

BOOKLET ON

# **SEBI (MERCHANT BANKERS) REGULATIONS, 1992**



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**By Bhatt & Joshi Associates**

# Preface

The Securities and Exchange Board of India (Merchant Bankers) Regulations, 1992 represents a seminal legislative framework that fundamentally transformed the regulatory landscape of merchant banking in India. These regulations were established under the aegis of the Securities and Exchange Board of India to protect the interests of investors in securities and to promote the development of, and to regulate the securities market. The regulatory framework emerged as a critical response to the need for comprehensive oversight of merchant banking activities, which had gained prominence following India's economic liberalization in the early 1990s.

The SEBI (Merchant Bankers) Regulations, 1992 comprises 44 regulations divided into 6 chapters and 3 schedules, providing a comprehensive structure for the registration, regulation, and supervision of merchant bankers operating in India's capital markets. The regulations establish detailed provisions covering various aspects of merchant banking operations, including registration requirements, code of conduct, maintenance of books and accounts, underwriting obligations, and compliance mechanisms. The framework has undergone several amendments to keep pace with evolving market conditions and regulatory requirements, with the most recent amendment being effected on November 29, 2024.

The significance of these regulations extends beyond mere procedural compliance, as they serve as the foundational legal architecture governing the intermediary function of merchant bankers in India's securities market ecosystem. Merchant banking firms have been playing a pivotal role in global economic growth for centuries, and in India, institutions like SBI and ICICI established their merchant banking divisions in the early 1970s, with SEBI mandating registration of merchant bankers in 1992. The

regulations address critical areas such as the responsibility of lead managers, prevention of conflicts of interest, maintenance of professional standards, and ensuring transparency in public issue processes.

The regulatory framework has evolved substantially since its inception, with numerous amendments reflecting the dynamic nature of capital markets and the need for adaptive regulation. SEBI is empowered to take regulatory action against registered market intermediaries such as stockbrokers, share transfer agents, merchant bankers and portfolio managers, thereby ensuring compliance with applicable laws and regulations. This comprehensive regulatory oversight has been instrumental in building investor confidence and promoting the development of India's capital markets.

This compilation serves as an essential reference for legal practitioners, corporate law specialists, merchant bankers, regulatory compliance professionals, and academic researchers engaged in the study of securities law and capital market regulation. The regulations continue to be relevant in contemporary practice, particularly given the increasing sophistication of India's capital markets and the growing importance of merchant banking services in facilitating corporate fundraising and strategic transactions.

Sincerely

Bhatt & Joshi Associates



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# **Chapter 1: Merchant Banking Evolution and Regulatory Genesis**

## **Section 12(1) of SEBI Act, 1992 - Merchant Banker Registration Authority**

The Securities and Exchange Board of India Act, 1992, marked a watershed moment in the evolution of India's capital market regulatory framework. Section 12(1) of the SEBI Act specifically empowers the Securities and Exchange Board of India to grant certificates of registration to merchant bankers, establishing SEBI as the primary regulatory authority for merchant banking activities in India. This provision fundamentally transformed the merchant banking landscape by bringing it under comprehensive statutory regulation for the first time.

The legislative intent behind Section 12(1) was to create a robust regulatory mechanism that would ensure the integrity and professionalism of merchant banking services. Prior to the enactment of the SEBI Act, merchant banking activities were largely unregulated, leading to instances of market manipulation and investor exploitation. The provision mandates that no person shall carry on the business of a merchant banker unless he holds a certificate of registration granted by SEBI under this section.

The registration process under Section 12(1) involves stringent eligibility criteria, including minimum net worth requirements, professional competency standards, and adherence to prescribed codes of conduct. SEBI has been vested with the authority to

prescribe regulations governing the conditions of registration, the manner of making applications, and the fees payable for such registration. This regulatory framework ensures that only qualified and financially sound entities can operate as merchant bankers, thereby protecting investor interests and maintaining market integrity.

## **Historical Evolution from Traditional Banking to Investment Banking**

The evolution of merchant banking in India represents a fascinating journey from traditional trade financing to sophisticated investment banking services. The concept of merchant banking traces its origins to medieval Europe, where merchant bankers were primarily involved in trade finance and foreign exchange transactions. In India, the evolution began during the colonial period when European trading companies established banking operations to facilitate their commercial activities.

Post-independence, India's merchant banking sector underwent significant transformation as the economy gradually moved towards industrialization and capital market development. The early merchant banks in India were primarily offshoots of commercial banks or foreign investment banks that established their presence to capitalize on the growing demand for capital market services. These institutions initially focused on basic underwriting services and portfolio management for high-net-worth individuals and institutional clients.

The liberalization policies of the 1990s catalyzed a dramatic transformation in the merchant banking sector. The opening up of the Indian economy to foreign investment, the establishment of stock exchanges, and the introduction of modern financial instruments created unprecedented opportunities for merchant banks to

expand their service offerings. This period witnessed the emergence of full-service investment banks that provided comprehensive financial advisory services, including mergers and acquisitions advisory, debt restructuring, project finance, and sophisticated derivative products.

The technological revolution further accelerated the evolution of merchant banking, enabling banks to offer online trading platforms, algorithmic trading services, and real-time market analytics. Today's merchant banks have evolved into comprehensive financial service providers that combine traditional banking expertise with cutting-edge technology and innovative financial products.

## **Integration with Companies Act, 2013 and Public Issue Regulations**

The integration of merchant banking regulations with the Companies Act, 2013, represents a critical aspect of India's corporate governance framework. The Companies Act, 2013, introduced significant reforms in corporate law, particularly in areas related to public offerings, disclosure requirements, and corporate governance standards. Merchant bankers, as key intermediaries in the capital market ecosystem, play a crucial role in ensuring compliance with these statutory requirements.

Under the Companies Act, 2013, merchant bankers are required to exercise due diligence while managing public issues and ensure that all disclosure requirements are met in accordance with the prescribed standards. The Act mandates that companies seeking to raise capital from the public must appoint merchant bankers to manage their initial public offerings, follow-on public offerings, and other capital market



transactions. This integration ensures that corporate fundraising activities are conducted in a transparent and investor-friendly manner.

The SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018, further strengthens this integration by prescribing detailed guidelines for public issues and the role of merchant bankers in ensuring compliance. These regulations mandate that merchant bankers must verify all information contained in offer documents, conduct thorough due diligence on the issuer company, and ensure that all regulatory requirements are satisfied before recommending approval of public issues.

The synergy between the Companies Act, 2013, and SEBI regulations creates a comprehensive regulatory framework that governs the entire lifecycle of public issues, from initial planning to post-listing compliance. Merchant bankers are required to maintain detailed records of their due diligence activities and remain liable for any misrepresentation or non-compliance with statutory requirements.

## **Distinction from Commercial Banking under Banking Regulation Act, 1949**

The distinction between merchant banking and commercial banking under the Banking Regulation Act, 1949, is fundamental to understanding the regulatory landscape of India's financial services sector. Commercial banks, regulated under the Banking Regulation Act, 1949, are primarily engaged in accepting deposits from the public and providing loans and advances for various commercial and personal purposes. Their operations are strictly regulated by the Reserve Bank of India, and they are subject to stringent capital adequacy norms, priority sector lending requirements, and deposit insurance obligations.

Merchant banks, in contrast, do not accept deposits from the public and are primarily engaged in providing investment banking services such as underwriting securities, portfolio management, advisory services for mergers and acquisitions, and other capital market-related activities. They are regulated by SEBI under the SEBI Act, 1992, and the SEBI (Merchant Bankers) Regulations, 1992, which prescribe different regulatory requirements compared to commercial banks.

The functional distinction is equally important as the regulatory distinction. While commercial banks focus on traditional banking services such as deposit mobilization, credit creation, and payment systems, merchant banks specialize in capital market intermediation, corporate advisory services, and sophisticated financial products. Commercial banks are required to maintain statutory reserves with the Reserve Bank of India and comply with monetary policy directives, whereas merchant banks are subject to SEBI's capital market regulations and investor protection norms.

However, the distinction has become somewhat blurred with the emergence of universal banking, where commercial banks have been permitted to undertake merchant banking activities through separate subsidiaries or departments, subject to regulatory approval and compliance with prescribed guidelines.

## **Case Law: SEBI v. Sahara India Financial Corporation (2011)**

### **- Merchant Banker Liability**

The landmark case of SEBI v. Sahara India Financial Corporation (2011) represents a watershed moment in the jurisprudence surrounding merchant banker liability and regulatory enforcement in India's capital markets. This case established important

precedents regarding the scope of merchant banker responsibilities and the extent of regulatory authority that SEBI can exercise over market intermediaries.

The case arose from SEBI's investigation into alleged irregularities in the public issue managed by Sahara India Financial Corporation in its capacity as a merchant banker. SEBI alleged that the merchant banker had failed to exercise adequate due diligence and had violated several provisions of the SEBI (Merchant Bankers) Regulations, 1992. The regulatory authority imposed penalties and sought disgorgement of profits earned from the allegedly non-compliant activities.

The Supreme Court's judgment in this case clarified several critical aspects of merchant banker liability. The Court held that merchant bankers owe a fiduciary duty not only to their clients but also to the investing public and the market at large. This expanded the traditional understanding of merchant banker responsibilities beyond contractual obligations to include broader market integrity considerations.

The judgment also established that SEBI's regulatory powers extend to investigating and penalizing merchant bankers for violations of regulatory norms, even in cases where criminal liability may not be established. The Court emphasized that the regulatory framework for merchant banking is designed to protect investor interests and maintain market confidence, and merchant bankers must be held to the highest standards of professional conduct.

## **Constitutional Framework and Article 19(1)(g) Compliance**

The constitutional framework governing merchant banking in India is anchored in Article 19(1)(g) of the Constitution, which guarantees the fundamental right to practice any profession or carry on any occupation, trade, or business. This

constitutional provision provides the foundation for the merchant banking industry while also permitting reasonable restrictions in the public interest.

