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SEBI's delisting protections not applicable for delisting under IBC

Bombay High Court upholds validity of Regulation 3(2)(b)(i) of Delisting Regulations

In a recent decision in *Harsh Mehta v. Securities and Exchange Board of India*¹ (SEBI), the Bombay High Court (Court) upheld the validity of Regulation 3(2)(b)(i) (Impugned Regulation) of SEBI (Delisting of Equity Shares) Regulations, 2021 (Delisting Regulations) which exempts the application of the protections granted to shareholders under the Delisting Regulations in case of delisting of a corporate debtor pursuant to an approved resolution plan.

The National Company Law Tribunal (NCLT) approved the resolution plan (Plan) of Reliance Capital Ltd (RCL) under the framework of the Insolvency and Bankruptcy Code, 2016 (Code). The Plan provided for delisting of RCL's shares on Bombay Stock Exchange and National Stock Exchange in terms of the Impugned Regulation, without providing an exit option to shareholders as otherwise required under the Delisting Regulations. Harsh Mehta, a shareholder of RCL, challenged NCLT's approval of the Plan and the validity of the Impugned Regulation before the Bombay High Court for removing the protections granted to shareholders under the Delisting Regulations, and thus being contrary to the object of the SEBI Act, 1992 (SEBI Act) to protect the interests of investors.

Despite questioning the motives of Mehta for approaching the Court, who had purchased the shares after RCL was admitted into insolvency and did not challenge the assessment of the liquidation value of RCL's shares as nil, the Court upheld the Impugned Regulation for the following reasons:

- The exemption granted under the Impugned Regulation is within SEBI's scope and ambit of powers under the SEBI Act and the Securities Contracts (Regulation) Act, 1956 (SCRA).
- Sufficient protections are provided in the Code to maximise the corporate debtor's assets. The provisions of the Code, a later legislation, prevail over the SEBI Act and the SCRA in view of the *non-obstante* clause contained in Section 238 of the Code. The provisions of SEBI Act, on the other hand, are in addition to and not in derogation of other laws, in terms of Section 32. SEBI consciously incorporated the Impugned Regulation to aptly address this controversy.

- The overriding effect of the Code results in the following:
 - The approved resolution plan will bind all stakeholders in terms of Section 31 of the Code upholding the commercial wisdom the Committee of Creditors (CoC).
 - The requirement under Section 30(2)(e) of the Code for the resolution plan to conform with provisions of other laws is satisfied in terms of its Explanation, which accords deemed approval by the shareholders of the corporate debtor wherever required in law.

The Court upheld the Impugned Regulation and dismissed the challenge to the Plan. The judgment rightly affirms the primacy of the Code over shareholder protections under the SEBI Act and SCRA, as the Code prioritises the interests of creditors – financial, workmen, and operational – over shareholders, because creditors typically provide secured or contractual investments with a legal right to repayment, whereas shareholders willingly take on higher risk with no guaranteed return, making their equity a residual claim that is subordinate to creditor interests in the event of insolvency. This differentiation is reflected in the waterfall mechanism under Section 53 of the Code, which has been upheld by the Supreme Court in *Swiss Ribbons Pvt Ltd v. Union of India*². Furthermore, there is nothing barring a shareholder from selling his shares during the moratorium period prior to the approval of the resolution plan.

In the Court's view, the successful resolution applicant, whose primary goal is to maximise the value of assets for creditors and secure the revival of the corporate debtor, should not be burdened with the additional obligation of buying out all shareholders, as the corporate debtor's equity plays an essential part in ensuring an effective and sustainable corporate revival.

¹ 2024 SCC OnLine Bom 3697

² (2019) 4 SCC 17

Stamp duty not applicable on mergers of wholly-owned subsidiaries

Delhi High Court resolves ambiguity on central government's exemption notification for NCT of Delhi

