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FIIs bypass India on tighter rules

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Only seven register with Sebi in the first six months of this year.

With the Securities and Exchange Board of India (Sebi) making the registration process for foreign institutional investors (FIIs) stringent, the number of applications from investors abroad for a licence to directly participate in Indian stock markets has plunged.

The number of registered FIIs was 1,713 on June 30, an increase of just seven in the first six months of this year. In comparison, the number went up by 38 in the previous six months ending December 31, 2009.

The number of foreign investors opting for sub-accounts has also come down. In the six months ended June 30, the number of registered sub-accounts rose by 95 to 5,426, according to Sebi data. There was an addition of 160 sub-accounts in the six months ended December 31.

Officials at law firms, who advise overseas investors, cite stringent declarations, complex disclosures and increased compliance requirements as the reasons. “The market regulator has been more vigilant on FII registrations,” said Neerav Merchant, associate partner at law firm Majmudar & Company. “This is clearly demonstrated by the fact that the format of forms for FII registrations and instructions sought for completing the forms prescribe numerous declarations and undertakings.”

Sebi is also not comfortable with foreign investors from tax havens having a multi-class structure. On April 15, it asked new applicants as well as existing FIIs and sub-accounts to give more information about their structures. It asked applicants to furnish declarations that they were not a protected cell company (PCC) or a segregated portfolio company (SPC). The applicants also have to declare that they are not a multi-class share vehicle (MCV) under their constitution. If they are, they need to undertake that common portfolios will be allocated across various share classes and will be broad-based. All existing FIIs and sub-accounts have to comply with these norms by September 30. “These changes make the registration process difficult and cumbersome,” said Merchant.

A structure like PCC or SPC segregates assets and liabilities of investors by providing for distinct assets, either in the form of a separate class of share, or a dedicated sub-fund attributed to each investor. An entity like an MCV has the flexibility to issue multiple classes of shares having differential benefits attached, so that each class has the ability to represent the interest of a particular investor, or for specific investments.

Pending issuance of the April circular, Sebi had deferred clearing FII applications, officials at law firms said. Only one FII and 45 sub-accounts were added during January 1-April 15. “Possibly, many of those applicants may have multi-class structures, which need to be re-worked to comply with the new guidelines,” said Siddharth Shah, head of the corporate and securities practice group at law firm Nishith Desai Associates. “Sebi norms reduce structural flexibility for new applicants. They may be re-evaluating their strategy in terms of either going for direct FII registration or taking the participatory note (P-note) route,” he added.