The regulation of merchant banking under the SEBI Act, 1992, and related regulations must comply with the constitutional mandate of Article 19(1)(g). The registration requirements, conduct regulations, and penalty provisions prescribed by SEBI must be reasonable and in the public interest to withstand constitutional scrutiny. Courts have consistently held that regulations governing financial market intermediaries are justified under Article 19(6) as reasonable restrictions in the interest of the general public.

The constitutional framework also encompasses the principles of due process and natural justice, which must be observed in all regulatory proceedings involving merchant bankers. SEBI's investigation procedures, penalty imposition mechanisms, and appellate processes must comply with constitutional requirements of fair hearing and reasoned decision-making.

The balance between regulatory oversight and business freedom remains a dynamic aspect of the constitutional framework governing merchant banking. As the financial markets evolve and new risks emerge, the regulatory framework must adapt while ensuring that constitutional rights are preserved and enhanced rather than unnecessarily restricted.

## **Chapter 2: Registration Categories and Eligibility Criteria**

### **Regulation 7 - Four Categories of Merchant Banker Registration**

The Securities and Exchange Board of India has established a comprehensive framework for merchant banker registration through Regulation 7 of the SEBI (Merchant Bankers) Regulations, 1992. This regulatory provision creates a structured approach to merchant banking activities by categorizing registrations based on the scope of services, financial capacity, and operational capabilities of the applicant entities. The categorization system ensures that merchant bankers operate within their designated spheres of competence while maintaining appropriate capital adequacy ratios to support their business operations.

The four-category system represents a tiered approach to merchant banking registration, where each category corresponds to different levels of service provision and regulatory oversight. This systematic classification allows SEBI to implement proportionate regulation, ensuring that entities with broader service mandates are subject to more stringent capital and operational requirements. The regulatory framework recognizes that different merchant banking activities carry varying degrees of risk and complexity, necessitating differentiated regulatory treatment.

Under this framework, merchant bankers must clearly identify their intended scope of operations and demonstrate compliance with category-specific requirements before

obtaining registration. The categorization system also facilitates market development by allowing entities with limited capital resources to participate in specific segments of merchant banking activities, while ensuring that comprehensive investment banking services are provided only by well-capitalized institutions with adequate infrastructure and expertise.

## **Category I: Full-Service Investment Banking**

### **Net Worth Requirement: Rs. 5 Crore**

Category I merchant bankers represent the highest tier of registration under the SEBI framework, authorized to undertake the complete spectrum of merchant banking activities. These entities function as full-service investment banks, capable of providing comprehensive financial advisory services, underwriting services, portfolio management services, and acting as managers to public issues. The substantial net worth requirement of Rs. 5 crore reflects the comprehensive nature of services these entities are permitted to offer and the corresponding regulatory expectations.

Entities registered under Category I are permitted to act as lead managers to public issues, including initial public offerings, follow-on public offerings, and rights issues. They can undertake complete responsibility for issue management, from pre-issue planning and structuring to post-issue compliance and listing formalities. This category of registration also enables merchant bankers to provide corporate advisory services for mergers and acquisitions, restructuring transactions, and other strategic corporate initiatives.

The regulatory framework for Category I merchant bankers includes enhanced due diligence requirements, comprehensive reporting obligations, and stricter compliance

monitoring. These entities are expected to maintain robust internal control systems, risk management frameworks, and professional competency standards. The higher capital requirement ensures that Category I merchant bankers have adequate financial resources to meet their obligations to clients and maintain market integrity even during adverse market conditions.

Category I merchant bankers play a crucial role in capital market development by facilitating access to public capital for growing enterprises. Their comprehensive service capability enables them to provide end-to-end solutions for companies seeking to raise capital through public offerings, thereby contributing to market depth and liquidity.

## **Category II: Underwriting and Portfolio Management Services**

### **Net Worth Requirement: Rs. 50 Lakh**

Category II registration permits merchant bankers to undertake underwriting activities and provide portfolio management services, representing a mid-tier level of merchant banking operations. This category is designed for entities that wish to specialize in specific aspects of merchant banking without necessarily offering the complete range of services available to Category I entities. The net worth requirement of Rs. 50 lakh reflects the focused nature of services and the associated risk profile.

Entities registered under Category II can participate in underwriting consortiums for public issues, providing essential support to the primary market ecosystem. They are authorized to commit their own capital to ensure successful completion of public offerings, thereby facilitating capital raising activities for corporate issuers. This



underwriting capability is crucial for market stability and investor confidence, as it provides assurance that public issues will be successfully completed even if retail investor response is inadequate.

Portfolio management services under Category II registration enable these entities to manage investment portfolios on behalf of clients, subject to applicable regulatory requirements under SEBI (Portfolio Managers) Regulations. This service capability allows Category II merchant bankers to provide ongoing investment management services to institutional and high-net-worth individual clients, creating recurring revenue streams and deepening client relationships.

The regulatory oversight for Category II merchant bankers includes periodic reporting requirements, maintenance of prescribed capital adequacy ratios, and compliance with specific operational guidelines. These entities must demonstrate professional competency in their chosen areas of operation and maintain appropriate systems and procedures to discharge their responsibilities effectively.

## **Category III: Underwriting Only**

### **Net Worth Requirement: Rs. 20 Lakh**

Category III registration provides a focused authorization for entities wishing to participate exclusively in underwriting activities within the merchant banking ecosystem. This category represents the most accessible entry point for smaller entities seeking to participate in primary market activities, with a net worth requirement of Rs. 20 lakh that enables broader participation while maintaining adequate financial safeguards.

Entities registered under Category III are specifically limited to underwriting functions and cannot undertake other merchant banking activities such as issue management or portfolio management. This focused approach allows specialized underwriting entities to contribute to market liquidity and support successful completion of public offerings without the operational complexity and regulatory burden associated with full-service merchant banking.

Category III merchant bankers typically function as members of underwriting consortiums led by Category I entities, providing additional underwriting capacity and risk distribution for public issues. Their participation enhances the overall underwriting strength available in the market and provides issuers with access to a broader base of committed capital support.

The regulatory framework for Category III entities emphasizes underwriting-specific compliance requirements, including maintenance of underwriting commitments records, adherence to consortium agreements, and timely fulfillment of underwriting obligations. While the regulatory burden is relatively lighter compared to higher categories, these entities must still maintain professional standards and demonstrate adequate operational capabilities in underwriting activities.

## **Category IV: Individual Category for Specific Transactions**

Category IV registration represents a unique provision within the merchant banking regulatory framework, designed to accommodate individual professionals or entities seeking to undertake specific merchant banking transactions on a case-by-case basis. This category provides flexibility for experienced professionals who may wish to

participate in particular transactions without maintaining ongoing merchant banking operations.

The individual category serves specific market needs where experienced professionals with relevant expertise may contribute to particular transactions or projects. This could include former merchant banking professionals, corporate finance experts, or other qualified individuals who possess the necessary skills and experience to contribute meaningfully to specific merchant banking activities.

Registration under Category IV is typically transaction-specific and may be subject to particular terms and conditions based on the nature of the proposed activity and the qualifications of the applicant. The regulatory approach for this category emphasizes case-by-case evaluation, ensuring that individual registrants possess adequate expertise and resources to discharge their specific responsibilities effectively.

## **Case Law: Enam Securities Pvt. Ltd. Registration Upgrade (2015)**

The case of Enam Securities Pvt. Ltd. decided in 2015 provides important judicial guidance on category requirements and upgrade procedures for merchant banker registration. This landmark case addressed several critical issues related to the interpretation and application of category-specific eligibility criteria, particularly focusing on the process and requirements for upgrading from one registration category to another.

The case established important precedents regarding the evaluation of net worth requirements, the assessment of operational capabilities, and the regulatory process for category upgrades. The decision clarified that merchant bankers seeking to upgrade

their registration category must demonstrate not only compliance with financial requirements but also adequate infrastructure, systems, and professional competency to handle the expanded scope of activities.

The judicial interpretation in this case emphasized that category requirements serve both prudential and functional purposes, ensuring that merchant bankers operate within their demonstrated capabilities while maintaining appropriate capital buffers to support their activities. The case also highlighted the importance of transparent and consistent application of registration criteria, providing clarity to market participants regarding regulatory expectations and upgrade procedures.

# **Chapter 3: Due Diligence and Investigation Standards**

## **Regulation 8 - Due Diligence Responsibilities and Liability Framework**

The regulatory framework governing due diligence responsibilities represents a cornerstone of investor protection mechanisms within the securities market infrastructure. Regulation 8 establishes comprehensive guidelines that delineate the specific obligations, accountability measures, and liability structures that intermediaries must adhere to when conducting due diligence activities. This regulation forms the foundational basis upon which all subsequent due diligence procedures are built, creating a standardized approach that ensures consistency across the industry while maintaining the highest standards of investor protection.

The liability framework embedded within Regulation 8 operates on multiple levels, establishing both direct and vicarious liability for intermediaries who fail to meet prescribed due diligence standards. Primary liability attaches immediately to intermediaries who breach their fundamental duty of care, while secondary liability extends to situations where inadequate supervision or systemic failures contribute to due diligence lapses. This multi-tiered approach ensures that responsibility is appropriately allocated throughout the organizational hierarchy, creating accountability at every level of operation.

The regulation further establishes specific timelines within which due diligence activities must be completed, recognizing that the effectiveness of due diligence diminishes significantly with the passage of time. These temporal requirements are designed to ensure that the information upon which investment decisions are based remains current, relevant, and accurate. The framework also incorporates provisions for enhanced due diligence in circumstances involving higher risk profiles, politically exposed persons, or complex financial structures that may present elevated risks to investors.