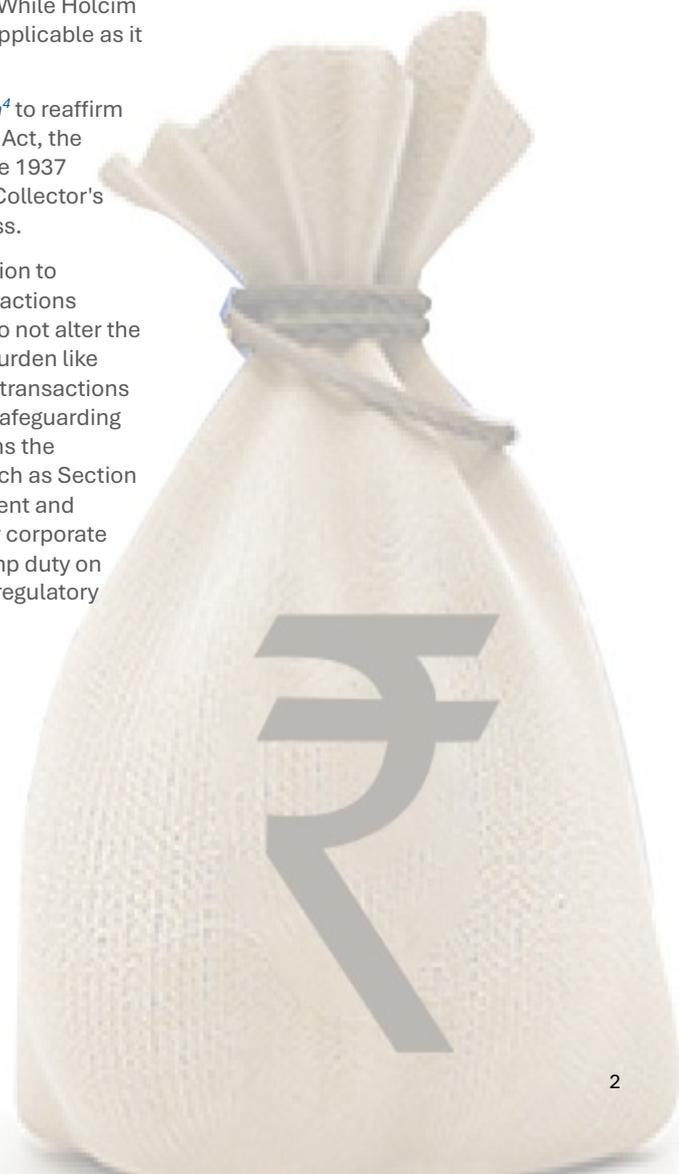
The Delhi High Court's (**Court**) recent judgment in **Ambuja Cements Ltd v. Collector of Stamps**³ addressed a long-standing ambiguity in Delhi regarding the enforcement of exemptions provided for intra-group restructurings under the Indian Stamp Act, 1899 (**Act**) and clarified the applicability of stamp duty exemptions under Central Government's Notification No. 13 dated December 25, 1937 (**1937 Notification**) for mergers involving wholly-owned subsidiaries.

The 1937 Notification, which was not explicitly repealed or adopted in Delhi, exempts stamp duty on transfers between a parent company and its wholly-owned subsidiary or between two subsidiaries of a common parent, provided at least 90% of the issued share capital is in the beneficial ownership of the other entity. This exemption recognises that intra-group transfers do not result in a material change in ownership or financial position.

The instant case involved the merger of Ambuja Cements India Pvt Ltd (**ACIPL**) into Holcim (India) Pvt Ltd (**Holcim**), both wholly-owned subsidiaries of Holderind Investments Ltd, Mauritius. The only assets of ACIPL were shares in ACC Ltd (**ACC**) and Ambuja Cements Ltd (**ACL**), held in dematerialised form. Upon merger, Holcim issued shares to Holderind based on a share swap ratio. The Collector of Stamps demanded payment of INR 218.87 crore as stamp duty arguing that the merger order constituted a 'conveyance' under Article 23 of Schedule I-A to the Act. While Holcim relied on the 1937 Notification, the Collector contended that it was inapplicable as it was allegedly repealed in Delhi.

Although the Court relied on **Hindustan Lever v. State of Maharashtra**⁴ to reaffirm that court-sanctioned merger orders qualify as 'conveyance' under the Act, the Court also relied on **Delhi Towers Ltd v. GNCT of Delhi**⁵ to hold that the 1937 Notification was valid, applicable and binding. The Court rejected the Collector's attempt to impose duty on cancelled shares, deeming it legally baseless.

