of the day. The IMSS has imbedded a system to generate alerts.

SEBI staff informed that it is currently in the process of upgrading the IMMS by incorporating transactions date of the last five years and improving its capabilities. These enhancements are being achieved by adding a new module, the Data Warehouse and Business Intelligence System (DWBIS). The DWBIS will have the following components:

data warehouse, data mining and predictive forecast capabilities;
scenario development, research and what-if analysis platform; and
sophisticated drill down reporting and charting tool.

Oversight

Powers of SEBI

The SCRA provides SEBI (via notification from the CG) the following powers vis-à-vis RSE:

direct a RSE to make rules or changes to existing rules, within a period of two months from the order. If the RSE fails to do so, SEBI can directly make the rules (Section 8);

power to make by-laws in any of the areas where RSE can make by-laws or amend them. (Section 10);

power to issue directions to exchange or clearing corporation, to any company whose securities are listed (12A);

supersede the governing body of a RSE, provided that the RSE is given an opportunity to be heard (Section 11);

suspend the business of a RSE for not more than seven days, by notification in the gazette, for not more than 7 days; but such period can be extended via a new notification (Section 12);

withdrawal of recognition (Section 5); and

levy penalty up to Rs. 25 crore rupees for failure to furnish periodical returns, failure to make or amend byelaws or failure to comply with directions issued by SEBI (Section 23G).

	<p>Off-site supervision</p> <p>As indicated on Principle 7, the RSE are required to submit a wide array of periodic reports to SEBI. Some of these reports deal directly with the operation of the trading platforms and their robustness. Other reports allowed SEBI to oversee how the RSEs are performing their self-regulatory functions. In addition, SEBI complements such reporting system with regular meetings on issues of market development and more recently with the constitution of a committee on non compliance with listing requirements, for issues related to listing obligations.</p> <p>Robustness of the trading platforms</p> <p><i>Risk management certification of the subsidiary as explained in Principle 7 on a half yearly basis.</i></p> <p><i>Compliance reports regarding inspection observations on a quarterly basis.</i></p> <p><i>System audit reports on an annual basis.</i></p> <p>Oversight of listing obligations</p> <p><i>A committee was recently constituted with the participation of the NSE and the BSE. The Committee has developed very detailed recommendations including for the RSES to develop a plan of action to deal with non compliant issuers.</i></p> <p>Market surveillance</p> <p><i>Monthly (for the two largest RSE, NSE and BSE) or quarterly development reports (for the remaining exchanges).</i></p> <p><i>SEBI also holds weekly meetings with the NSE and BSE and monthly meeting with depositories to discuss market developments.</i></p> <p>Supervision of brokers</p> <p><i>Monthly reports on investors complaints.</i></p> <p><i>Findings of on-site inspections.</i></p> <p><i>Consolidated reports regarding the audit reports that broker are required to submit, along with the actions taken by the RSE</i></p> <p><i>On-site supervision.</i></p> <p>Both the NSE and the BSE are subject to annual inspections. SEBI inspections cover a wide range of aspects, including issues related to the robustness of the trading infrastructure to issues related to the SEs role as SROs.</p>
Assessment	Fully implemented
Comments	
Principle 27.	Regulation should promote transparency of trading.
Description	<p>Exchanges</p> <p>RSEs are required to have transparency of trading.</p> <p>Market participants can see the best five bids and offer on real-time basis, as well as total volume. Information on executed transactions can be seen also by market participants (last price at which executed). More stringent disclosure requirements</p>

