Printed from

THE ECONOMIC TIMES

FIIs entering via Mauritius face bumps
5 Nov, 2007, 1055 hrs IST,Sugata Ghosh, TNN
MUMBAI: Foreign institutions keen to register themselves as FIIs in India are grappling with a tricky question: Can they set up an 'investment holding company' in Mauritius to enter India? While this is a tax-friendly and convenient route, and the investment vehicle can be put in place within a few weeks, there is a question mark on whether this would be adequate under the present regulations.

Such a downline investment company would be handy for entities based in Delaware and Cayman Islands and other jurisdictions. However, it is feared that an investment holding company based in Mauritius may not qualify for FII status. It may still be acceptable to set up a proprietary sub-account or a sub-account with an FII, but there are doubts whether the investment entity would be recognised as an FII.

"We are awaiting more clarity on the issue. While the present regulations don't provide for any such category, we need to find out whether an investment holding company will be eventually treated as an eligible entity," said legal & tax counselling firm Nishith Desai Associates' Suneet Barve.

A related question that crops up is whether such an investment entity, registered with the Financial Services Commission (FSC) of Mauritius, would be considered regulated. FSC was established as the regulator for the non-bank financial services sector under the Financial Services Development Act, 2001. The commission's website says it "licenses, regulates and supervises non-bank financial institutions in Mauritius".

If the investment holding company route doesn't work, foreign investors can set up an asset management company in Mauritius, instead of having the original fund in Cayman and an investment company in Mauritius. However, this can be a cumbersome and time-consuming process, according to PricewaterhouseCoopers executive director Punit Shah. Besides, most foreign investors putting their money with FIIs are more familiar with tax havens such as Cayman rather than Mauritius.

"Typically, investment holding companies are not in the nature of asset management companies or funds or any other eligible category. An appropriate amendment or clarification may be required from Sebi to register them as FIIs," Mr Shah said.

Given the restrictions on sub-accounts and issuance of participatory notes — derivative instruments sold to overseas investors where the underlying investment is in Indian stocks — several foreign institutions want to get registered as FIIs with Sebi.

This will not only enable them to invest directly in the Indian market but also make it possible for them to issue P-notes to other foreign investors. (Sebi has barred issue of P-note by sub-accounts, be it proprietary or otherwise). However, the P-note business is no longer a major attraction since issuance of such instruments by a new entity during a year could only be up to 5% of assets under custody.

More significantly, Sebi has barred the issuance of P-notes to unregulated entities. Several hedge funds have been affected by the decision, and some are trying to find a suitable route to play in the Indian market directly. A foreign investor must also have at least a one-year track record and be regulated by an 'appropriate foreign regulatory authority'.

Under the circumstances, who is an appropriate regulator? "This is something the FII community has to find out. For instance, will Cayman Islands Monetary Authority be considered a regulator? Some hedge funds are registered with the Commodity Futures Trading Commission (CFTC), which, for a long time, was perceived as a commodity market regulator. Is CFTC now an appropriate regulator?" an official with an FII wondered.