By extending the application of the exemption under the 1937 Notification to mergers and acquisitions, the judgment importantly clarifies that transactions without material external changes such as intra-group restructurings do not alter the parent's financial position and should not attract additional financial burden like stamp duty. This is in conformity with the principle of non-taxability for transactions without external value addition, preventing unwarranted taxation and safeguarding the efficiency of corporate restructurings. Moreover, the judgment aligns the treatment of stamp duty with established principles under tax laws, such as Section 47 of the Income Tax Act, 1962 which exempts transfers between a parent and subsidiary under specific conditions. This judgment provides clarity for corporate restructurings in Delhi, eliminating the discretionary imposition of stamp duty on such mergers, and fostering a more predictable and business-friendly regulatory environment.



³ 2024 SCC OnLine Del 7710

⁴ (2004) 9 SCC 438

⁵ 2009 SCC OnLine Del 3959

Overhaul of the angel fund regulations

SEBI's consultation paper on review of regulatory framework for angel funds in AIF Regulations

Securities and Exchange Board of India (SEBI) issued a consultation paper on November 13, 2024 based on the recommendations of the Alternative Investment Policy Advisory Committee (AIPAC), a committee constituted by SEBI for deliberating on certain issues related to Alternative Investment Funds (AIF). The consultation paper proposed significant changes to the existing framework for angel funding to address operational gaps and expand investment opportunities for a diverse range of investors based on their risk appetite.

Angel funds, a sub-category of AIFs, are governed by the SEBI (AIF) Regulations, 2012 (AIF Regulations). Angel fund structures are typically of two types:

- Closed-ended venture capital funds with a predetermined corpus and duration
- Angel networks without fixed corpus sizes or durations, offering flexibility for investors to join or exit at will

Key proposals:

- **Accredited investors:** To address the concerns of low-risk appetite investors, angel fund participation would be restricted to accredited investors, who meet specific net-worth criteria and are verified through a third-party mechanism. The requirements of minimum investment of INR 25 lakh over 5 years and minimum corpus requirement of INR 5 crore would be replaced by a condition requiring angel funds to commence investing only after onboarding at least 5 accredited investors. The sponsor's/manager's continuing interest would be tied to total investments rather than the corpus size. If implemented, it would render the limit of 200 investors per company redundant.
- **Offered investment versus actual contribution:** To address the challenges involved in allocating investments based on individual investor preferences, all investment opportunities would be offered to angel fund investors. Contributions would be distributed as outlined in the Private Placement Memorandum (PPM), eliminating unrestricted manager discretion. Investors would exercise rights related to investments proportionate to their contributions.
- **Investment limits:** The minimum and maximum investment limits per start-up under Regulation 19F(2) of AIF Regulations would be changed to INR 10 lakh (currently INR 25 lakh) and INR 25 crore (currently INR 10 crore) respectively, to reflect the diversified funding needs and investor capacities. This broadens the investor base and supports start-ups at more mature growth stages. The removal of Regulation 19F(5), which limits total investment

in a single venture across all schemes of an angel fund, is expected to enhance operational flexibility, enabling funds to allocate resources strategically without cumbersome compliance requirements.

- **Follow-on investments:** Angel funds can now protect their initial stakes and participate in the growth trajectory of portfolio companies, promoting stability and long-term partnerships with start-ups. The funds can exercise pre-emptive rights in portfolio companies no longer classified as start-ups, as follow-on investments are enabled on the following conditions:
 - Only original investors may contribute
 - Post-issue beneficial interest must not exceed pre-investment levels
 - Follow-on investments must not exceed the proposed maximum limit of INR 25 crore per company
- **Skin-in-the-game requirement:** The limit of minimum continuing interest to be maintained by sponsors/managers under Regulation 19G(2) is changed to 0.5% of the investment amount or INR 1 lakh, whichever is higher, calculated at the individual investment level (currently 2.5% in the fund's total corpus or INR 50 lakh, whichever is lower). This change aligns the interests of sponsors with individual investments without imposing an undue burden on fund managers and recognises that angel funds operate on a deal-by-deal basis rather than by pooling a large corpus upfront.
- **PPM template:** To enhance transparency and uniformity in the documentation, a standardised PPM template would be filed by merchant bankers with SEBI. As the scale of operations grows, regulatory oversight would be increased to promote investor confidence, as angel funds exceeding INR 100 crore investments would be subject to PPM audits.
- **Employees and directors of angel funds:** To recognise the role of internal stakeholders and encourage internal engagement, the minimum investment threshold is reduced to INR 5 lakh for employees and directors.
- **Term sheet requirement:** Aligning with practices of other AIFs to streamline operational processes and reduce administrative burden while maintaining necessary disclosures (through PPM), angel funds would not be required to file term sheets with SEBI before launching a scheme. This simplifies the compliance landscape, encouraging efficiency and agility, critical for dynamic investment activities.