	<p>apply to “bulk” trades. A bulk trade is defined as all transactions in a security where the total quantity of shares bought/sold is more than 0.5 percent of the number of equity shares of the company listed on the exchange. The quantitative limit of 0.5 percent can be reached through one or more transactions executed during the day in the normal market segment. In the case of bulk trades disclosure requirements are as follows:</p> <p><i>brokers shall disclose to the stock exchange the name of the security, name of the client, quantity of shares bought/sold and the traded price;</i></p> <p><i>the disclosure shall be made immediately upon execution of the trade; and</i></p> <p><i>the RSEs shall disseminate such information on the same day after market hours to the general public.</i></p> <p>RSEs have been permitted to provide a separate window to facilitate execution of the large trades through a single transaction easily without putting either the buyer or the seller in a disadvantageous position. Such trades are referred to as ‘block deals’ and are subject to the following conditions:</p> <p>Such trading window may be kept open for a limited period of 35 minutes from the beginning of trading hours.</p> <p>The orders may be placed in this window at a price not exceeding 1 percent from the ruling market price/previous day closing price, as applicable.</p> <p>An order may be placed for a minimum quantity of 5,00,000 shares or minimum value of Rs.50 million (\$1.11 million approximately, assuming exchange rate of \$1=Rs 45.00)</p> <p>Every trade executed in this window must result in delivery and shall not be squared off or reversed.</p> <p>The same information available to market participants is available to investors via the websites of the exchanges, almost in real time.</p> <p>OTC markets</p> <p>SEBI has also imposed post-trade reporting obligations for Over-the-Counter (OTC) trades.</p> <p>OTC trades are allowed in corporate bonds under Section 18 of SCRA. There is an obligation on all participants to report such OTC bond trades. SEBI circular SEBI/CFD/DIL/BOND/1/2006/12/12 dated December 12, 2006, requires that all transactions in corporate bonds of the value of Rs.1,00,000 or above be reported to the corporate bond platform. The transactions shall be reported within 30 minutes of closing the deal. Where transactions are executed through the intermediary, reporting responsibility lies with the intermediary. If executed otherwise, reporting will be made either through an authorized intermediary or directly by the contracting parties.</p> <p>In case of equity cash segment, SEBI vide circular SMD/RCG/CIR/(BKG)/293/95 dated March 14 1995 has directed brokers to report all transactions done on a spot basis (off-the-floor transactions) on the same day.</p> <p>OTC trades in equity derivatives are not allowed.</p>
Assessment	Fully implemented
Comments	

Principle 28.	Regulation should be designed to detect and deter manipulation and other unfair trading practices.
Description	<p>Misconducts</p> <p>Section 11(2)(e) and section 12A of SEBI Act prohibit fraudulent or deceptive conduct or market abuse, manipulation, and deceptive devices. Section 12A of SEBI Act states as under:</p> <p>12A. No person shall directly or indirectly:</p> <p>(a) use or employ, in connection with the issue, purchase or sale of any securities listed or proposed to be listed on a recognized stock exchange, any manipulative or deceptive device or contrivance in contravention of the provisions of this Act or the rules or the regulations made there under;</p> <p>(b) employ any device, scheme or artifice to defraud in connection with issue or dealing in securities, which are listed or proposed to be listed on a recognized stock exchange;</p> <p>(c) engage in any act, practice, course of business which operates or would operate as fraud or deceit upon any person, in connection with the issue, dealing in securities which are listed or proposed to be listed on a recognized stock exchange, in contravention of the provisions of this Act or the rules or the regulations made there under;</p> <p>(d) engage in insider trading; and</p> <p>(e) deal in securities while in possession of material and non-public information or communicate such material non public information to any other person, in a manner in which it is in contravention of the Provisions of the Act or its regulations.</p> <p>SEBI has issued Regulations on Market Manipulation and Insider Trading, which further detail the misconducts that fall under both categories.</p> <p>As per Section 15 H and G the penalty for such misconducts is of 25 crore rupees(US\$ 5 million) or three times the amount of profits made, whichever is higher. In addition, as per Section 24 such violations also constitute a crime, punishable with imprisonment up to 10 years or a fine up to 25 crore rupees (US\$ 5 million) or both. In addition, as indicated in Principle 9 SEBI can also impose other type of sanctions, including directions, and debarring.</p> <p>Market surveillance</p> <p>As indicated under principle 26 the RSEs have in place automated systems of market surveillance which are complemented by SEBI's own system which allows for surveillance across exchanges and segments of the market. Furthermore the imposition of a unique identification number for each client for purposes of transacting in the securities markets, and of a 13 digit code for each transaction that allow to identify the person/person behind each transaction greatly enhances the ability of the RSEs and SEBI to monitor unfair practices.</p> <p>Data provided by SEBI support the conclusion that RSEs have actively investigated potential cases of market manipulation and other unfair trading practices. In this regard, the RSEs initiated 1,978, 1,126 and 1,588 investigations for the years 2007–2008, 2008–2009, and 2009–2010.</p>