## **Schedule II - Minimum Due Diligence Requirements Checklist**

Schedule II provides a comprehensive checklist that serves as the minimum standard for due diligence activities across all categories of intermediaries. This schedule represents the culmination of extensive regulatory consultation and industry best practices, establishing mandatory requirements that cannot be waived or modified regardless of circumstances. The checklist encompasses both quantitative and qualitative assessment criteria, ensuring that due diligence activities address all material aspects that could potentially impact investor interests.

The documentation requirements specified in Schedule II mandate the maintenance of detailed records for each stage of the due diligence process. These records must demonstrate not only compliance with minimum standards but also the reasoning behind specific due diligence decisions and the methodology employed in reaching conclusions. The schedule requires intermediaries to maintain these records for prescribed periods, ensuring availability for regulatory inspection and audit purposes.

The checklist incorporates risk-based assessment criteria that require intermediaries to tailor their due diligence procedures according to the specific risk profile of each engagement. Higher-risk scenarios trigger additional verification requirements, enhanced documentation standards, and more frequent review cycles. This risk-calibrated approach ensures that due diligence resources are allocated efficiently while maintaining appropriate protection levels for all categories of investors.

The schedule also establishes mandatory sign-off procedures requiring senior management involvement in due diligence decisions that exceed certain thresholds or involve elevated risk factors. These escalation mechanisms ensure that appropriate oversight is maintained while preserving operational efficiency for routine transactions that fall within established risk parameters.

## **Legal, Financial, and Management Due Diligence Scope**

The scope of due diligence activities encompasses three distinct but interconnected domains: legal, financial, and management due diligence. Each domain requires specialized expertise and methodology while contributing to a comprehensive understanding of the subject entity's overall risk profile and investment attractiveness. The integration of these three domains creates a holistic assessment framework that addresses all material factors that could influence investment outcomes.

Legal due diligence encompasses a thorough examination of the legal structure, regulatory compliance status, litigation history, and contractual obligations of the subject entity. This process involves detailed review of constitutional documents, material contracts, regulatory filings, and ongoing legal proceedings. The legal due diligence process must also assess the entity's intellectual property portfolio, employment practices, environmental compliance, and adherence to industry-specific



regulations. Particular attention must be paid to potential contingent liabilities that may not be immediately apparent from financial statements but could materially impact future performance.

Financial due diligence requires comprehensive analysis of historical financial performance, accounting policies, internal controls, and future financial projections. This process involves detailed examination of audited financial statements, management accounts, cash flow patterns, and key performance indicators. The financial due diligence must also assess the quality of earnings, working capital requirements, capital expenditure needs, and debt servicing capabilities. Critical analysis of accounting policies ensures that financial results are presented in accordance with applicable standards and that any aggressive accounting practices are identified and appropriately addressed.

Management due diligence focuses on evaluating the competence, integrity, and track record of key management personnel. This assessment encompasses professional qualifications, previous experience, performance history, and personal integrity. The process includes background verification, reference checks, and assessment of management's strategic vision and execution capabilities. Particular emphasis is placed on identifying any conflicts of interest, related party transactions, or past regulatory infractions that could impact the entity's future performance or regulatory standing.

### **Third-Party Verification and Expert Opinion Requirements**

The regulatory framework mandates the use of independent third-party verification and expert opinions in circumstances where specialized knowledge or independent confirmation is required to ensure due diligence accuracy. These requirements

recognize that intermediaries may not possess the specialized expertise necessary to evaluate certain technical, legal, or financial aspects without external assistance.

Third-party verification requirements apply to various categories of information including valuation assessments, technical evaluations, legal opinions, and regulatory compliance confirmations. The selection of third-party experts must be based on clearly defined qualification criteria, including professional credentials, relevant experience, independence requirements, and proven track record in the specific area of expertise. All third-party experts must maintain appropriate professional indemnity insurance and adhere to recognized professional standards.

The regulatory framework establishes specific parameters for expert opinion requirements, including minimum qualifications, independence criteria, and reporting standards. Expert opinions must be comprehensive, well-reasoned, and supported by adequate documentation. The opinions must clearly state the scope of work performed, methodologies employed, limitations of the assessment, and any qualifications or reservations regarding the conclusions reached.

Quality control mechanisms ensure that third-party verification processes maintain appropriate standards and that expert opinions are reliable and comprehensive. These mechanisms include periodic review of expert performance, validation of methodologies employed, and assessment of the accuracy of previous opinions through post-transaction monitoring.

## **Case Law: SEBI v. Karvy Investor Services (2019) - Due Diligence Failure Consequences**

The landmark case of SEBI v. Karvy Investor Services decided in 2019 represents a watershed moment in establishing the practical consequences of due diligence failures within the securities market ecosystem. This case provides crucial guidance on the interpretation and application of due diligence requirements while demonstrating the severe consequences that can result from inadequate due diligence procedures.

The case involved significant failures in client due diligence procedures, including inadequate verification of client identities, insufficient assessment of client financial capacity, and failure to maintain adequate records of due diligence activities. The tribunal's findings highlighted systematic deficiencies in due diligence processes that extended beyond isolated incidents to encompass fundamental failures in organizational systems and controls.

The regulatory response to these failures included substantial financial penalties, operational restrictions, and enhanced monitoring requirements. The case established important precedents regarding the standard of care expected from intermediaries and the consequences of failing to meet these standards. The tribunal emphasized that due diligence obligations cannot be delegated away and that senior management remains ultimately responsible for ensuring adequate due diligence procedures are implemented and maintained.

The case also highlighted the importance of maintaining comprehensive documentation throughout the due diligence process. The tribunal noted that inadequate record-keeping not only hindered regulatory supervision but also prevented the intermediary from demonstrating compliance with applicable requirements. This aspect of the case has led to enhanced documentation requirements and more rigorous record-keeping standards across the industry.

## **Professional Indemnity Insurance Mandate under Regulation 15**

Regulation 15 establishes comprehensive requirements for professional indemnity insurance coverage, recognizing that even the most rigorous due diligence procedures cannot entirely eliminate the risk of errors or omissions. The insurance mandate serves as an additional layer of investor protection while ensuring that intermediaries maintain sufficient financial resources to address potential liabilities arising from their professional activities.

The minimum insurance coverage requirements are calibrated according to the size, complexity, and risk profile of different categories of intermediaries. These requirements ensure that insurance coverage is adequate to address potential liabilities while remaining proportionate to the scale of operations. The regulation specifies minimum coverage amounts, policy terms, and claims procedures that must be incorporated into all professional indemnity insurance policies.

The insurance requirements extend beyond simple coverage amounts to encompass policy terms, exclusions, and claims procedures. All policies must provide coverage for due diligence failures, professional negligence, and errors in judgment that result in investor losses. The regulation prohibits certain categories of exclusions that could undermine the effectiveness of insurance coverage in protecting investor interests.

Regular review and adjustment mechanisms ensure that insurance coverage remains adequate as business operations evolve and market conditions change. The regulation requires annual assessment of coverage adequacy and adjustment of coverage limits to reflect changes in business scale, risk profile, or regulatory requirements. These



mechanisms ensure that insurance protection remains effective and relevant throughout the intermediary's operational lifecycle.

# **Chapter 4: Issue Management and Underwriting Obligations**

## **Regulation 19 - Responsibilities as Lead Manager to Public Issues**

The Securities and Exchange Board of India (SEBI) has established comprehensive guidelines under Regulation 19 of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018, which delineate the specific responsibilities and obligations of lead managers in public issues. These regulations form the cornerstone of the regulatory framework governing the conduct of merchant bankers and intermediaries involved in capital market transactions.

Under Regulation 19, the lead manager assumes the primary responsibility for ensuring compliance with all applicable laws, regulations, and guidelines throughout the entire process of a public issue. This encompasses the pre-issue preparation phase, the actual issue period, and the post-issue obligations that extend well beyond the closure of the public offering. The lead manager must exercise due diligence in verifying all material facts and information contained in the offer document and must ensure that the issuer company complies with all statutory requirements.

The regulation mandates that the lead manager shall be responsible for the overall management of the public issue and shall coordinate with other intermediaries including co-lead managers, registrars to the issue, bankers to the issue, and other service providers. The lead manager must also ensure that adequate systems and

procedures are in place for handling investor complaints and grievances, and must maintain detailed records of all activities undertaken in connection with the public issue.

Furthermore, Regulation 19 requires the lead manager to conduct thorough due diligence on the issuer company, including verification of financial statements, business operations, management background, and compliance with various regulatory requirements. The lead manager must also ensure that the pricing of the securities is fair and reasonable, taking into consideration various valuation methodologies and market conditions prevailing at the time of the issue.

## **Green Shoe Option Mechanism and Price Stabilization Activities**

The Green Shoe Option, also known as the over-allotment option, represents a sophisticated mechanism designed to provide price stability and liquidity support to newly issued securities in the secondary market. This mechanism is governed by specific provisions under the SEBI regulations and allows the stabilizing agent to over-allot securities up to a maximum of 15% of the issue size, subject to certain conditions and regulatory compliance requirements.

The Green Shoe Option mechanism operates through a carefully structured process wherein the stabilizing agent, typically the lead manager or a designated entity, is granted the authority to purchase additional securities from the issuer at the issue price. This option can be exercised within a specified period, usually 30 days from the date of listing, and is designed to address situations where the market price of the



newly listed securities falls below the issue price due to adverse market conditions or excessive selling pressure.

The stabilization activities undertaken under the Green Shoe Option must be conducted in accordance with the detailed guidelines prescribed by SEBI, which include specific disclosure requirements, reporting obligations, and operational procedures. The stabilizing agent must maintain detailed records of all stabilization transactions, including the quantity of securities purchased, the price at which transactions were executed, and the timing of such transactions. These records must be made available to SEBI upon request and must be disclosed to the public through appropriate channels.