The proposals are likely to create a flexible framework for angel funds that balances investor interest with evolving regulatory requirements. The abolition of the 'angel tax' in the FY 2024-25 budget has catalysed the need for a dynamic and investor-centric regulatory architecture. However, as the focus shifts to maintaining angel funds as a secure and regulated alternative to direct investments, concerns about the impact on smaller angel networks that benefit from operational flexibility under current regulations remain to be addressed.

Performance Bank Guarantee must remain valid until the complete implementation of the resolution plan

Supreme Court suggests steps for streamlining the insolvency process

In the matter of *SBI v. Consortium of Murari Lal Jalan & Florian Fritsch*⁶, the Supreme Court (**Court**) on November 7, 2024 ordered the liquidation of Jet Airways Ltd (**Jet Airways**) and set aside the National Company Law Appellate Tribunal's (**NCLAT**) order allowing the Performance Bank Guarantee (**PBG**) submitted by the Successful Resolution Applicant (**SRA**) to be adjusted against the payment otherwise required to be made under the approved Resolution Plan (**Plan**).

The dispute before the Court pertained to non-compliance by the SRA of the terms of the Plan for Jet Airways. The SRA had submitted a PBG of INR 150 crore under Regulation 36B(4A) of the IBBI (Insolvency Resolution Process for Corporate Persons) Regulations, 2016 (**CIRP Regulations**). The SRA deposited only INR 200 crore towards the first tranche payment of INR 350 crore and sought to adjust the PBG towards the balance. The NCLAT permitted this adjustment which was challenged by the lenders before the Supreme Court.

While setting aside the NCLAT order, the Supreme Court observed that under Regulation 36B(4A) of CIRP Regulations, the PBG serves as security in case of failure of the Plan and must remain valid until its complete implementation. The Court relied on its decision in *Ebix Singapore Pvt Ltd v. Educomp Solutions Ltd (CoC)*⁷, which held that modifications to an approved Plan are impermissible, allowing the lenders to encash the PBG and other funds infused by the SRA which were declared as forfeited.

The decision highlights the critical importance of carefully structuring the resolution plan and its financing, with clear terms regarding financial guarantees and payment schedules, to ensure that payments to creditors and the revival of the debtor proceed as intended and to avoid disputes that could hinder compliance with the plan's objectives.

While lamenting the practice of the NCLT and NCLAT to easily grant extension of timelines and relaxations under approved plans, the Court highlighted several deficiencies in the existing framework and made the following suggestions to the Insolvency and Bankruptcy Board of India (**IBBI**) and the Central Government to streamline the insolvency process:

- Regular identification of deficiencies in the insolvency framework and quick redressal.
- Strict adherence to the existing provisions of the Code by all stakeholders.
- Establishment of an oversight committee to enforce the standards for the Committee of Creditors on impartiality, professional competence, supervision and timeliness, feasibility of the corporate debtor, and regular meetings, as reflected in IBBI's guidelines dated August 8, 2024.
- Active support by creditors to facilitate the implementation of the Plan.
- Sensitisation of the members of the NCLT and NCLAT to judiciously exercise their discretion to extend timelines.
- NCLT and NCLAT to record in their orders, the next steps to be undertaken by stakeholders for commencement of the Plan.
- Incorporation of a statutory provision for constitution of a monitoring committee to supervise the Plan and ensure compliance with all regulations while updating the NCLT and the creditors about the status of the Plan's implementation.

⁶ 2024 SCC OnLine SC 3187

⁷ (2022) 2 SCC 401



Changes to the equity index derivatives framework

SEBI's Circular to increase investor protection and stability in equity index derivatives

The Securities and Exchange Board of India (**SEBI**) recently issued a Circular aimed at strengthening the equity index derivatives framework. These measures are designed to enhance investor protection and ensure market stability amidst the evolving dynamics of the derivatives market, i.e. increased retail participation, offering of short-tenure index options contracts, and heightened speculative trading volumes, particularly on expiry days. SEBI's measures are a response to these challenges, aimed at regulating and stabilising the market effectively.