	<p>The majority of these cases pertain to manipulation, insider trading, front running, etc. For the above, after the preliminary investigations exchanges have either imposed penalties or issued warning letters.</p> <p>While a limited proxy the data on investigations and enforcement included in Principle 10 leads to conclude that SEBI has been active in the investigation and enforcement of cases of insider trading and market manipulation. Criminal enforcement requires further strengthening as successful cases appear to be restricted to CIS schemes.</p> <table border="1" data-bbox="456 474 1468 762"> <thead> <tr> <th>Particulars</th> <th>2009–10</th> <th>2008–09</th> <th>2007–08</th> </tr> </thead> <tbody> <tr> <td>Preliminary Investigation Taken Up</td> <td>1,588</td> <td>1,126</td> <td>1,978</td> </tr> <tr> <td>Finalized/completed ¹</td> <td>1,575</td> <td>1,131</td> <td>2,003</td> </tr> <tr> <td>Closed</td> <td>1,335</td> <td>962</td> <td>1,824</td> </tr> <tr> <td>Forwarded to SEBI for necessary actions</td> <td>240</td> <td>169</td> <td>179</td> </tr> </tbody> </table> <p>1/ Includes completed cases which were taken up in the previous period.</p> <p>Cross-border surveillance</p> <p>The level of cross border trading of Indian securities is limited. There are a few IDRs. Nevertheless as indicated in Principles 12 and 13 India has been active providing information to foreign counterparties.</p>	Particulars	2009–10	2008–09	2007–08	Preliminary Investigation Taken Up	1,588	1,126	1,978	Finalized/completed ¹	1,575	1,131	2,003	Closed	1,335	962	1,824	Forwarded to SEBI for necessary actions	240	169	179
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Assessment	Fully implemented																				
Comments	<p>Challenges in criminal enforcement have been taken into consideration for the grade of Principle 10.</p> <p>The more sophisticated the markets become the more the need for surveillance systems that allow to process massive quantities of data on an automated manner to detect patterns and trends. The assessor welcomes the commitment that SEBI is showing to improving the capabilities of its surveillance system.</p>																				
Principle 29.	Regulation should aim to ensure the proper management of large exposures, default risk and market disruption.																				
Description	<p>Management of large exposures</p> <p>The RSEs have robust risk-management systems that seek to ensure proper management of large exposures, default risk and market disruption.</p> <p>Such systems include a base minimum capital, and margining, including mark to market margin. Margins are posted by the broker in the case of the cash market, and by the client in the case of derivatives market and therefore in the latter case clients margins are kept segregated from the brokers own account. There are also clear rules concerning haircut of collateral. The RSEs have surveillance systems in place that allow them to monitor exposures of members on real time. Furthermore the requirement of a single identification number for clients allows them also to monitor positions at client level.</p> <p>The RSEs can request members to reduce exposures, order them not to take new positions, or even ask for additional and/or special margins. They can also deactivate the terminal of a member if the member fails to pay margins, settle transactions, or if it is facing financial difficulties or serious irregularities or frequent violations of trading restrictions placed on them are detected.</p>																				