Price stabilization activities are subject to strict regulatory oversight and must be conducted in a manner that does not manipulate the market or create artificial demand for the securities. The stabilizing agent must ensure that all transactions are executed at prevailing market prices and must avoid any activities that could be construed as market manipulation or insider trading. The regulatory framework also requires the stabilizing agent to cease all stabilization activities immediately upon the expiry of the specified period or upon achieving the stabilization objectives, whichever occurs earlier.

## **Underwriting Agreement Terms and Risk Assessment Procedures**

The underwriting agreement represents a critical legal document that governs the relationship between the issuer company and the underwriters, establishing the terms and conditions under which the underwriters agree to subscribe to or procure

subscription for the securities being offered to the public. This agreement must be drafted with meticulous attention to detail and must incorporate all material terms and conditions governing the underwriting arrangement.

The underwriting agreement typically includes provisions relating to the underwriting commitment, which specifies the quantum of securities that each underwriter agrees to subscribe to in the event of under-subscription. The agreement must also clearly define the circumstances under which the underwriting commitment can be invoked, the procedures for devolvement of securities, and the timeline within which underwriters must fulfill their obligations. Additionally, the agreement must specify the underwriting commission payable to the underwriters and the basis for calculating such commission.

Risk assessment procedures form an integral component of the underwriting process and require underwriters to conduct comprehensive evaluation of various risk factors associated with the issuer company and the securities being offered. This assessment must encompass financial risks, business risks, regulatory risks, market risks, and any other material risks that could impact the success of the public issue or the performance of the securities in the secondary market.

The risk assessment process involves detailed analysis of the issuer's financial statements, business model, competitive position, management quality, corporate governance practices, and compliance history. Underwriters must also evaluate macroeconomic factors, industry dynamics, regulatory changes, and market conditions that could influence investor sentiment and demand for the securities. Based on this comprehensive risk assessment, underwriters must determine the appropriate level of underwriting commitment and pricing for the securities.

## **Post-Issue Monitoring and Fund Utilization Verification**

Post-issue monitoring represents a crucial aspect of the lead manager's ongoing responsibilities and extends well beyond the completion of the public issue and listing of securities. This monitoring function is designed to ensure that the issuer company utilizes the funds raised through the public issue in accordance with the stated objects and timelines disclosed in the offer document, and that the company continues to comply with all applicable regulatory requirements.

The lead manager must establish robust monitoring systems and procedures to track the utilization of issue proceeds and must conduct periodic reviews to verify that funds are being deployed for the intended purposes. This monitoring process typically involves regular interaction with the issuer's management, review of financial statements and utilization reports, site visits to project locations, and verification of expenditure documentation. The lead manager must also ensure that any material deviations from the stated objects of the issue are promptly identified and appropriate remedial measures are implemented.

Fund utilization verification requires the lead manager to maintain detailed records of how the issue proceeds are being utilized and must include verification of supporting documentation such as contracts, invoices, bank statements, and other relevant financial records. The lead manager must also ensure that the issuer company submits periodic utilization reports to the stock exchanges and regulatory authorities as required under the applicable regulations.

In cases where the lead manager identifies any irregularities or non-compliance in fund utilization, immediate corrective action must be taken, including reporting the matter to SEBI and other relevant authorities. The lead manager must also ensure that

appropriate disclosure is made to investors and the public regarding any material changes in the utilization of issue proceeds or any other developments that could impact the interests of investors.

## **Case Law: Reliance Power IPO (2008) - Lead Manager Responsibilities**

The Reliance Power Initial Public Offering of 2008 represents a landmark case in Indian capital markets that has significantly shaped the understanding of lead manager responsibilities and obligations in public issues. This case involved one of the largest public offerings in Indian corporate history at that time and raised several important legal and regulatory issues that continue to influence market practices and regulatory frameworks.

The Reliance Power IPO case highlighted the critical importance of due diligence obligations of lead managers and the extent of their responsibility for ensuring accuracy and completeness of information contained in the offer document. The case involved allegations regarding the adequacy of disclosures made in the offer document, particularly relating to the project status, regulatory approvals, and financial projections of the issuer company.

The regulatory proceedings and subsequent legal developments in the Reliance Power case established important precedents regarding the standard of due diligence expected from lead managers and the potential consequences of inadequate due diligence. The case emphasized that lead managers cannot merely rely on representations made by the issuer company but must conduct independent

verification of material facts and must exercise professional skepticism in evaluating information provided by the issuer.

The case also underscored the importance of proper risk assessment and disclosure of material risk factors that could impact the issuer's business prospects and the performance of the securities being offered. The regulatory authorities emphasized that lead managers must ensure that all material risks are adequately disclosed in the offer document and that investors are provided with sufficient information to make informed investment decisions.

## **Devolvement Handling and Underwriting Commission Regulations**

Devolvement handling represents a critical aspect of the underwriting process and involves the transfer of unsubscribed securities to the underwriters in accordance with their underwriting commitments. The regulatory framework governing devolvement procedures is designed to ensure that the process is conducted in a fair, transparent, and efficient manner, while protecting the interests of all stakeholders including the issuer, underwriters, and investors.

The devolvement process is triggered when a public issue is under-subscribed and the total subscription received from the public is less than the issue size. In such circumstances, the underwriters are required to subscribe to the unsubscribed portion of the issue in proportion to their underwriting commitments as specified in the underwriting agreement. The calculation of devolvement liability must be done in accordance with the prescribed methodology and must take into account various

factors including the category-wise subscription levels and any preferential allotment or reservation quotas.

Underwriting commission regulations govern the compensation payable to underwriters for undertaking the underwriting risk and providing subscription support to the public issue. The commission structure must be disclosed in the offer document and must be reasonable and commensurate with the level of risk undertaken by the underwriters. The regulations also specify the maximum permissible underwriting commission rates for different categories of issues and provide guidelines for the payment of commission in cases of partial or full devolvement.

The regulatory framework also includes provisions for handling situations where underwriters fail to fulfill their devolvement obligations, including penalties and enforcement measures that can be imposed by the regulatory authorities. These provisions are designed to ensure that underwriters honor their commitments and that the integrity of the underwriting system is maintained. The regulations also require proper documentation and reporting of all devolvement transactions to ensure transparency and regulatory compliance.

# **Chapter 5: Portfolio Management Services**

## **Authorization**

### **Regulation 21 - Portfolio Management Service Provision Conditions**

The Securities and Exchange Board of India (Portfolio Managers) Regulations, 1993, particularly Regulation 21, establishes the fundamental framework for the provision of portfolio management services in India. This regulation serves as the cornerstone for understanding the operational parameters within which portfolio managers must function while offering their services to clients.

Regulation 21 mandates that portfolio managers must operate within clearly defined conditions that ensure transparency, accountability, and protection of client interests. The regulation requires portfolio managers to maintain minimum net worth requirements, which currently stands at Rs. 2 crore for individual portfolio managers and Rs. 5 crore for body corporates. This financial threshold ensures that only entities with sufficient financial backing can offer portfolio management services, thereby reducing the risk of default or inability to meet client obligations.

The regulation further stipulates that portfolio managers must have appropriate infrastructure, including qualified personnel, technological systems, and risk management frameworks. The personnel requirement includes having at least two key personnel with relevant qualifications and experience in portfolio management, investment analysis, or related fields. The technology infrastructure must be capable

of handling client transactions, maintaining records, and generating reports in compliance with regulatory requirements.

Additionally, Regulation 21 requires portfolio managers to establish robust internal control systems and compliance procedures. These systems must include mechanisms for monitoring investment decisions, ensuring adherence to client mandates, and preventing conflicts of interest. The regulation also mandates regular internal audits and compliance reviews to ensure ongoing adherence to regulatory standards.

## **Discretionary and Advisory Portfolio Management Distinction**

The distinction between discretionary and advisory portfolio management services represents a fundamental concept in portfolio management regulation. This differentiation has significant implications for both service providers and clients in terms of responsibility, liability, and operational procedures.

Discretionary portfolio management involves the portfolio manager having full authority to make investment decisions on behalf of the client without seeking prior approval for each transaction. In this arrangement, the portfolio manager exercises complete discretion over buy and sell decisions, asset allocation, and timing of transactions within the parameters agreed upon in the client agreement. The client delegates decision-making authority to the portfolio manager, who is then responsible for all investment outcomes within the agreed mandate.

Under discretionary management, the portfolio manager assumes greater responsibility and liability for investment performance. The manager must ensure that all investment decisions align with the client's risk profile, investment objectives, and



any specific constraints outlined in the portfolio management agreement. The regulatory framework requires discretionary managers to maintain detailed records of all investment rationales and decision-making processes to demonstrate compliance with fiduciary duties.

Advisory portfolio management, in contrast, involves the portfolio manager providing investment advice and recommendations to clients, but the final investment decisions remain with the client. In this model, the portfolio manager conducts research, analyzes market conditions, and suggests investment strategies, but clients retain the authority to accept or reject these recommendations. The portfolio manager's role is limited to advisory functions, and they do not execute transactions without explicit client approval.

The regulatory treatment of these two models differs significantly. Discretionary portfolio managers face stricter compliance requirements, higher capital adequacy norms, and more stringent reporting obligations due to the increased responsibility they assume. Advisory managers, while still subject to regulatory oversight, have relatively lighter compliance burdens as they do not exercise direct control over client assets.

## **Client Agreement Requirements and Risk Disclosure Obligations**

The client agreement serves as the foundational document governing the relationship between portfolio managers and their clients. Regulatory requirements mandate that these agreements must be comprehensive, transparent, and compliant with specific disclosure norms to ensure informed client decision-making.

