



Financial Services Bulletin

July 2021

*covering developments during April to June 2021

Nangia Andersen LLP

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Foreword

Last quarter saw several path breaking changes impacting financial services sector comprising commercial banks, NBFCs, insurance companies, mutual funds, and other market intermediaries in one of the world's most vibrant capital markets. The RBI allowed payment banks to operate and play a crucial role in the sector. The Government of India has introduced several reforms to strengthen the sector in particular relating to regulations of NBFCs and the asset management industry as well as promoting GIFT-IFSC as a competitive jurisdiction to set-up business presence for international business.

Equity mutual funds continued to be buoyant and insurance industry has been expanding rapidly. The government had earlier allowed 100% FDI for insurance intermediaries and increased FDI limit in the insurance sector to 74% from 49%, and recently issued further conditions for the increased FDI. The relaxation of foreign investment rules has received a positive response from the insurance sector, with many companies announcing plans to increase their stakes in joint ventures with Indian companies. Over the coming quarters, there could be a series of joint venture deals between global insurance giants and local players.

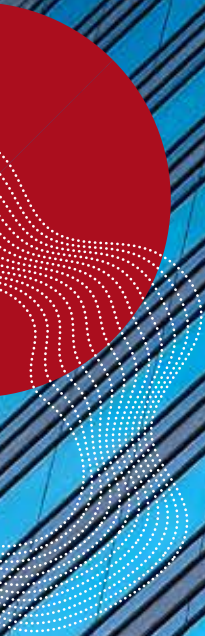
RBI has in December 2020, issued a draft circular on declaration of dividends by NBFCs, wherein it proposed that NBFCs should have at least 15% Capital to Risk Weighted Assets Ratio (Capital Adequacy Ratio) for the last 3 years, including the accounting year for which it proposes to declare a dividend. The final guidelines have now been issued.

Last 12 months saw GIFT authorities and IFSCA taking every possible step to iron out remaining hurdles in making GIFT as an attractive alternative to domicile an international fund in competition to popular jurisdictions like Luxembourg, Ireland, Cayman, and Mauritius. The last quarter saw further measures in the same directions.

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01

Regulatory updates

I. Mutual funds - Key persons of the Asset Management Companies (AMCs) be paid in the form of units of the schemes

SEBI vide circular¹ dated April 28, 2021, has mandated for AMCs to pay its key employees at least 20% in the form of units of the schemes wherein they have the roles/oversight. The compensation break-up, lock-in period, clawback clause, oversight and the definition of key employees is provided in the Circular. Further, the date of implementation of the circular is extended to October 1, 2021, from July 1, 2021, vide circular² dated June 25, 2021.



II. Conditions with respect to FDI norms for Insurance sector

Ministry of finance notified final rules³ for foreign investment limit of 74 % in the insurance sector, which came into effect on 19 May 2021, thereby amending the Indian Insurance Companies (Foreign Investment) Rules, 2015. The highlights of the amendments include the following:

- The Indian insurance companies with foreign investment will now need to ensure that: (i) a majority of their directors; (ii) a majority of their key management persons (KMPs); and (iii) at least one among the board chairperson, the managing director and the CEO, are “resident Indian citizens”.
- Indian insurance companies with more than 49% foreign investment will now need to retain at least 50% of their net profit, as part of their general reserves if, in the relevant financial year, they have paid a dividend on their equity shares and their solvency margin is lower than 1.2 times of the control level of solvency.
- Indian insurance companies with more than 49% foreign investment will now need to satisfy the following governance requirements:
 - a. At least half of the board will need to comprise independent directors (if the board chairperson is not independent); or
 - b. At least one-third of the board will need to comprise independent directors (if the board chairperson is independent).