	<p>In addition, the RSEs are required to maintain a settlement guarantee fund to meet the shortages arising out of nonfulfillment or partial fulfillment of funds obligations by members in a settlement before declaring the concerned member defaulter. Since 1997, the RSEs/clearing corporations have been advised to assess the minimum level of corpus of SGF (Stress Test of SGF) on a regular basis.</p> <p>Default procedures</p> <p>The By-Laws of the exchanges contain default procedures. A declaration of default by the SE must be communicated to all other members, and SEBI. Pursuant to SEBI circular default in one exchange, automatically triggers default of the broker in any other exchange of which he is a member.</p> <p>Upon declaration of default by a SE all the deposits, assets or collateral shall be vested on the RSE. A defaulters committee is in charge of assessing and paying claims. The defaulters' committee is empowered to (a) initiate any proceedings in a court of law either in the name of the Exchange or in the name of the defaulter against any person for the purpose of recovering any amounts due to the defaulter; and (b) to initiate any proceedings in a court of law either in the name of the Exchange or in the name of the creditors (who have become creditors of the defaulter as a result of transactions executed subject to Byelaws, Rules and Regulations of the Exchange) of the defaulter against the defaulter for the purpose of recovering any amounts due from the defaulter.</p> <p>Market disruption</p> <p>The RSEs have established individual securities bands in the cash market of 2, 5, 10, and 20 percent. The securities are periodically shifted from one band to another based on parameters set by the exchanges. Price bands changes are effected as a coordinated action of the NSE and the BSE. In respect of securities on which one price band at one RSE is less than at the other, the more stringent price is made applicable across exchanges.</p> <p>There are also market wide circuit breakers when either Sensex or NIFTY breaches the thresholds of 10, 15, and 20 percent of the previous quarter's index closing. There are also "dummy" filters put in place by stock exchanges for securities on which derivatives products are available and for securities included in indices on which derivatives products are available, which are triggered when prices vary in more than 20 percent. The filter triggers an alert and the RSE requires then an explicit confirmation from the member.</p> <p>Coordination</p> <p>There is a crisis management contingency contact group comprising of officials of Gol, SEBI, RBI, IRDA, Stock Exchanges etc., which operates as a quick response team in a crisis time to ensure smooth functioning of the securities market including payment settlement.</p>
Assessment	Fully implemented
Comments	The assessor consider that the current framework meets the key issues and questions of the IOSCO Methodology; thus the grade. A full assessment of the CCPs under the CPSS-IOSCO Methodology found the current risk management framework robust. A few recommendations were issued to improve the system. Those recommendations are included in the TN on payments.

Principle 30. Systems for clearing and settlement of securities transactions should be subject to regulatory oversight, and designed to ensure that they are fair, effective and efficient and that they reduce systemic risk.	
Description	Not assessed
Assessment	
Comments	