Key proposals:

Effective from November 20, 2024

- **Contract size for index derivatives:** Due to significant growth in market values and prices, the contract size for index derivatives has been revised to a minimum of INR 15 lakh at the time of introduction (previously between INR 5 to 10 lakh). Further, the lot size shall be fixed in a manner that the contract value of the derivative on the day of review is within INR 15 lakh to INR 20 lakh. This measure will ensure that the derivatives market remains accessible to investors with adequate risk-taking capabilities.
- **Rationalisation of weekly index derivatives products:** In response to hyperactive trading in index options on expiry day, products offered by exchanges which expire on a weekly basis will be rationalised, and each exchange will provide derivative contracts for only one of its benchmark indices.
- **Increase in tail risk coverage on expiry day:** To cover the heightened speculative activity and attendant risks on expiry days, SEBI will levy an additional Extreme Loss Margin (**ELM**) of 2% on short options contracts. Designed to increase tail risk coverage, this measure will apply to all open short options at the start of the day, as well as those initiated during the day that are due for expiry.

Effective from February 1, 2025

- **Upfront collection of option premium:** The mandate for the upfront collection of options premiums from buyers by the Trading Member (**TM**)/ Clearing Member (**CM**) is intended to prevent undue intraday leverage and its potential losses and discourage practices that allow positions beyond the collateral at the end-client level.
- **Removal of calendar spread treatment on expiry day:** To reduce the significant 'basis risk' observed on expiry days, where the value of expiring contracts can diverge significantly from similar future contracts, the benefit of offsetting

positions across different expiries (calendar spread) will not be available on the day the contract is expiring. The existing margin calculations for calendar spread positions involving all other expiries other than the contracts expiring on a given day will remain unchanged.

Effective from April 1, 2025

- **Intraday monitoring of position limits:** To address the risk of undetected intraday positions beyond permissible limits, particularly on expiry days when trading volumes are high, the existing position limits for equity index derivatives shall be monitored intraday by the exchanges by taking a minimum of four position snapshots during the day, randomly within pre-defined time windows. This measure will help identify and prevent excessive positions and potential market manipulation.

Challenges:

- **Operational adjustments:** Stock exchanges and clearing corporations will need to undertake significant operational adjustments, such as upgrading systems for intraday monitoring, recalibrating contract sizes, and ensuring the upfront collection of option premiums. Stock exchanges can expect a reduction in the number of options contracts, and thus, in clearing costs.
- **Trading strategies:** Market participants, particularly retail investors, may need time to recalibrate their trading strategies to adapt to the new framework, which would impact their trading volumes and liquidity.
- **Increased costs:** Increased compliance costs is **anticipated** for trading members and clearing members arising from technology upgrades, process changes, and additional resources to monitor compliance with the new framework.

With some of the proposed changes coming into effect, NSE's and BSE's notional average daily trading values for index options in the first week of December 2024 decreased by 42% and 22%, respectively, compared to the first week of November 2024. However, by addressing key areas such as risk management, speculative trading, and market stability, the changes are likely to reduce speculative risks, ensure market stability, and create a more secure and transparent trading environment, leading to long-term benefits that will outweigh the short-term challenges. It is crucial for all stakeholders, including stock exchanges, clearing corporations, and market participants, to collaborate effectively to ensure a smooth transition to the new framework, and create a more resilient and efficient market ecosystem that benefits all participants. Ultimately, by enhancing investor confidence these measures are expected to promote the development of the equity derivatives market.

Creditor-led insolvency to be implemented soon

IBBI to implement 'debtor-in-control' model insolvency framework

The Chairman of Insolvency and Bankruptcy Board of India (IBBI) recently stated that the framework for Creditor-led Insolvency Resolution Process (CLRP) is underway and is likely to be implemented soon. To address the delays at the stage of admission and the stage of approval of the resolution plan by the National Company Law Tribunal (NCLT), an expert committee was constituted by the IBBI to recommend a framework for CLRP. Key aspects of the report are as follows:

- **Initiation by creditor:** Financial creditors holding at least 50% of the total financial debt may initiate CLRP and appoint a Resolution Professional (RP) without requiring an admission order by the NCLT, after serving a notice of default on the corporate debtor. Once initiated, the financial creditor would approach the NCLT to intimate the initiation of CLRP and the appointment of the RP as well as to seek imposition of moratorium in terms of Section 14 of the Insolvency and Bankruptcy Code, 2016 (Code).
- **Management of the corporate debtor:** The existing management of the corporate debtor would not be suspended and would remain in control of the corporate debtor's affairs. Section 28, which empowers the CoC to take major decisions in a CIRP, would not be applicable to CLRP. The RP would be only responsible for managing the resolution process including collation of claims, conducting meetings, filing applications and inviting resolution plans.
- **Timeline:** CLRP has a timeline of 150 days starting from the date of filing the application for intimation of appointment of RP, with a further period of 45 days available for extension.
- **Failure of CLRP:** If the CoC-approved resolution plan is rejected by the NCLT or if the implementation of the approved resolution plan fails, the CLRP is deemed unsuccessful, and the creditors may then file a fresh Section 7 application seeking initiation of CIRP.

It will be interesting to see how the CLRP pans out. While the creditor-led and debtor-in-control models have seen success in countries like the United Kingdom, United States, Australia, Germany, and Singapore, the success of this model in India hinges on the assumption that the corporate debtor will cooperate, incentivised by the control it retains during the CLRP. Yet, once the process concludes, the debtor will lose this control, reducing the incentive to cooperate to a mere facade. Additionally, the possibility of extensive litigation during the Section 14-moratorium stage presents another challenge, potentially delaying the resolution process and undermining its intended efficiency.

Key changes to streamline compounding under FEMA

Foreign Exchange (Compounding Proceedings) Rules, 2024

The Ministry of Finance recently notified the Foreign Exchange (Compounding Proceedings) Rules, 2024 (New Rules), replacing the erstwhile Foreign Exchange (Compounding Proceedings) Rules, 2000 to streamline and modernise the process for compounding contraventions under the Foreign Exchange Management Act, 1999 (FEMA).

Key changes:

- **Increased monetary thresholds for compounding authorities:** Officers at the Assistant General Manager level can now handle cases involving sums up to INR 60 lakh, compared to INR 10 lakh earlier. Higher thresholds have also been set for other senior officers, reducing administrative burdens and expediting processes.
- **Heightened application fee:** Application fee has been doubled to INR 10,000, and online payment options, such as NEFT, are now permitted.
- **Clarity on non-compoundable contraventions:** Rule 9 of the New Rules specifies non-compoundable contraventions, including those involving money laundering, terror financing, or unquantifiable sums.

Although these changes simplify procedures and promote compliance, unresolved challenges remain. The New Rules lack clarity on the scope of 'similar contraventions' for the cooling-off period. Similarly, while compounded cases are protected from further inquiries, the provision allowing the Directorate of Enforcement to investigate raises concerns about jurisdictional clarity, particularly after high-profile cases like NDTV.

Businesses acting in good faith but inadvertently contravening FEMA face hesitations in admitting violations. The 180-day resolution timeline remains unchanged, and further digitisation of the application process is necessary. It is apposite to address these issues to enhance the effectiveness of the reform and foster greater compliance under FEMA.

Full refund of advance money in absence of forfeiture clause

Telangana RERA imposes penalty for contravening Section 13 of RERA Act

In a recent judgment in *Bhavani Velivala v. Pagadala Constructions*⁸, the Telangana Real Estate Regulatory Authority (**Authority**) ordered a builder to refund the complete advance money when the homebuyer refused to execute the sale agreement.

A homebuyer, who had purchased a flat worth over INR 61 lakh, cancelled the purchase for personal reasons after having already paid INR 12 lakh (including INR 6 lakh approximately as token money). Upon requesting refund, the developer refused to return INR 4 lakh due to the cancellation. The parties had not entered into any formal agreement for sale or memorandum of understanding, and after payment of 20% of the total amount, only a 'Confirmation Letter of Sale' had been provided to the homebuyer. The homebuyer approached the Authority under Section 31 of the Real Estate (Regulation and Development) Act, 2016 (**Act**) seeking refund of the complete amount paid, i.e. INR 12 lakh.

The Authority noted that the developer had violated Section 13 of the Act which bars collection of more than 10% of the total sale consideration without entering into a formal sale agreement. The provisions of the Confirmation Letter of Sale, which provided for charges to be borne by the homebuyer for delay in payment, cancellation, and cost of resale upon cancellation, were skewed in favour of the developer – the Authority reaffirmed that one-sided and arbitrary clauses, which contradict the model sale agreement, are not acceptable.