Companies vide notification dated 27th April 2021 to supersede the existing circulars/notification on appointment of statutory auditors by Banks and NBFC. The Guidelines provide necessary instructions for the appointment of statutory auditors, their eligibility criteria as well as norms for ensuring the independence of auditors. The eligible entities are required to appoint joint statutory auditors based on their asset size as provided below:

Sr.No	Asset size of eligible entities	Minimum number of statutory auditors	Maximum number of statutory auditors
1	Less than ₹15,000 crores	1	4
2	Above ₹15,000 crores up to ₹5,00,000 crore	2	4
3	Above ₹ 5,00,000 crore and up to ₹ 10,00,000 crore	2	6
4	Above ₹ 10,00,000 crore and up to ₹ 20,00,000 crore	2	8
5	Above ₹ 20,00,000 crore	2	12

The auditors can be appointed for a continuous period of 3 years subject to conditions and not be eligible for reappointment in the same entity for 6 years (two tenures) after completion of full or part of one term of the audit tenure. The guidelines to be applicable from FY 2021-22 with certain exceptions.

III. Guidelines for appointment of statutory auditors for banks and NBFCs

The Reserve Bank of India has issued guidelines⁴ for the appointment of statutory central auditors/statutory auditors of commercial banks (excluding Regional Rural Banks), United Co-operative Banks and NBFCs including Housing Finance

¹ SEBI/HO/IMD/IMD-I/DOF5/P/CIR/2021/553

² SEBI/HO/IMD/IMD-I/DOF5/P/CIR/2021/582

³ F. No. 13011/19/2013-Ins.II

⁴ RBI/2021-22/25 Ref.No.DoS.CO.ARG/SEC.01/08.91.001/2021-22

IV. RBI caps dividend declaration by NBFCs

RBI vide notification⁵ dated June 24, 2021, has prescribed guidelines on declaration of dividend by NBFCs with an objective to infuse transparency and uniformity in the practice. The said guidelines will be effective from profits of financial year 2021-22. The said guidelines are highlighted below:

Sr.No	Particulars	Provision
1	Aspects to be considered by Board of Directors	<ul style="list-style-type: none">• Classification and provisioning for NPA• Qualifications in the Auditors' Report to the financial statements• Long term growth plans of the NBFC
2	Eligibility criteria	<ul style="list-style-type: none">• NBFC (other than SPD) shall meet Capital Adequacy requirements during last 3 financial years including current financial year in which dividend is proposed.• SPD should have maintained a minimum Capital Adequacy Ratio of 20 per cent for the financial year (all the four quarters) for which dividend is proposed.• Net NPA ratio shall be less than 6% during current year and last 3 financial years• NBFC shall comply with Section 45IC of The Reserve Bank of India Act, 1934 (Reserve Fund) and Housing Finance Company with section 29 C of the National Housing Bank Act, 1987 (Reserve Fund) and prevailing regulations.
3	Quantum of Dividend Payable	<ul style="list-style-type: none">• Dividend Payout Ratio to be Amount of dividend/Net profit (Extra-ordinary and exceptional profit shall be reduced from the Net profit)• Maximum dividend payout ratio to be:<ul style="list-style-type: none">- Non-deposit NBFCs (without customer interface) – no ceiling- Core Investment Company & SPD – 60%- Other NBFCs – 50%
4	Exception	NBFC (other than SPD) not meeting the applicable prudential requirement prescribed above for each of the last three financial years, may be eligible to declare dividend, subject to a cap of 10% on the dividend payout ratio, provided they comply with the following conditions: (a) meets the applicable capital adequacy requirement in the financial year for which it proposes to pay dividend; and (b) has net NPA of less than 4% as at the close of the financial year.
5	Reporting	Submission of report in the prescribed format within fortnight from the declaration of dividend by- <ul style="list-style-type: none">- Deposit taking NBFC- Non-Deposit Taking Systematically Important NBFC- Housing Finance Company & Core Investment Company

V. Limit for overseas investment by AIFs/VCFs increased

SEBI vide circular⁶ dated May 21, 2021, in consultation of the RBI has enhanced the limit from USD 750 million to USD 1500 million, in terms of the overseas investment by AIFs and VCFs. Further, all other regulations governing such overseas investment by eligible AIFs/VCFs shall remain unchanged.