ANNEX I. STATUS OF IMPLEMENTATION OF THE NEW IOSCO PRINCIPLES

	The Regulator should have or contribute to a process to monitor, mitigate and manage systemic risk, appropriate to its mandate.
Description	<p>SEBI authorities highlighted that while the institution has not formally had a strategy toward systemic risk identification and monitoring; in practice it has done so via the supervision that departments do of the specific segment of the market under their supervision. Once a risk is identified, then SEBI decides whether regulatory or other types of measures are needed.</p> <p>SEBI mentioned as examples of this approach the arrangements that have been required for RSEs to address settlement risks (including margins and a settlement fund) or to address market disruption through circuit breakers.</p> <p>In addition, SEBI authorities highlighted that in practice coordination between them and the RBI for purposes of addressing systemic stability concerns has worked well. In this regard, for example, they mentioned coordinated measures taken after the failure of Lehman Brother subsidiaries in the country, as well as regarding redemption pressures in the money market industry. SEBI has recently created a systemic stability unit that would allow it to take a more systematic approach toward systemic risk identification and monitoring.</p> <p>Via Notification of the CG of December 2010, a Financial Stability Development Council was established. This Council should serve as the vehicle to develop a process to identify, monitor and address systemic risk. The FSDC is chaired by the MoF, which also holds the secretariat. The FSDC is still at an early stage, but the authorities mentioned that their objective is that high level issues be discussed there and more operational issues should be dealt at the level of the subcommittee mentioned below. There are no formal arrangements regarding the frequency of the meetings of the FSDC; nor voting arrangements. The authorities informed that the FSDC meets when and as necessary, and that decisions are being taken on a consensual basis. Since its constitution it has met twice and a third meeting has already been scheduled. When an issue is decided, the agenda for the next meeting includes a follow up on actions taken.</p> <p>Within the umbrella of the FSDC a subcommittee on inter-regulatory coordination has been set up. It is integrated by the heads of the regulatory agencies, and chaired by the RBI. As in the case of the FSDC, there are no formal arrangements regarding the frequency of the meetings of the subcommittee. The authorities informed that it meets also when and as necessary. Since its creation it has met three times.</p> <p>FSDC subcommittee in its meeting on August 26, 2011 constituted an Inter Regulatory Technical Group to address issues related to risks to Systemic Financial stability and inter regulatory coordination and to provide essential inputs for meetings of subcommittee. The group includes representatives of four regulators at the level of Executive Directors.</p> <p>In the meanwhile, pursuant to the decision by SEBI Board in its meeting on July 28, 2011, SEBI approved the constitution of up a Systemic Stability Unit (SSU) in SEBI. The SSU will have a holistic approach toward regular monitoring and mitigation of systemic risks likely to emanate from securities markets. SSU would also offer coordinated assistance/ inputs from SEBI to FSDC in monitoring Systemic Risks in respect of Securities Market and monitoring of Systemically Important Financial</p>

	<p>Institutions, if any, under the jurisdiction of SEBI. Accordingly, the SSU is mandated to:</p> <ul style="list-style-type: none"> <i>identify and collect systemic risk information through a template for regular review to identify, assess & mitigate emerging systemic risks;</i> <i>develop a time series of core set of securities market indicators having bearing on systemic stability of financial market;</i> <i>conduct stress test of systemically important institutions in securities market to assess resilience;</i> <i>conduct research relating to Systemic Issues in securities market viz., ownership structure; leverage; inter-connectedness of market segments; risk concentration; behavior under stressed conditions; unregulated products/markets/entities, etc. and recommend regulations to manage systemic c risk;</i> <i>prepare periodic Systemic Stability Report in respect of securities market in India;</i> <i>mandate risk assessment methodologies to relevant market participants for their self-assessment and reporting to SEBI; and</i> <i>coordinate with and provide assistance to FSDC/FSB/ Standing Committee (SC7) of IOSCO on issues pertaining to financial stability, macro prudential regulation and supervision.</i> <p>The SSU was set up on September 30, 2011, and has already started functioning.</p>
Assessment	N/A.
Comments	
	<p>The Regulator should have or contribute to a process to review the perimeter of regulation regularly.</p>
Description	<p>SEBI's review of the perimeter of regulation is to a large extent imbedded in its process of identification of risk described in Principle 6. There are also several standing/ advisory committees that look into issues pertaining to primary market, secondary market, mutual funds, debt market, etc. which can take on issues relating to the perimeter of regulation in their respective areas.</p> <p>In addition, SEBI highlighted that Section 12 (1) of SEBI Acts provides it with authority to extend the perimeter of regulation to other entities currently not cover by the registration regime, via regulations. Such provision states that "no stock-broker, sub-broker, share transfer agent, banker to an issue, trustee of trust deed, registrar to an issue, merchant banker, underwriter, portfolio manager, investment adviser and such other intermediary who may be associated with securities market shall buy, sell or deal in securities except under, and in accordance with, the conditions of a certificate of registration obtained from the Board in accordance with the regulations made under this Act."</p> <p>In the meanwhile, SEBI Board in its meeting on July 28, 2011 has approved a proposal to set up an inter-departmental regulations review committee chaired by a WTM with Executive Directors as members to make rigorous and regular review of rules and regulations in Indian securities markets to:</p> <ul style="list-style-type: none"> <i>identify gaps and comply with relevant global standards;</i> <i>consider the extent to which current regulation adequately addresses investor protection, fair, efficient and transparent markets;</i>