The Authority importantly noted that forfeiture implies the imposition of penalty and is only applicable where a formal agreement containing such a clause has been entered into between the parties. Observing the absence of a legal basis for such forfeiture, the Authority directed the promoter to refund the full amount of INR 12 lakh and deposit an amount of INR 2.6 lakh approximately as penalty for contravening Section 13 of the Act.

The Act does not specifically address the refund of advance money, except under Section 12, which is applicable only when there is cancellation due to a deviation from the promises made in advertisements or prospectuses. The Authority took a homebuyer-friendly approach by interpreting the absence of an explicit provision on refund of advance money in favour of the homebuyer, holding such a stipulation in a formal agreement to be an essential requirement for a promoter to forfeit advance payments. This interpretation further strengthens homebuyer protections against unfair trade practices by unscrupulous promoters, in light of the Supreme Court's ruling in *Pioneer Urban Land and Infrastructure Ltd. v. Govindan Raghvan*⁹ invalidating one-sided builder-buyer clauses.

⁸ Complaint No. 1184 of 2023

⁹ (2019) 5 SCC 725

RBI simplifies forex regulations for start-ups

Foreign Exchange Management (Foreign Currency Accounts by a Person Resident in India) (Fourth Amendment) Regulations, 2024

The Reserve Bank of India (**RBI**) has notified the Foreign Exchange Management (Foreign Currency Accounts by a Person Resident in India) (Fourth Amendment) Regulations, 2024, aligning with the updated definition of start-ups introduced by the Department for Promotion of Industry and Internal Trade (**DPIIT**) in 2019. This amendment aims to streamline the process for DPIIT-recognised start-ups to open and maintain foreign currency or Indian Rupee interest-bearing accounts, which process had previously been unclear for authorised dealer banks.

Under the revised criteria, start-ups can now benefit from recognition for up to 10 years from incorporation (earlier limited to 5 years), with a turnover cap of INR 100 crore enhanced from INR 25 crore. This change significantly broadens the eligibility of start-ups for various financial benefits, including the ability to engage in foreign currency transactions and access funding for growth. The enhanced turnover limit is especially beneficial for scaling businesses, as it allows larger start-ups to access global capital markets and foreign investments more easily.

With over 1.5 lakh DPIIT-recognised start-ups, the amended regulations are expected to further ease the process of doing business, contributing to the promotion of entrepreneurship and innovation and fostering a more conducive environment for start-ups in India.

Moreover, this move also aligns with the Budget 2024-25 proposal to standardise the definition of start-ups across various legislations, ensuring consistency and reducing compliance burden for businesses.

Integrating accountability standards for AI-use in financial markets

SEBI's consultation paper on assigning responsibility for use of AI-tools by market entities regulated by SEBI

The Securities and Exchange Board of India (SEBI) has released a consultation paper on November 13, 2024 on regulating artificial intelligence (AI) and machine learning (ML) tools within Market Infrastructure Institutions (MIIs), intermediaries, and other regulated entities (collectively, market entities), with a balanced approach that embraces innovation while safeguarding stakeholder interests.

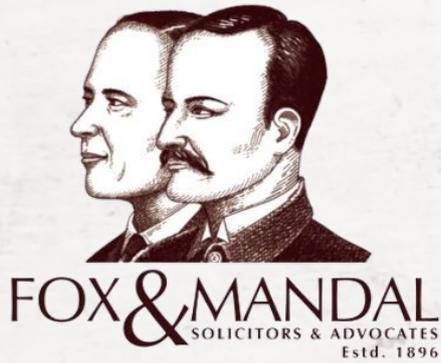
The paper proposes allocating responsibility to market entities deploying AI systems. SEBI has outlined proposed amendments to existing regulations – Securities and Exchange Board of India (Intermediaries) Regulations, 2008; Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2018; Securities and Exchange Board of India (Depositories and Participants) Regulations, 2018 – to enhance accountability, safeguard data, ensure compliance within the securities market, and oversee the outcome and address the consequences of use of AI. This will ensure that market entities adopting AI and ML technologies are custodians of the trust. This includes the proposed introduction of:

- **Regulation 16C** to Securities and Exchange Board of India (Intermediaries) Regulations, 2008
- **Regulation 39B** to Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2018
- **Regulation 82B** to Securities and Exchange Board of India (Depositories and Participants) Regulations, 2018

While the proposed amendments are an important first step, the framework requires comprehensive development on the following issues:

- **Specific liability:** SEBI's emphasis on accountability requires legal clarity to address issues of specific liability, ensuring that all stakeholders – from developers to operators as well as the management of MIIs – share responsibility for errors or misuse. For instance, if an AI tool misclassifies securities or triggers an unwarranted investigation due to faulty training data, the consequences must be clearly defined with recourse mechanisms in place to rectify these errors. This will hold the decision makers under MIIs to a higher threshold of diligence and accountability, and thus foster trust among market participants and encourage innovation by providing a safety net for responsible experimentation.
- **Collaboration with global market regulators:** As international regulators increasingly adopt AI-driven systems for market surveillance and fraud detection, SEBI's proposal recognises AI's competitive edge to support both domestic and cross-border investments in India by enabling faster data analysis, enhanced compliance monitoring, and seamless integration of international market standards. This necessitates robust collaboration between SEBI and global regulatory counterparts to ensure interoperability and shared learning.
- **Adopting a hybrid approach:** The integration of AI tools can simplify access to financial markets for investors, particularly retail investors as tools driven by AI can democratise market insights, making sophisticated strategies and analytics accessible to a broader audience. However, SEBI must guard against over-reliance on these systems, ensuring investors are not misled by over-optimistic projections or opaque algorithms. A hybrid approach that combines AI-powered tools with human advisory services can strike the right balance, offering convenience without compromising on prudence.
- **Addressing emerging threats:** Addressing emerging threats like algorithmic manipulation and cyber risks becomes important as rogue algorithms or hacking incidents targeting AI-based systems can destabilise markets, causing significant economic repercussions. Pre-emptive safeguards, rigorous stress testing, and regular audits of AI frameworks are essential to prevent such scenarios.
- **Addressing built-in biases:** AI models, trained on historical data, often carry the biases embedded in that data. These biases, if unchecked, can lead to discriminatory outcomes, skewed predictions, and potentially unfair regulatory practices.

SEBI's forward-looking stance marks a pivotal moment in India's financial sector as the adoption of AI in MIIs and intermediaries offers remarkable potential for transforming financial markets. The integration of clear accountability frameworks, safeguards against biases, and a focus on transparency would further elevate efficiency, foster trust, and solidify India's position as a leader in tech-driven financial regulation. However, this journey demands vigilance and adaptability to ensure that technological progress aligns with ethical and equitable principles.



CONTRIBUTORS

Arindam Sarkar | Partner
arindam.sarkar@foxandmandal.co.in

Anwasha Sinha | Senior Associate
anwasha.sinha@foxandmandal.co.in

Abhinav Jain | Associate
abhinav.jain@foxandmandal.co.in

Ayushi Awasthi | Associate
ayushi.awasthi@foxandmandal.co.in

Rangita Chowdhury | Associate
rangita.chowdhury@foxandmandal.co.in

Tanika Rampal | Assistant Manager
tanika.rampal@foxandmandal.co.in

Ashutosh Gupta | Partner
ashutosh.gupta@foxandmandal.co.in

Rudresh Mandal | Senior Associate
rudresh.mandal@foxandmandal.co.in

Akshay Luthra | Associate
akshay.luthra@foxandmandal.co.in

Biprojeet Talapatra | Associate
biprojeet.talapatra@foxandmandal.co.in

Suyash Sharma | Associate
suyash.sharma@foxandmandal.co.in

OUR OFFICES

BENGALURU

G 102, Embassy One Pinnacle
8 Bellary Road, Bengaluru 560 032
Email: bengaluru@foxandmandal.co.in

KOLKATA

7th Floor, 206 AJC Bose Road
Kolkata 700 017
Email: calcutta@foxandmandal.co.in

KOLKATA

12, Old Post Office Street
Kolkata 700 001
Email: calcutta@foxandmandal.co.in

MUMBAI

105, Arcadia Building, 195 NCPA Marg
Nariman Point, Mumbai 400 021
Email: mumbai@foxandmandal.co.in

NEW DELHI

Fox & Mandal House
D 394, Defence Colony, New Delhi 110 024
Email: newdelhi@foxandmandal.co.in

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