Changes introduced by the AIF (Second Amendment) Regulations⁷, 2021 dated May 5, 2021:

⁵ RBI/2021-22/59 DOR.ACC.REC.No.23/21.02.067/2021-22

⁶ SEBI/HO/IMD/DF6/CIR/P/2021/565

⁷ SEBI/LAD-NRO/GN/2021/21

VI. Angel Funds, Start-ups and VCUs

- “Start-up” definition is harmonized with the definition as per the Department for Promotion of Industry and Internal Trade (DPIIT).
- Angel Funds are now eligible to invest in Start-ups - broadens the investment horizon of angel funds.
- Scope of the definition of VCU has been broadened for Category I AIFs by removal of the list of restricted activities in the definition of a VCU.

VII. Investment in Other AIFs

- An AIF investing in other AIFs is not further permitted to have an AIF as its investor.
- AIFs which employ fund-of-funds strategy should seek a confirmation from their investee AIFs that such investee AIFs will not further be investing in other AIFs.
- Investment by an AIF in other AIF shall have to be in the following manner:
 - i. a Category I AIF can invest in units of other Category I AIFs of the same sub-category;
 - ii. a Category II AIF can invest in Category I or II AIF; and
 - iii. a Category III AIF can invest in units of Category I, II or III AIFs

VIII. Code of Conduct

- Code of conduct for AIFs, AIF managers, their key management personnel, AIF trustees, directors of the AIF trustee and the members of the Investment Committee
- AIFs are required to maintain policies and procedures which are jointly approved by the AIF manager and the AIF trustee.
- The AIF manager shall be responsible to ensure that every decision of the AIF is in compliance with such policies and procedures, the AIF Regulations, terms of the PPM, other AIF documents and the applicable laws.
- Investment Committee members shall ensure that their decisions are also in compliance with the policies and procedures of the AIF, provided that a waiver can be obtained in this regard by AIFs where each investor has a capital commitment of at least INR 70 crores to each such AIF.

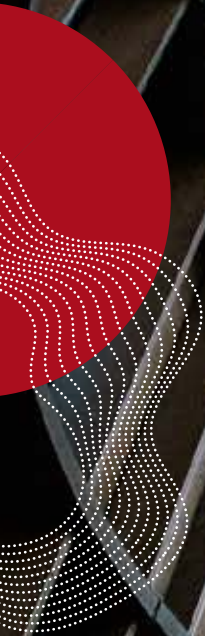
IX. Regulatory reporting by AIFs

SEBI vide Circular⁸ dated April 7, 2021, has decided that AIFs are required to submit the reports on their activity to SEBI on a quarterly basis, within 10 calendar days from the end of each quarter, provided that Category III AIFs shall submit their reports on leverage undertaken, on a quarterly basis.

Moreover, the Circular also requires that any changes made to the PPM or any other fund document to be intimated to the investor and SEBI on a consolidated basis, within 1 month from the end of each financial year. The revised reporting requirement shall be applicable for quarter ending December 31, 2021, onwards, however other provisions shall be applicable from the date of the circular.



⁸ SEBI/HO/IMD/IMD-1/DOF6/CIR/2021/549



02

International Financial Services Centre (IFSC)

I. SEBI allows for off-market transfer by FPIs to IFSC

The Finance Act 2021 introduced a provision relating to foreign funds located in countries like Mauritius and Singapore that are holding existing investments in India qualifying for capital gains tax exemption. It provided that capital gains tax exemption available to FPIs under the tax treaties would continue to be available to the Fund in IFSC. Further, the relocation from another country to IFSC would be tax neutral for the Fund as well as the investors in the Fund.

The relocation is envisaged to be a cashless transfer whereby the Fund or its wholly owned special purpose vehicle would transfer securities to IFSC fund (resultant Fund) that will issue new units to investors or the Fund in lieu of original units. Such a resultant Fund will continue to get capital gains exemption on future sale of grandfathered investments otherwise available under the respective tax treaty. Separately, the resultant Fund also enjoys capital gains exemption on debt/ derivatives/ mutual fund units and interest and dividend income taxable at 10% as per the domestic tax law.

Till now there were regulatory restrictions. Since FPI transactions are carried out on the stock markets, Securities and Exchange Board of India was not allowing cashless or free of price transfer of shares by one FPI to another.