	<p><i>consider the degree to which existing regulations are outmoded or no longer necessary or the degree to which they should be modified to take into account new market developments;</i></p> <p><i>whether regulatory premises underlying any existing regulatory exemptions continue to be valid;</i></p> <p><i>undertake assessment of overall costs to stakeholders; and</i></p> <p><i>seek legislative amendments to securities laws and regulations, etc.</i></p> <p>SEBI has setup Regulators Review Committee which has started functioning from October 14, 2011.</p>
Assessment	N/A.
Comments	
	The Regulator should seek to ensure that conflicts of interest and misalignment of incentives are avoided, eliminated, disclosed, or otherwise managed.
Description	<p>SEBI authorities emphasized that the obligation to address conflicts of interest is imbedded in the regulations for all types of intermediaries, as well as in the corresponding codes of conduct. In addition, the supervisory process (mainly on-site inspection program) allows it to monitor whether conflicts of interest are in practice been adequately address.</p> <p>Also, as part of its strategy to identify risks and problems with products at an early stage, SEBI has a separate department on derivatives and new products.</p> <p>In the meanwhile, SEBI Board in its meeting on July 28, 2011 has approved a proposal to prescribe Guidelines for dealing with Conflicts of Interests of Associated Persons in Securities Market. These Guidelines are aimed at dealing with conflicts of interests by all participants in Indian securities market, associated persons, investment vehicles, collective pools of capital, institutional investors, stock exchanges, etc. These guidelines would adequately focus on active involvement of senior management of market participants; adoption of clear and concise policies; adequate disclosures; information barriers; effective procedures; remuneration to commensurate the activities; maintaining record of activities; specific prohibitions, etc.</p>
Assessment	N/A
Comments	
	Auditors should be subject to adequate levels of oversight
Description	<p>The current system of auditors oversight lies mainly in ICAI, which could be considered a professional body—although its creation by statute has imposed on them certain additional features—for example representation of the regulatory authorities on ICAI—aimed at strengthening its independence.</p> <p>ICAI established the Peer Review Board in 2002, which undertakes peer reviews of firms with focus on documentation and processes adopted for the engagements to ensure compliance with technical standards. It issues peer review certificates if the compliance, processes and documentation are found to be satisfactory. Such certificate is valid for a period of three years. As per SEBI's circular dated April 05, 2010, in respect of all listed entities, limited review/statutory audit reports submitted to the concerned stock exchanges shall be given only by those auditors who have subjected themselves to the peer review process of ICAI and who hold a valid certificate. Further, SEBI has mandated that financial information disclosed in the offer</p>