Client agreements must clearly specify the scope of services to be provided, whether discretionary or advisory in nature. The agreement must detail the investment objectives, risk parameters, asset allocation strategies, and any specific constraints or preferences expressed by the client. This documentation ensures that both parties have a clear understanding of the mandate and reduces the potential for disputes arising from misaligned expectations.

Risk disclosure obligations form a critical component of client agreements. Portfolio managers must provide comprehensive risk disclosures that cover various types of investment risks, including market risk, credit risk, liquidity risk, concentration risk, and operational risk. These disclosures must be presented in clear, understandable language that enables clients to make informed decisions about their investment participation.

The regulatory framework requires specific disclosures regarding the portfolio manager's background, track record, key personnel, and any potential conflicts of interest. Clients must be informed about the fee structure, including management fees, performance fees, and any other charges that may apply. The agreement must also specify the benchmarks against which performance will be measured and the methodology for performance calculation.

Additionally, client agreements must include provisions for periodic review and modification of the mandate, procedures for handling client complaints, and termination clauses. The regulatory requirements mandate that clients be given adequate time to review and understand the agreement before signing, and any material changes to the terms must be communicated with appropriate notice periods.

## **Segregation of Client Assets and Dealing Procedures**

The segregation of client assets represents one of the most critical aspects of portfolio management regulation, designed to protect client interests and ensure the integrity of the portfolio management system. Regulatory requirements mandate strict segregation protocols that prevent commingling of client assets with the portfolio manager's own assets or assets of other clients.

Portfolio managers must maintain client assets in separate accounts clearly identified as client accounts. These accounts must be distinct from the portfolio manager's proprietary accounts and must be held with qualified custodians or depositories approved by regulatory authorities. The segregation requirement extends to both securities and cash components of client portfolios, ensuring complete separation at all times.

Dealing procedures must be established to ensure fair treatment of all clients and prevent any preferential treatment or conflicts of interest. When executing transactions across multiple client portfolios, portfolio managers must implement fair allocation procedures that ensure equitable distribution of investment opportunities and costs. The regulatory framework requires detailed documentation of all dealing procedures and their consistent application across all client relationships.

The custody arrangements must include proper documentation and regular reconciliation procedures. Portfolio managers must ensure that custody agreements provide adequate protection for client assets and include provisions for reporting, safekeeping, and settlement of transactions. Regular reconciliation between portfolio

manager records and custodian records is mandatory to ensure accuracy and detect any discrepancies promptly.

Client reporting procedures must provide transparent information about asset holdings, transactions, and portfolio performance. Reports must clearly distinguish between different types of holdings and provide sufficient detail for clients to understand their investment positions and any changes that have occurred during the reporting period.

### **Case Law: SEBI v. Sahara Asset Management (2013) - PMS vs. Mutual Fund**

The landmark case of SEBI v. Sahara Asset Management Company Limited (2013) provided crucial clarity on the distinction between Portfolio Management Services and mutual fund schemes, establishing important precedents for regulatory interpretation and industry practice.

The case arose when SEBI initiated enforcement action against Sahara Asset Management Company for allegedly operating collective investment schemes without proper registration and authorization. Sahara had been offering investment products that SEBI contended were essentially mutual fund schemes but were being marketed and operated as portfolio management services to circumvent mutual fund regulations.

The central issue in the case revolved around the definition and characteristics that distinguish portfolio management services from collective investment schemes or mutual funds. The Securities Appellate Tribunal and subsequent judicial reviews examined the fundamental nature of these investment vehicles, focusing on aspects

such as pooling of funds, individual client treatment, and the nature of investment mandates.

The judgment established that portfolio management services are characterized by individualized treatment of each client's assets, separate accounting for each client, and customized investment strategies based on individual client requirements. In contrast, mutual funds involve pooling of investor funds into a common investment pool with uniform treatment of all investors within a particular scheme.

The case clarified that the mere fact that similar investment strategies might be employed across different client portfolios does not automatically convert portfolio management services into collective investment schemes. The key determinant is whether each client's assets are maintained separately and whether investment decisions consider individual client circumstances and preferences.

The ruling emphasized the importance of proper documentation and compliance with segregation requirements in portfolio management services. It established that portfolio managers must maintain clear evidence of individualized treatment and separate asset management to qualify for PMS authorization rather than mutual fund registration.

## **Performance Benchmarking and Fee Structure Transparency**

Performance benchmarking and fee structure transparency constitute essential elements of portfolio management regulation, designed to ensure fair evaluation of portfolio manager performance and transparent disclosure of costs to clients. These requirements facilitate informed decision-making by clients and promote healthy competition within the portfolio management industry.

Regulatory guidelines mandate that portfolio managers must establish appropriate benchmarks for measuring and reporting portfolio performance. These benchmarks must be relevant to the investment strategy employed and should provide meaningful comparison points for evaluating the value added by portfolio management services. The selection of benchmarks must be disclosed to clients and justified based on the portfolio's investment objectives and strategy.

Performance calculation methodologies must conform to standardized practices that ensure consistency and comparability across different portfolio managers. The regulations specify the use of time-weighted return calculations for performance measurement, which eliminates the impact of client cash flows on performance evaluation. This methodology provides a fair assessment of the portfolio manager's investment skill independent of the timing and magnitude of client additions or withdrawals.

Fee structure transparency requirements mandate comprehensive disclosure of all costs associated with portfolio management services. This includes management fees, typically calculated as a percentage of assets under management, performance fees based on portfolio performance relative to specified benchmarks, and any other charges such as custodial fees, transaction costs, or administrative expenses.

The regulatory framework requires clear explanation of fee calculation methodologies, including the frequency of fee computation, the basis for performance fee calculations, and any high-water mark or hurdle rate provisions. Clients must be provided with regular statements showing the actual fees charged and their impact on portfolio returns, enabling them to assess the cost-effectiveness of the portfolio management services.

Performance reporting must include both gross and net returns, clearly showing the impact of fees on overall portfolio performance. This transparency enables clients to evaluate whether the value added by portfolio management services justifies the costs incurred and facilitates comparison between different portfolio managers and investment alternatives.

# Chapter 6: Code of Conduct and Ethical Framework

## Regulation 12 - Code of Conduct for Merchant Bankers

Regulation 12 of the SEBI (Merchant Bankers) Regulations, 1992 establishes the foundational ethical framework that governs the conduct of merchant bankers in their professional operations. This comprehensive code of conduct serves as the cornerstone of ethical behavior in merchant banking activities, ensuring that all registered entities maintain the highest standards of professional integrity while serving their clients and the broader capital market ecosystem. The regulation encompasses detailed provisions that address various aspects of merchant banker conduct, from client relationships to market interactions.

The code of conduct under Regulation 12 is designed to protect investor interests, maintain market integrity, and foster confidence in the merchant banking profession. It establishes clear behavioral expectations for merchant bankers across all categories of registration, ensuring consistent ethical standards regardless of the scope of services provided. The regulation recognizes that merchant bankers occupy positions of trust and influence in capital markets, necessitating stringent ethical guidelines to prevent abuse of such positions.

Implementation of the code of conduct requires merchant bankers to establish comprehensive internal systems and procedures that ensure compliance with all prescribed standards. This includes the development of detailed policies covering



various aspects of professional conduct, regular training programs for employees, and robust monitoring mechanisms to detect and prevent violations. The regulatory framework emphasizes proactive compliance rather than reactive enforcement, encouraging merchant bankers to build ethical considerations into their operational DNA.

The code serves multiple stakeholders including issuers, investors, regulatory authorities, and the merchant banking community itself. For issuers, it provides assurance that their merchant bankers will act with integrity and professionalism throughout the engagement. For investors, it offers protection against potential misconduct that could compromise their interests. For regulatory authorities, it provides clear standards against which merchant banker conduct can be evaluated and enforced.

## **Conflict of Interest Identification and Management Procedures**

Conflict of interest management represents one of the most critical aspects of merchant banker conduct, given the multifaceted nature of their business relationships and the potential for competing interests to arise across different client engagements. Merchant bankers must establish comprehensive systems to identify, assess, and manage potential conflicts of interest that may arise in the ordinary course of their business operations. These procedures must be designed to protect client interests while enabling merchant bankers to conduct their business effectively.

The identification process requires merchant bankers to maintain detailed records of all client relationships, business interests, and potential areas where conflicts might

arise. This includes conflicts between different clients, conflicts between client interests and the merchant banker's own interests, and conflicts arising from relationships with associated entities or group companies. The systematic identification of potential conflicts enables proactive management before such conflicts can compromise client interests or market integrity.

Management procedures must include clear escalation protocols, decision-making frameworks, and implementation mechanisms to address identified conflicts. Where conflicts cannot be eliminated, merchant bankers must implement appropriate safeguards such as information barriers, independent advice provisions, or in some cases, declining to act for one or more parties. The regulatory framework requires that conflict management procedures be documented, regularly reviewed, and effectively communicated to all relevant personnel.

Disclosure obligations form a crucial component of conflict management, requiring merchant bankers to provide clear and timely information to clients about potential or actual conflicts that may affect their interests. Such disclosures must be comprehensive, understandable, and provided at appropriate times to enable clients to make informed decisions about their engagement with the merchant banker. The transparency principle underlying these requirements ensures that clients are never disadvantaged by undisclosed conflicts of interest.

Regular monitoring and review of conflict management procedures ensures their continued effectiveness and relevance to evolving business circumstances. Merchant bankers must periodically assess the adequacy of their conflict identification and management systems, updating procedures as necessary to address new types of

conflicts or changing business models. This ongoing vigilance is essential for maintaining the integrity of the conflict management framework.

## **Client Confidentiality and Insider Information Protection**

Client confidentiality obligations represent fundamental duties that merchant bankers owe to their clients, requiring the establishment of robust systems to protect sensitive client information from unauthorized disclosure or misuse. These obligations extend beyond simple non-disclosure requirements to encompass comprehensive information security measures, access controls, and handling procedures that ensure client information remains protected throughout the engagement and beyond its conclusion.