SEBI has issued a circular⁹ dated June 1, 2021, wherein it is clarified that the Designated Depository Participants (DDP) after appropriate due diligence would accord its approval for a one-time 'off-market' transfer of securities for such relocation to the FPIs. Further, FPIs opting for relocation request will have to apply for surrender of its FPI registration with the DDP.

II. Eligible foreign investors exempt from obtaining Permanent Account Number (PAN) in IFSC

CBDT vide notification¹⁰ dated May 4, 2021, provided exemption to eligible foreign investors investing in the specified securities and non-resident investors/unit holders of Category III AIF set-up in IFSC from the requirement of obtaining a PAN subject to satisfaction of prescribed conditions.

III. Sponsor contribution to an AIF set up in overseas jurisdiction, including IFSC to be considered as ODI

The RBI vide Circular dated 12 May 2021, has amended provisions pertaining to Indian Party making investment/financial commitment in an entity outside India, engaged in the financial services sector.

According to the amendment, any sponsor contribution from an Indian Party to an AIF set up in an overseas jurisdiction, including IFSCs in India, as per the laws of the host jurisdiction, will be treated as ODI. Therefore, now an Indian party can set up AIF in overseas jurisdictions, including IFSCs, under the automatic route provided it complies with the conditions specified under ODI Regulations.

IV. IFSCA eases capital requirements for AIFs

Subsequent to the IFSCA circular¹² dated December 9, 2020, modifying framework for AIFs and providing relaxations in diversification and leverage norms for AIFs in IFSC, the IFSCA now vide circular¹³ dated June 25, 2021, has done away with the need for managers or sponsors to have continuing interest i.e., lower of 2.5% of corpus or \$750,000 for category I and II AIFs, and lower of 5% of corpus or \$1,500,000 for a category III AIF domiciled in IFSC. The circular also allows the AIFs to invest in units of schemes launched by mutual fund regulated in Financial Action Task Force compliant jurisdiction (including India).

V. IFSCA (Finance Company) Regulations, 2021

IFSCA vide notification¹⁴ dated 25 March 2021 has issued the International Financial Services Centres Authority (Finance Company) Regulations, 2021 to provide a framework for finance companies in the IFSC. The Regulation have come into force from March 25, 2021. The key aspects of the Regulations are as follows:

Registration Requirement to set-up FC/FU:

- Meet minimum owned fund requirement
- Obtain certificate of registration from IFSCA for carrying out the specified activities
- A FC can be set up either as a subsidiary or a joint venture, or as a newly incorporated company under the Companies Act, 2013
- No-Objection Certificate from the home country regulator for setting up a FU in the IFSCs
- The applicant entity and/ or its promoters to be from a Financial Action Task Force compliant jurisdiction.

⁹ SEBI/HO/FPI&C/P/CIR/2021/0569

¹⁰ Notification No. 42/2021 F. No.370133/08/2020-TPL

¹¹ Circular No. 04

¹² F. No. 81/IFSCA/AIFs/2020-21

¹³ No. 81/IFSCA/AIFs/2020-21/03

¹⁴ IFSCA/2020-21/GN/REG010



Registration Requirement to set-up FC/FU:

- IFSCA has specified the prudential regulations for the FC in relation to the Capital Ratio, Liquidity Ratio and Exposure ceiling
- Operational guidelines shall be issued by the Authority with respect to the implementation of the above-mentioned requirements.

Miscellaneous

Furthermore, IFSCA has specified miscellaneous guidelines with respect to the FC/FU, including the following parameters:

- Permitted Specialized Activities, Permitted Core Activities, Permitted Non-Core Activities
- Currency of Operations
- Know Your Customer and Anti-Money Laundering
- Corporate Governance and Disclosure Requirements
- Reporting Requirements
- Power has been given to the Authority to Specify Procedures and Issue Clarifications
- Action by the Authority in Case of Default

VI. Framework for FC/ FU in IFSC to undertaking Global/ Regional Corporate Treasury activities

The IFSCA has issued a framework vide Circular¹⁵ dated June 25, 2021, for undertaking Global/ Regional Corporate Treasury Centres activities by FC/FU in an IFSC in India. The framework allows the global or regional corporate treasury centre, after being granted registration, to undertake permitted treasury activities and provide permitted treasury services to its group entities.