	<p>documents need to be signed by auditors holding peer review certificates.</p> <p>A Financial Reporting Review Board (FRRB) was constituted in 2002 to review compliance by issuers with accounting standards; its nature is that of nonstanding committee of ICAI. The FRRB has representatives from ICAI, as well as from different stakeholders including the regulatory authorities.</p> <p>To perform this function the FRRB has developed certain criteria (mainly net worth, but also industrial class and random sampling) based on which roughly 150–200 companies are selected and their annual financial statements are reviewed. In the past three years, FRRB has reviewed 459 cases and referred 14 cases out of the same to regulatory bodies for necessary action.</p> <p>Under the Chartered Accountants Act, ICAI has disciplinary powers over auditors. Such function is exercised via a Disciplinary Board, the Disciplinary Committee and Appellate Board which has representation of members appointed by the CG, in addition to representatives of ICAI. ICAI informed that it has been active in applying disciplinary measures against auditors. In the past three years, ICAI has initiated action against 306 members and found 115 members guilty. The List of Persons/Members found guilty under First & Second Schedule is displayed on ICAI website.</p> <p>In addition, in 2007, the CG constituted a Quality Review Board to review the quality of services provided by chartered accountants, provide guidance to them for improvement in quality of services and to make recommendations to the Council of ICAI. The Chairman of the Board is appointed by CG and it has equal representation of ICAI Council members and members appointed by CG. The assessor was informed that such body is currently in the process of developing a plan/strategy for its operation.</p> <p>In the meanwhile, SEBI Board has approved a proposal for SEBI to benchmark the operation and oversight of audit profession and accounting standards in India to the new Principles relating to oversight and independence of auditors, and audit standards and to write to the CG pointing out the gaps and possible solutions.</p>
Assessment	N/A.
Comments	
	Auditors should be independent of the issuing entity that they audit.
Description	<p>Section 226 of the Companies Act contains a few provisions aimed at ensuring auditors' independence. In particular an internal auditor cannot be the statutory auditor of a company or a person who is indebted to the company or who is holding the shares of the company cannot be appointed as a statutory auditor. ICAI has also issued a Code of Ethics and issued a Guidance Note on Auditor's independence.</p> <p>SEBI staff informed that the Companies Bill placed in the parliament, has more stringent provisions pertaining among others to auditors' independence, including qualification, rotation, performance of non-audit services, liabilities of auditors.</p> <p>The current listing agreement requires that Audit Committee should recommend to the Board of directors regarding the appointment, reappointment and, if required, the replacement or removal of the statutory auditor and the fixation of audit fees. Two thirds of the member of the Audit Committee should be independent directors.</p>
Assessment	N/A
Comments	

	Audit standards should be of a high and internationally acceptable quality.
Description	<p>As indicated in Principle 14 as part of their annual reporting listed companies (whether they issue equity or debt) are required to submit annual audited financial statements. The listing agreements require them to submit quarterly financial statement. As per the Companies Act, such statements must be prepared according to the accounting standards approved by the Institute of Chartered Accountants (ICAI), on the basis of the procedures described below. Auditors must conduct their audits of such statements according to the auditing standards approved by ICAI.</p> <p>ICAI is a statutory body established under the Chartered Accountants Act of 1949. It is in charge of establishing accounting and auditing standards. To this end it has constituted separate committees, the Accounting Standards Board (ASB) and the Auditing and Assurance Standard Board (AASB). Both Committees have wide representation of public interest and have representatives of regulators, industry chambers and educationists besides members of Council of ICAI. SEBI is member of both Committees.</p> <p>ICAI has adopted local auditing standards. However, under the Clarity Project it is seeking to adopt the International Auditing Standards (IAS). There is currently no independent oversight mechanism for ensuring compliance of auditing standards by the auditors.</p> <p>As mentioned under Principle 16, ICAI established the Peer Review Board in 2002, which undertakes peer reviews of firms with focus on documentation and processes adopted for the engagements to ensure compliance with technical standards. It issues peer review certificates if the compliance, processes and documentation are found to be satisfactory. Such certificate is valid for a period of three years. Listed companies and the companies making public offers need to get their financial results certified by peer reviewed auditors as per SEBI Regulations/listing Agreement.</p> <p>Further, as mentioned under Principle 16, the CG constituted a QRB to review the quality of services provided by chartered accountants, provide guidance to them for improvement in quality of services and to make recommendations to the Council of ICAI and such body is currently in the process of devising a strategy to fulfill its mandate.</p> <p>The current framework allows publication of qualified financial statements. Though, Clause 49 of the Equity Listing Agreement contains a non-mandatory requirement stating that company may move toward a regime of unqualified financial statements.</p>
Assessment	N/A.
Comments	
	Credit rating agencies should be subject to adequate levels of oversight. The regulatory system should ensure that credit rating agencies whose ratings are used for regulatory purposes are subject to registration and ongoing supervision.
Description	<p>In India Credit Rating Agencies (CRAs) are registered and regulated under the SEBI (Credit Rating Agency) Regulations, 1999. There are currently six credit agencies registered with SEBI under this regulation.</p> <p>The SEBI regulations for CRAs address the principles developed by IOSCO in the IOSCO Code of Conduct. The Regulations governing the CRAs and circulars issued from time to time provide for submission of periodic reports, inspection of CRAs and</p>

