Sebi bars FIIs without broadbased structures from new positions

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Foreign institutional investors (FIIs) which are not in compliance with a notice to make amendments to their structures would not be allowed to take fresh positions in the cash or derivatives market with effect from October 1, said a circular from the regulator. The Securities and Exchange Board of India (Sebi) said that they would be allowed to retain their current holdings or unwind them.

Sebi had asked FIIs in a circular in April 2010 to make sure that their structures were more broadbased to ensure that they couldn't be used for round-tripping, where money originating from Indian shores would come back as foreign investment. In order for a fund to be considered broadbased, it would have to have a minimum of 20 investors with none of them holding more than 49% of the total shares in the fund.

FIIs made use of a number of structures such as multi-class vehicles, protected cell companies and segregated portfolio companies to differentiate funds on the basis of different investment objectives. According to experts, there were apprehensions that such structures could also be used to facilitate round-tripping.

Most funds have complied with the regulations after the Sebi circular earlier in the year, according to legal experts.

"The majority of clients would have undergone restructuring. The affected party is not expected to be very large," said Siddharth Shah, head- funds practice at Nishith Desai Associates.

A number of foreign institutions are said to have been lobbying for an extension of the deadline.

A list of non-complaint institutions is to be put up on the Sebi website.

It is also expected that those who would not have been able to comply with the necessary regulations may turn to participatory notes, which allow those who are not registered as FIIs to invest in Indian markets.

"One may see a shift from direct ownership to the offshore derivative instruments (ODI, or participatory notes)," said Siddharth Shah.

Participatory notes currently account for 16.37% of total FII positions as of August 2010. Use of the notes hit a peak in June 2007, when they accounted for 55.7% of the FII holdings.

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