⁹ F. No. 331/IFSCA/GRCTC/2021-22



An aerial photograph of the Golden Gate Bridge in San Francisco, California, taken during the "golden hour" of sunset. The bridge's iconic orange-red towers and suspension cables are silhouetted against a vibrant, deep blue sky. The bridge deck is visible with several cars and a bus. In the background, the city of San Francisco and the surrounding hills are visible under the twilight sky. On the left side of the image, there is a decorative graphic consisting of a solid red circle at the top, with a series of white dotted lines that curve downwards and outwards, resembling a stylized wave or a modern logo element.

03

Direct Tax

I. ITAT holds that Morgan Stanley's income from IDRs would be exempt under Article 22 of the India-Mauritius Tax Treaty

- In case of Morgan Stanley Mauritius Co. Ltd¹⁶, the Mumbai ITAT assessed the taxability of income arising from IDRs issued by Standard Chartered Bank- India (SCB-India) with the underlying asset in the form of shares in a UK based company Standard Chartered Bank Plc (SCB UK).
- The Tribunal held that the dividend received was taxable in India considering the income as deemed to be accrue or arise in India as per section 9(1)(i) of the Income Tax Act, 1961. Further, under Article 10 (Dividends) of the India Mauritius DTAA, SCB India or SCB UK did not qualify the requirements of a company being a resident of the contracting states. Thus, dividend cannot be subject to tax under Article 10 of the DTAA.
- Furthermore, the dividend income could only be assessed as 'Other Income' under Article 22 of the India Mauritius DTAA which gave exclusive taxation rights to the residence state i.e., Mauritius.
- Hence, the ITAT ruled in the favour of assessee that dividends from IDRs were not taxable under the India Mauritius DTAA. However, given the amendment to Article 22, the decision only applies to payments before April 1, 2017.

II. ITAT allows carry-forward of Short-Term Capital Losses, although such gains 'exempt' under India- Singapore DTAA

- The Mumbai Bench of the ITAT in the case of Goldman Sachs India Investments (Singapore) Pte. Ltd¹⁷ dealt with the issue of allowability of carry forward of short-term capital loss on sale of shares. The ITAT ruled in favor of the non-resident assessee and held that the short-term capital losses from transactions executed in the Indian capital markets shall be deemed as income accruing or arising in India.
- Consequently, such short-term capital losses would be eligible to be carried forward to subsequent years, irrespective of whether the capital gains earned by the assessee are exempt under the provisions of the DTAA or not. The ITAT confirmed that the provisions of the Act being more beneficial to the assessee, shall apply to it.

III. Delhi High Court allows beneficial withholding tax rate of 5% on dividend income owing to MFN clause in India Netherlands tax treaty

- The Delhi High Court in the case of Concentrix Services Netherlands BV and Optum Global Solutions International BV¹⁸ ruled that the lower rate of 5% with holding tax rate on dividend income by virtue of MFN clause as per India Netherlands DTAA, read with the India-Slovenia DTAA, is to be applied while making payment of dividend by Indian entity to its shareholder in Netherlands.
- The High Court also held that the Protocol forms an indispensable part of the DTAA and becomes applicable automatically. There is no need for it to be separately notified to enable the provisions contained therein.
- Furthermore, the High Court rendered the contention of the Revenue that the benefit of the MFN clause should be granted only if the country with which India enters into a tax treaty was an Organisation for Economic Co-operation and Development (OECD) member at the time of execution of the tax treaty as injudicious. Referring to the language of the MFN clause, the High Court held that the word "is" describes a state of affairs that exist on the date of claiming the benefit and not necessarily at the time the DTAA was executed.

IV. CBDT provides format, procedure and guidelines for furnishing financial transactions by specified reporting entities to enable pre-filing of income-tax returns

CBDT vide notifications¹⁹ dated April 20, 2021, and April 30, 2021, has notified format, procedure, timelines, and guidelines for submission of Statement of Financial Transactions for reporting of following transactions by the specified reporting entities in order to enable pre-filing of tax returns.