	<p>also for initiating action(s) against them, wherever deemed fit, after following the prescribed procedure.</p> <ul style="list-style-type: none"> • SEBI has further strengthened its regulations for CRAs recently via circular dated 3.5.2010, whereby it has mandated additional disclosures from CRAs. In this regard the circular requires additional disclosures as well as measures to deal with conflict of interest, including, for example: • Disclosure on a semiannual basis of the fees they charge companies for assessing their debt profile and the default rate on their previous ratings. • Ensure their analysts do not participate in any marketing and business development, including fee negotiations with the issuer whose securities they are rating and employees involved in the rating process and their dependents do not own shares of the issuer; • Maintain records of the important factors underlying the credit rating and a summary of discussions with all the stakeholders involved, as well as decisions of the rating committee, including voting details and notes of dissent. <p>SEBI requires half yearly internal audit for credit rating agencies to be conducted by Chartered Accountants, Company Secretaries or Cost and Management Accountants who are in practice and who do not have any conflict of interest with the CRA. The audit shall cover all aspects of CRA operations and procedures, including investor grievance redress mechanism and compliance with the provisions of the securities laws.</p> <p>SEBI informed that onsite inspections of CRAs have been carried out in the past. The CRAs are also scheduled to be inspected in the current financial year.</p>
Assessment	N/A.
Comments	
	<p>Other entities that offer investors analytical or evaluative services should be subject to oversight and regulation appropriate to the impact their activities have on the market or the degree to which the regulatory system relies on them.</p>
Description	<p>There are no specific regulations for research analysts. The only provisions that indirectly relate to analytical or evaluative services are included in the Regulations for brokers and portfolio managers. Such regulations include general obligations in regard to the provision of investment advice by these two types of intermediaries. Such obligations require them not to provide advice unless they have ground to believe that the recommendation is suitable to them. In addition, investment advice in publicly accessible media shall include a disclosure of interest of the broker as well as the specific employee responsible for it. This provision might be considered to cover research analysis.</p> <p>CRAs are currently providing a service that might be considered to fall under this Principle, which relates to the provision of a pricing methodology for mutual funds. As indicated in the corresponding principle SEBI has mandated that mutual funds value their portfolios based on the bond valuation metrics provided by two credit rating agencies. Such activity is currently not subject to regulation.</p> <p>In the meanwhile, SEBI Board in its meeting on July 28, 2011 has approved a proposal to regulate research analysts in Indian securities market through an exclusive and comprehensive regulation.</p>

Assessment	N/A.
Comments	
	Regulation should ensure that hedge funds and/or hedge fund managers/advisers are subject to appropriate oversight.
Description	<p>SEBI has developed regulations for venture capital funds (VCFs). There is no separate regulatory framework for regulating private pool of capital except Venture Capital Funds and Foreign Venture Capital Investors. However SEBI authorities informed that hedge funds do not appear to be operating from India.</p> <p>SEBI authorities informed that they are in the process of developing regulations for hedge funds, so that such type of investment vehicles is available in the jurisdiction.</p> <p>In the meanwhile, SEBI Board in its meeting on July 28, 2011 has approved a proposal to have a clear regulatory framework for private pools of capital, including Venture Capital Fund, Private Equity Fund, Strategy Fund (Residual Category, including all varieties of funds such as Hedge funds, if any). Accordingly, SEBI on August 1, 2011, has put a Concept Paper on the Proposed Alternative Investment Funds and the draft Alternative Investment Funds Regulations on SEBI website for public comments.</p>
Assessment	N/A.
Comments	