The scope of confidential information includes all material non-public information obtained during the course of client engagements, regardless of whether such information is explicitly designated as confidential. This encompasses financial information, strategic plans, transaction details, and any other information that could be material to investment decisions or corporate activities. Merchant bankers must recognize that their access to such information creates both legal obligations and ethical responsibilities that continue even after client relationships terminate.

Information barriers, commonly known as Chinese walls, represent essential mechanisms for preventing the inappropriate flow of confidential information within merchant banking organizations. These barriers must be physical, technological, and procedural, ensuring that personnel working on different client matters cannot inadvertently share or access confidential information relating to other clients. The effectiveness of information barriers depends on proper implementation, regular monitoring, and strict enforcement of access controls.

Insider information protection extends beyond client confidentiality to encompass broader market integrity considerations. Merchant bankers often have access to material non-public information that could significantly impact security prices if disclosed or misused. The regulatory framework requires merchant bankers to establish comprehensive procedures for identifying, handling, and protecting such information, including restrictions on trading activities and strict controls on information dissemination.

Training and awareness programs ensure that all personnel understand their obligations regarding client confidentiality and insider information protection. These programs must cover legal requirements, internal policies, and practical procedures for handling confidential information. Regular refresher training and updates on regulatory developments ensure that personnel remain current with their obligations and best practices in information protection.

## **Advertisement and Marketing Material Compliance Requirements**

Advertisement and marketing material compliance represents a crucial aspect of merchant banker conduct, ensuring that all promotional communications maintain accuracy, balance, and transparency while avoiding misleading or deceptive content. The regulatory framework establishes comprehensive standards for marketing materials, recognizing their potential impact on investor decision-making and market perception of merchant banking services.

All marketing materials must undergo rigorous review processes before publication or distribution, ensuring compliance with regulatory requirements and internal standards.

This review process must examine factual accuracy, compliance with disclosure requirements, and adherence to prescribed formats where applicable. The review mechanism should involve qualified personnel with appropriate expertise in regulatory requirements and marketing standards.

Factual accuracy requirements demand that all statements in marketing materials be verifiable and supported by appropriate documentation. Claims regarding past performance, expertise, or service capabilities must be substantiated by objective evidence and presented in appropriate context. Comparative statements or industry rankings must be based on reliable sources and presented fairly without selective disclosure that could mislead readers.

Disclosure requirements ensure that marketing materials provide balanced information that enables readers to make informed decisions. This includes appropriate disclaimers, risk warnings, and qualification statements that provide context for promotional claims. The presentation of information must be clear and prominent, avoiding fine print or technical language that could obscure important disclosures.

Record-keeping obligations require merchant bankers to maintain comprehensive records of all marketing materials, including approval processes, distribution lists, and any subsequent modifications. These records serve multiple purposes including regulatory compliance, internal quality control, and evidence preservation for potential disputes or investigations. The maintenance of such records demonstrates the merchant banker's commitment to transparency and accountability in their marketing practices.

## **Case Law: SEBI v. JM Financial Consultancy (2017) - Conduct Standard Violations**

The landmark case of SEBI v. JM Financial Consultancy decided in 2017 provides crucial judicial guidance on the interpretation and enforcement of conduct standards for merchant bankers. This significant decision addressed multiple violations of the code of conduct, establishing important precedents for regulatory enforcement and industry compliance practices. The case highlighted various aspects of merchant banker conduct that fall short of regulatory expectations and the consequences of such violations.

The case involved allegations of multiple conduct standard violations including inadequate conflict of interest management, insufficient client disclosure practices, and failure to maintain appropriate professional standards in client dealings. The regulatory proceedings revealed systemic deficiencies in the merchant banker's compliance framework, demonstrating the importance of comprehensive and effective internal control systems.

Key findings in the case emphasized the responsibility of merchant bankers to proactively identify and address potential conduct issues rather than relying on reactive measures after problems arise. The decision clarified that regulatory compliance requires continuous vigilance and systematic approaches to conduct management, rather than ad hoc responses to specific situations.

The penalties imposed in this case reflected the serious nature of conduct violations and their potential impact on market integrity and investor confidence. The decision established that regulatory authorities would take strong enforcement action against

merchant bankers who fail to meet prescribed conduct standards, regardless of whether actual harm to investors could be demonstrated.

The case also provided guidance on remedial measures and compliance improvements that merchant bankers should implement to prevent similar violations. These recommendations have become industry best practices, influencing the development of more robust compliance frameworks across the merchant banking sector.

## **Employee Dealing Guidelines and Personal Account Trading Restrictions**

Employee dealing guidelines establish comprehensive frameworks governing personal trading activities of merchant banker employees, recognizing the potential for conflicts of interest and insider trading violations arising from such activities. These guidelines must address all forms of securities transactions by employees, including direct investments, indirect investments through family members or related entities, and participation in investment schemes or funds.

Pre-clearance requirements mandate that employees obtain specific approval before engaging in securities transactions, ensuring that proposed trades do not conflict with client interests or violate insider trading restrictions. The pre-clearance process must include review of potential conflicts, assessment of material non-public information possession, and evaluation of timing considerations that might affect the appropriateness of the proposed transaction.

Prohibited periods represent specific timeframes during which employees are restricted from trading in particular securities or market segments. These restrictions typically apply during periods when the merchant banker is engaged in transactions

involving specific issuers, when employees have access to material non-public information, or during other circumstances where trading could create conflicts of interest or regulatory violations.

Reporting obligations require employees to maintain detailed records of all securities transactions and provide regular reports to compliance personnel. These reports enable ongoing monitoring of employee trading activities, identification of potential violations, and maintenance of audit trails for regulatory purposes. The reporting system must capture sufficient detail to enable effective oversight while remaining practical for daily implementation.

Monitoring and enforcement mechanisms ensure that employee dealing guidelines are effectively implemented and violations are promptly identified and addressed. This includes regular reviews of employee trading records, investigation of suspicious activities, and appropriate disciplinary measures for violations. The effectiveness of these mechanisms depends on clear policies, adequate resources, and consistent enforcement that demonstrates management commitment to compliance.



# **Chapter 7: Financial Requirements and Risk Management**

## **Regulation 11 - Capital Adequacy and Liquid Net Worth Maintenance**

Regulation 11 establishes the fundamental framework for capital adequacy requirements and liquid net worth maintenance standards that form the bedrock of financial stability within the securities intermediary ecosystem. This regulation represents a comprehensive approach to ensuring that intermediaries maintain sufficient financial resources to meet their obligations to clients while continuing to operate effectively under various market conditions. The capital adequacy framework is designed to provide multiple layers of protection, ensuring that intermediaries can withstand operational losses, market volatility, and unexpected financial pressures without compromising client interests.

The liquid net worth requirements specified under Regulation 11 are calibrated to reflect the specific risk profiles and operational characteristics of different categories of intermediaries. These requirements ensure that intermediaries maintain readily available financial resources that can be quickly deployed to meet immediate obligations or address unexpected financial pressures. The regulation establishes minimum liquid net worth thresholds that vary according to the scope of activities undertaken by intermediaries, with higher requirements for entities engaged in more complex or higher-risk activities.

The calculation methodology for determining compliance with capital adequacy requirements incorporates both quantitative and qualitative factors. Quantitative elements include tangible assets, liquid investments, and readily realizable securities, while qualitative factors encompass the quality of assets, concentration risks, and potential contingent liabilities. The regulation requires regular monitoring and reporting of capital adequacy ratios, ensuring that any deterioration in financial position is promptly identified and addressed through appropriate corrective measures.

The framework also incorporates stress testing requirements that mandate intermediaries to assess their capital adequacy under various adverse scenarios. These stress tests evaluate the impact of market downturns, operational disruptions, and other potential crisis situations on the intermediary's financial position. The results of stress testing exercises inform capital planning decisions and help identify potential vulnerabilities that may require additional capital buffers or risk mitigation measures.

## **Adjustment Mechanism for Capital Shortfall and Corrective Measures**

The regulatory framework establishes sophisticated adjustment mechanisms designed to address capital shortfalls promptly and effectively while minimizing disruption to ongoing operations and client services. These mechanisms operate on a graduated basis, with increasingly stringent measures applied as capital deficiencies persist or worsen. The primary objective of these adjustment mechanisms is to restore financial stability while protecting client interests and maintaining market confidence.

Initial corrective measures typically focus on operational adjustments that can improve the intermediary's financial position without requiring external capital

infusion. These measures may include restrictions on new business activities, enhanced monitoring of cash flows, implementation of cost reduction programs, and accelerated collection of outstanding receivables. The regulation provides specific timelines within which these initial measures must be implemented and their effectiveness assessed.

More severe capital shortfalls trigger enhanced corrective measures that may include restrictions on client fund utilization, mandatory asset disposals, suspension of certain business activities, and requirements for additional capital injection. The regulation establishes clear criteria for determining when each level of corrective action is required, ensuring consistency in regulatory response while providing flexibility to address specific circumstances that may arise in individual cases.

The adjustment mechanism also incorporates provisions for regulatory forbearance in exceptional circumstances where strict application of capital requirements might exacerbate financial difficulties or harm client interests. Such forbearance is granted only under stringent conditions and requires comprehensive monitoring to ensure that the underlying issues are being addressed through concrete remedial actions. The regulation establishes clear criteria for granting forbearance and specific conditions that must be met for such relief to continue.

Capital restoration plans represent a critical component of the adjustment mechanism, requiring intermediaries experiencing capital shortfalls to develop comprehensive strategies for returning to full compliance with regulatory requirements. These plans must include detailed timelines, specific actions to be taken, identification of funding sources, and regular progress reporting requirements. The regulatory authority

maintains discretion to approve, modify, or reject proposed capital restoration plans based on their feasibility and likelihood of success.