Sr.No	Nature of transaction	Reporting entity
1	Capital gains on transfer of listed securities or units of mutual funds	Depositories
2	Capital gains on transfer of mutual funds	Registrar and Share transfer agent
3	Dividend income	Companies paying dividend
4	Interest income	<ul style="list-style-type: none"> • Banking company or a co-operative bank • Non-banking financial company • Post-Master General

¹⁶ ITA no. 7388 of 2019

¹⁷ ITA No. 6619/Mum/2016

¹⁸ Concentrix Services Netherlands B.V. and Optum Global Solutions International BV [TS-286-HC-2021 (Delhi High Court)

¹⁹ Notification No. 1 and 2 of 2021 dated 20 April 2021 and Notification No. 3 and 4 of 2021 dated 30 April 2021.



04

Indirect tax

I. High Court judges differ on constitutional validity of Place of Supply provision for Intermediary services under GST

Recently, division bench of the Bombay High Court has delivered a split verdict on the constitutional validity of Section 13(8)(b) of the Integrated Goods and Services Tax Act, 2017 which provide that in case of intermediary services provided to overseas customers, place of supply is location of such intermediary and hence such intermediary is liable to pay GST. While Justice Ujjal Bhuyan has held the provision to be unconstitutional, Justice Abhay Ahuja dissented. In July 2020, the Gujarat High Court has upheld the constitutionality of these provisions.

Primarily, the issue in this case is the differential treatment accorded to intermediary services under GST Law as compared to other services. An exception is carved out under the GST law for such intermediary services. The law precludes them from being considered as export of services, even when they are provided to overseas clients. Consequently, these services do not qualify as export and hence zero-rated status is not available as available to other export services.

The above judgement is also relevant to certain financial services where certain services have been treated as intermediary like stockbrokers, IBD (where only facilitation services are provided), business support services etc. The manner in which this judgment has been pronounced is a rarity, with both judges of the division bench not pronouncing their judgments simultaneously.

Since the matter was before a division bench which could not come to a unanimous conclusion, the matter is now to be placed before the Chief Justice. The final verdict by the Chief Justice is going to be a landmark decision for intermediaries and also to financial services sector as depending upon the ruling, the principle can be applied for Section 13(8)(a) as well i.e., services supplied by a banking company, or a financial institution, or NBFC to foreign account holders.

II. CESTAT- VCF trust is a service provider to its contributors, confirms service tax demand

The Bangalore bench of the Customs, Excise and Service Tax Appellate Tribunal ('CESTAT') in case of M/s. ICICI Econet Internet and Technology Fund has confirmed service tax demand on amount retained by the VCF Trust for defraying various expenses incurred by it and carry income distributed to class C unit holders including IM. Accordingly, the CESTAT held that VCFs are liable to pay service tax for the service provided to the investors/ contributors. The matter is remanded back to the adjudicating authorities for re-calculation of the gross value of the taxable services and availability of CENVAT credit. Since the provisions in GST Law are similar to those under the Service Tax, the principle would be applied under GST as well.

While the judgement is delivered in case of VCF, it is also going to have impact on others which follow the similar structure like, AIF, Mutual funds etc. The above ruling is not only significant for service tax/ GST but also for other tax laws.





05

Glossary



Glossary

AIF	Alternative Investment Fund
CBDT	Central Board of Direct Taxes
DTAA	Double Tax Avoidance Agreement
FC	Finance Company
FPI	Foreign Portfolio Investors
FU	Finance Unit
GST	Goods and Service Tax
IDRs	Indian Depository Receipts
IFSC	International Financial Services Centre
IFSCA	International Financial Services Centres Authority
ITAT	Income-tax Appellate Tribunal
MFN	Most Favoured Nation
NBFC	Non-banking Financial Company
NPA	Non-performing Assets
ODI	Overseas Direct Investment
PPM	Private Placement Memorandum
RBI	Reserve Bank of India
SEBI	Securities and Exchange Board of India
SPD	Standalone Primary Dealers
VCF	Venture Capital Funds
VCU	Venture Capital Undertaking



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