Cayman foreign institutional investors give India the miss

Sachin Mampatta / DNA

Thursday, January 21, 2010 2:03 IST

Mumbai: Although seven months have passed since the Securities and Exchange Board of India (Sebi) paved the way for Cayman Islands-based funds to register as foreign institutional investors (FIIs) in India, applications to the regulator have barely trickled in.

In fact, since the beginning of the financial year, there have been just five FII applications from the region. Four of these have been registered and the fifth is in the process.

This is a minuscule portion of the 9,862 funds with the Cayman Islands Monetary Authority (Cima), and experts suggest the absence of a tax treaty and use of alternative means of investing in Indian markets as the chief reasons for the same.

On June 10, Cima became a full member of the International Organisation of Securities Commissions (Iosco). As a part of this body, whose constituents regulate 90% of the world's securities markets, investment funds from the Cayman Islands would have found an easier route into India.

Earlier, a Cayman fund seeking to invest in India was required to undergo the Sebi's tedious scrutiny, and in most cases, the regulator treated these funds (especially hedge funds) unfavourably.

This situation may have altered from the perspective of the regulator, but it has not made up for the lack of a tax treaty.

"While the recognition by Iosco will certainly have helped the perception of Cayman Islands-based funds, most FIIs will still prefer to go through Mauritius, Singapore and Cyprus on account of the treaties that India has with those jurisdictions," said Pranay Bhatia, partner at Economic Laws Practice.

Indian FIIs record their income as business income or capital gains. The former is avoided if there is no permanent base in India, the latter can be saved through taxation treaties that India has signed with the other three jurisdictions.

In addition to tax benefits, many of the funds based out of the Cayman islands are still recovering from the financial crises.

"Most of the institutions that are based out the Cayman Islands fall under the hedge fund category. While many of these do not have a great deal of exposure to India, those that do are dealing with the fact that the industry has not recovered entirely from the financial crises," said Siddharth Shah, head - funds practice, Nishit Desai Associates.

Additionally, participatory notes are often deemed more convenient for such funds.

"A lot of them also prefer to go through the P-Note route as they find it more convenient than registering as a full-fledged FII. This also offers an advantage in terms of leverage," said Shah.

While investing through the P-Note route, entities may use underlying securities for leveraging their bets. This process is considerably more difficult for an FII, as they need to take special permission to leverage using Indian securities.

The total number of FIIs from Cayman Islands currently registered with the Sebi is at 19, of a total of 1,700 registered FIIs.