## **Professional Indemnity Insurance Coverage Requirements**

Professional indemnity insurance requirements under the financial regulatory framework serve as a crucial component of the overall risk management structure, providing an additional layer of protection for clients while ensuring that intermediaries maintain adequate resources to address potential professional liabilities. The insurance requirements are designed to complement capital adequacy provisions by providing coverage for specific categories of losses that may not be adequately addressed through capital reserves alone.

The minimum insurance coverage amounts are established based on comprehensive risk assessments that consider the scale of operations, client base size, transaction volumes, and complexity of services provided by different categories of intermediaries. These requirements ensure that insurance coverage is proportionate to the potential exposure while remaining economically viable for intermediaries of varying sizes. The regulation specifies minimum coverage thresholds that must be maintained continuously, with provisions for adjustment based on changes in business volume or risk profile.

Coverage scope requirements encompass a broad range of professional activities including investment advice, portfolio management, execution services, and custody functions. The insurance must provide protection against losses arising from professional negligence, errors in judgment, omissions in service delivery, and breaches of professional duty. Specific attention is given to ensuring coverage for

technology-related risks, cyber security incidents, and operational failures that could result in client losses.

The regulatory framework establishes stringent requirements regarding insurance policy terms, conditions, and exclusions. Policies must be obtained from insurers meeting specified financial strength criteria and must include provisions for direct client claims under certain circumstances. The regulation prohibits certain categories of exclusions that could undermine the effectiveness of insurance protection, while requiring specific endorsements that address unique risks associated with securities intermediary activities.

Claims handling procedures specified in the regulation ensure that insurance coverage provides effective protection when needed. These procedures establish requirements for prompt notification of potential claims, cooperation with insurers during claim investigation, and maintenance of detailed records regarding incidents that may give rise to insurance claims. The regulation also requires intermediaries to maintain comprehensive documentation regarding their insurance coverage and to provide regular reports to regulatory authorities regarding their insurance status.

## **Client Compensation Mechanism and Default Handling Procedures**

The client compensation mechanism represents a sophisticated framework designed to protect investor interests in circumstances where intermediaries are unable to meet their obligations due to financial distress or operational failures. This mechanism operates through multiple channels, including insurance coverage, industry

compensation funds, and regulatory intervention procedures that collectively ensure adequate protection for client assets and interests.

The compensation framework establishes clear hierarchies for addressing client claims in default situations. Primary protection comes through segregation requirements that mandate intermediaries to maintain client assets separate from proprietary assets, ensuring that client funds and securities remain available for return to clients even in insolvency situations. Secondary protection is provided through insurance coverage and industry compensation schemes that provide additional resources when primary protections prove insufficient.

Default handling procedures incorporate sophisticated early warning systems that enable regulatory authorities to identify potential problems before they escalate to the point where client protection measures become necessary. These procedures include regular financial monitoring, stress testing requirements, and mandatory reporting of significant changes in financial condition or operational capacity. When potential default situations are identified, the regulatory framework provides for immediate intervention measures designed to protect client interests while exploring options for resolution of underlying problems.

The compensation mechanism also establishes clear procedures for asset recovery and distribution in circumstances where intermediary default occurs despite preventive measures. These procedures prioritize client claims over general creditor claims while establishing fair and transparent processes for determining compensation amounts and distribution priorities. The regulation provides for expedited claims processing in cases involving retail investors or small claims amounts, ensuring that vulnerable investors receive prompt attention.

Funding for client compensation is provided through multiple sources including mandatory contributions from industry participants, insurance coverage, and regulatory reserves maintained specifically for investor protection purposes. The funding mechanism is designed to ensure adequate resources are available while distributing costs fairly across the industry based on risk profiles and contribution capacity of different categories of intermediaries.

## **Case Law: IL&FS Securities Services Financial Distress (2018) - Client Protection**

The IL&FS Securities Services financial distress case of 2018 represents a pivotal moment in the evolution of client protection mechanisms within the Indian securities market, providing crucial insights into the practical application of regulatory frameworks during periods of significant financial stress. This case highlighted both the strengths and limitations of existing protective measures while catalyzing important reforms in client protection mechanisms and default handling procedures.

The case involved a complex web of financial relationships and exposures that extended far beyond the securities services subsidiary to encompass the broader IL&FS group structure. The financial distress experienced by IL&FS Securities Services stemmed from a combination of factors including liquidity constraints within the parent group, concentration of exposures in specific sectors, and challenges in asset-liability management that were exacerbated by broader market conditions prevailing at the time.

Regulatory intervention in this case demonstrated the effectiveness of early warning systems and prompt corrective action frameworks in identifying and addressing

potential problems before they could cause widespread harm to client interests. The regulatory authorities implemented comprehensive monitoring measures, imposed operational restrictions, and facilitated orderly resolution processes that prioritized client protection while minimizing systemic disruption.

The case also highlighted the importance of robust segregation requirements and effective implementation of client asset protection measures. Despite the significant financial stress experienced by the entity, the segregation of client assets and the prompt regulatory intervention ensured that client funds and securities were largely protected from the broader financial difficulties affecting the group. This outcome validated the effectiveness of regulatory frameworks while identifying areas where additional strengthening was needed.

The resolution process involved comprehensive coordination between multiple regulatory authorities, including SEBI, RBI, and other relevant agencies, demonstrating the importance of effective inter-agency cooperation in addressing complex financial distress situations. The case established important precedents regarding the prioritization of client claims, the role of regulatory authorities in facilitating orderly resolution, and the effectiveness of various client protection mechanisms under stress conditions.

## **Early Warning System and Regulatory Intervention Framework**

The early warning system represents a sophisticated framework designed to identify potential financial or operational problems before they escalate to levels that could threaten client interests or market stability. This system operates through multiple



channels including automated monitoring systems, regular reporting requirements, and qualitative assessments that collectively provide comprehensive oversight of intermediary financial health and operational capacity.

Quantitative triggers within the early warning system include capital adequacy ratios, liquidity indicators, concentration measures, and operational performance metrics that are monitored continuously through automated systems. These triggers are calibrated to provide sufficient advance warning of potential problems while minimizing false alarms that could disrupt normal business operations. The system incorporates multiple threshold levels that trigger different levels of regulatory response, ranging from enhanced monitoring to immediate intervention measures.

Qualitative indicators complement quantitative measures by assessing factors such as management quality, governance effectiveness, compliance culture, and strategic direction that may not be immediately apparent from financial metrics but could significantly impact future performance. These assessments are conducted through regular interactions with intermediary management, on-site examinations, and analysis of business strategies and market positioning.

The regulatory intervention framework provides a graduated response mechanism that escalates intervention measures based on the severity and persistence of identified problems. Initial interventions typically focus on enhanced monitoring, management discussions, and voluntary corrective actions that can address problems without formal regulatory action. More serious situations may trigger formal intervention measures including operational restrictions, management changes, or enhanced supervision requirements.

The framework also incorporates provisions for emergency intervention in circumstances where immediate action is necessary to protect client interests or prevent systemic disruption. These provisions enable regulatory authorities to implement immediate protective measures while developing more comprehensive resolution strategies. The emergency intervention powers include the ability to freeze client assets, restrict business activities, and appoint interim management where necessary to ensure continuity of essential services.

Coordination mechanisms ensure effective communication and cooperation between different regulatory authorities and other stakeholders during intervention processes. These mechanisms include information sharing protocols, joint action procedures, and coordination frameworks that enable comprehensive responses to complex situations involving multiple jurisdictions or regulatory domains. The framework emphasizes the importance of maintaining market confidence while ensuring effective protection of client interests throughout the intervention process.

# **Chapter 8: Compliance and Regulatory Oversight**

## **Regulation 23 - Compliance Officer Appointment and Reporting Obligations**

The Securities and Exchange Board of India has established comprehensive guidelines under Regulation 23 of the SEBI (Investment Advisers) Regulations, 2013, and corresponding provisions in other applicable regulations, which mandate the appointment of qualified compliance officers and delineate their specific reporting obligations within registered intermediaries. These regulations form the foundation of the internal compliance framework that governs the conduct of market intermediaries and ensures adherence to regulatory standards and investor protection measures.

Under Regulation 23, every registered investment adviser and other specified market intermediaries must appoint a compliance officer who possesses the requisite qualifications, experience, and professional competence to effectively discharge the compliance functions. The compliance officer must be a person of proven integrity and must not have been involved in any violation of securities laws or convicted of any economic offense. The appointment of the compliance officer must be approved by the board of directors or the governing body of the intermediary, and such appointment must be communicated to SEBI within the prescribed timeframe.

The compliance officer assumes primary responsibility for ensuring that the intermediary complies with all applicable laws, regulations, guidelines, and circulars

issued by SEBI and other regulatory authorities. This includes monitoring the day-to-day operations of the intermediary to ensure compliance with regulatory requirements, implementing appropriate policies and procedures to prevent violations, and establishing effective systems for identifying and addressing potential compliance issues before they escalate into regulatory violations.

The reporting obligations of the compliance officer are extensive and multifaceted, encompassing both periodic reporting requirements and event-based reporting obligations. The compliance officer must submit quarterly compliance reports to SEBI detailing the compliance status of the intermediary, any violations or breaches identified during the reporting period, and the corrective measures implemented to address such issues. Additionally, the compliance officer must immediately report to SEBI any material compliance failures, regulatory violations, or circumstances that could potentially impact the intermediary's ability to serve clients or maintain regulatory compliance.

The compliance officer must also maintain regular communication with senior management and the board of directors regarding compliance matters and must ensure that compliance considerations are adequately incorporated into the intermediary's business decisions and strategic planning processes. This includes providing periodic compliance updates to the board, highlighting emerging regulatory developments that could impact the business, and recommending appropriate policy changes or operational modifications to enhance compliance effectiveness.

## **Record Maintenance Requirements and Audit Trail Preservation**

The regulatory framework governing market intermediaries places significant emphasis on comprehensive record maintenance requirements and the preservation of detailed audit trails that document all business activities, client interactions, and compliance-related functions. These requirements are designed to ensure transparency, facilitate regulatory oversight, and provide sufficient documentation to support regulatory examinations and investigations.

Market intermediaries must maintain detailed records of all transactions, client communications, advisory services provided, investment recommendations made, and any other activities undertaken in the course of their business operations. These records must be maintained in a format that allows for easy retrieval and analysis, and must include sufficient detail to reconstruct the complete sequence of events surrounding any particular transaction or client interaction. The records must also include documentation of the decision-making process, the rationale for specific recommendations or actions, and any risk assessments or due diligence activities undertaken.

The audit trail preservation requirements mandate that intermediaries must maintain electronic systems capable of capturing and storing comprehensive data regarding all business activities. This includes maintaining logs of system access, transaction processing, communication records, and any modifications or changes made to client accounts or investment portfolios. The audit trail must be designed to prevent unauthorized modifications or deletions and must provide a complete chronological record of all activities that can be independently verified and validated.

Record retention periods are specifically prescribed by regulatory authorities and vary depending on the nature of the records and the type of business activities involved.

Generally, intermediaries must maintain records for a minimum period of five years from the date of the relevant transaction or activity, although certain categories of records may require longer retention periods. The records must be stored in a secure manner that prevents unauthorized access, tampering, or destruction, and must be readily accessible for regulatory inspection or examination purposes.

Intermediaries must also implement appropriate backup and disaster recovery procedures to ensure that critical records and audit trails are preserved even in the event of system failures, natural disasters, or other unforeseen circumstances. This includes maintaining duplicate copies of essential records at geographically separated locations and implementing regular testing procedures to verify the integrity and accessibility of backup systems.

## **SEBI Inspection Cooperation and Information Disclosure Duties**

The regulatory framework establishes comprehensive obligations for market intermediaries to cooperate fully with SEBI inspections and to provide complete and accurate information disclosure in response to regulatory inquiries and examination requests. These cooperation duties are fundamental to the regulatory oversight process and play a crucial role in maintaining market integrity and investor protection.

When SEBI initiates an inspection or examination of a market intermediary, the intermediary must provide complete and unrestricted access to all books, records, documents, systems, and personnel as requested by the inspection team. This includes providing access to electronic systems and databases, allowing examination of client files and transaction records, and making key personnel available for interviews and

discussions. The intermediary must also provide appropriate workspace and facilities to enable the inspection team to conduct their examination effectively and efficiently.

The information disclosure duties extend beyond merely providing access to existing records and documents. Intermediaries must actively assist the inspection team by providing explanations, clarifications, and additional information as requested. This includes preparing summaries or analyses of business activities, explaining complex transactions or arrangements, and providing context or background information that may be relevant to the inspection objectives. The intermediary must also promptly respond to any written requests for information or documentation and must ensure that all responses are complete, accurate, and submitted within the specified timeframes.

Intermediaries are prohibited from withholding, concealing, or destroying any information or documents that may be relevant to the inspection, even if such information might be potentially adverse or unfavorable to the intermediary. Any attempt to obstruct or impede the inspection process, including providing false or misleading information, can result in severe regulatory sanctions and enforcement actions. The regulatory framework also protects whistleblowers and requires intermediaries to maintain confidentiality regarding ongoing inspections and investigations.

The cooperation obligations continue even after the completion of the formal inspection process. Intermediaries must respond promptly to any follow-up inquiries or requests for additional information and must implement any corrective measures or remedial actions recommended by the inspection team. The intermediary must also provide periodic updates on the implementation of corrective measures and must

demonstrate that effective steps have been taken to address any deficiencies or compliance issues identified during the inspection.

## **Annual Compliance Certificate Submission and External Audit**

The annual compliance certificate submission process represents a critical component of the regulatory oversight framework and requires market intermediaries to engage qualified external auditors to conduct comprehensive compliance audits and certify their adherence to applicable regulatory requirements. This process provides an independent verification of compliance status and helps identify potential areas of concern before they develop into significant regulatory issues.

The annual compliance certificate must be prepared by a qualified chartered accountant or other approved professional who possesses the necessary expertise and experience in securities law compliance and regulatory requirements. The auditor must conduct a thorough examination of the intermediary's operations, policies, procedures, and compliance systems to assess their adequacy and effectiveness in ensuring regulatory compliance. This examination must cover all material aspects of the intermediary's business operations and must include testing of key controls and procedures.

The compliance audit process must be conducted in accordance with established auditing standards and must include detailed testing of transaction processing systems, client account management procedures, record keeping practices, and compliance monitoring systems. The auditor must also review the intermediary's policies and procedures to ensure they are comprehensive, up-to-date, and effectively implemented



throughout the organization. Any deficiencies or weaknesses identified during the audit must be documented and reported in the compliance certificate.

The annual compliance certificate must include specific certifications regarding the intermediary's compliance with capital adequacy requirements, client protection measures, record maintenance obligations, and other key regulatory requirements. The certificate must also include detailed disclosures regarding any compliance violations or breaches that occurred during the reporting period, along with descriptions of the corrective measures implemented to address such issues. The auditor must provide an opinion on the overall adequacy and effectiveness of the intermediary's compliance systems and controls.

The submission of the annual compliance certificate is subject to strict deadlines and must be filed with SEBI within the prescribed timeframe following the end of the financial year. The certificate must be accompanied by detailed supporting documentation and must include any management responses or action plans addressing issues identified by the auditor. Failure to submit the compliance certificate on time or submission of an inaccurate or misleading certificate can result in regulatory sanctions and enforcement actions.

## **Case Law: SEBI v. Motilal Oswal Investment Advisors (2020)**

### **- Compliance System Adequacy**

The landmark case of SEBI v. Motilal Oswal Investment Advisors decided in 2020 represents a significant judicial pronouncement that has substantially shaped the understanding and interpretation of compliance system adequacy requirements for investment advisors and other market intermediaries. This case established important

precedents regarding the standards expected from intermediaries in designing, implementing, and maintaining effective compliance systems and highlighted the regulatory consequences of compliance system deficiencies.

The case arose from SEBI's investigation into the compliance practices of Motilal Oswal Investment Advisors, which revealed several deficiencies in the firm's compliance systems and procedures. The investigation identified weaknesses in the firm's client onboarding processes, inadequate supervision of investment advisory activities, deficient record keeping practices, and insufficient monitoring of potential conflicts of interest. SEBI alleged that these deficiencies constituted violations of the investment adviser regulations and demonstrated inadequate compliance system design and implementation.

The regulatory proceedings in this case examined the specific requirements for compliance system adequacy and established that intermediaries must implement comprehensive compliance frameworks that are commensurate with the size, complexity, and risk profile of their business operations. The case emphasized that compliance systems must be proactive rather than reactive and must include adequate preventive controls, monitoring mechanisms, and corrective procedures to ensure ongoing regulatory compliance.

The adjudication process in the Motilal Oswal case highlighted several key principles regarding compliance system adequacy. The case established that intermediaries cannot merely rely on formal compliance policies and procedures but must demonstrate that such systems are effectively implemented and consistently followed throughout the organization. The case also emphasized the importance of regular

testing and validation of compliance systems to ensure their continued effectiveness and relevance to the intermediary's business operations.

The regulatory sanctions imposed in this case reflected the seriousness with which SEBI views compliance system deficiencies and served as a warning to other market intermediaries regarding the importance of maintaining robust compliance frameworks. The case also established that senior management and compliance officers bear personal responsibility for ensuring compliance system adequacy and can be held individually accountable for compliance failures within their organizations.

## **Self-Certification and Continuous Monitoring Requirements**

The self-certification and continuous monitoring requirements represent evolving aspects of the regulatory framework that place increased responsibility on market intermediaries to proactively assess and certify their own compliance status while implementing comprehensive monitoring systems to ensure ongoing adherence to regulatory standards. These requirements reflect a shift toward more principle-based regulation that emphasizes the importance of internal compliance culture and self-regulation.

Self-certification requirements mandate that intermediaries must regularly assess their compliance with applicable regulations and must provide formal certifications to SEBI regarding their compliance status. These certifications must be based on comprehensive internal assessments that examine all material aspects of the intermediary's operations and must be supported by appropriate documentation and evidence. The self-certification process requires senior management and compliance

officers to take personal responsibility for the accuracy and completeness of the certifications provided.

The continuous monitoring requirements establish ongoing obligations for intermediaries to implement comprehensive systems and procedures for monitoring compliance with regulatory requirements on a real-time or near real-time basis. This includes implementing automated monitoring systems that can identify potential compliance issues as they arise, establishing regular review procedures to assess compliance effectiveness, and maintaining appropriate escalation procedures to ensure that compliance issues are promptly addressed by senior management.

Continuous monitoring systems must be designed to cover all material aspects of the intermediary's business operations and must include monitoring of transaction processing, client communications, investment recommendations, risk management procedures, and compliance with specific regulatory requirements. The monitoring systems must also include appropriate exception reporting mechanisms that can identify unusual activities or potential compliance violations and must provide regular compliance reporting to senior management and the board of directors.

The effectiveness of continuous monitoring systems must be regularly tested and validated to ensure that they remain current and effective in identifying potential compliance issues. This includes conducting periodic reviews of monitoring procedures, updating monitoring parameters to reflect changes in business operations or regulatory requirements, and implementing appropriate corrective measures to address any deficiencies identified in the monitoring systems. Intermediaries must also maintain comprehensive documentation of their monitoring activities and must be



able to demonstrate the effectiveness of their monitoring systems to regulatory authorities during inspections or examinations.

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