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SEBI makes it easier for FIIs committing 5% of corpus

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ET Bureau

MUMBAI: Foreign funds planning to enter the Indian stock market will get more time to comply with regulations if they commit to invest at least 5% of their corpus in local stocks. The move, aimed at giving greater flexibility to new funds and encouraging more portfolio investment, is part of an "internal decision" taken by the capital market regulator Sebi.

New funds, preferring to invest as a sub-account of a foreign institutional investor (FII), find it difficult to pool in investors unless it is registered with Sebi. Thus, funds often don't meet the criteria of a minimum-20 investors for setting up a broadbased sub-account while applying for registration.

This rule is now being relaxed, though not through any official circular. "We are considering applications of those fund entities who are giving an undertaking that they will invest a minimum 5% of their corpus in Indian securities, and will fulfil the broadbased criteria within three months," a Sebi official told ET.

According to sources, the regulator has given the approval to about a dozen funds. "It should not be difficult to comply with the requirements, but the sub-account will have to ensure that it fulfils with the broadbased criteria of the FII regulations within the period prescribed by Sebi," said Suneet Barve, a legal consultant.

A sub-account is an entity formed outside India and the money pooled in gets invested through an FII. The trading decisions can either be of the FII or a fund manager of the sub-account.

But there are finer points which need to be sorted out. "While on one hand this seems to be a welcome move, it is not clear what will happen to open-ended funds where the corpus may decrease considerably and the fund may not have the money to invest 5%.

Further, it is not clear whether this condition of 5% investment will have to be complied with by the sub-accounts even after they fulfil the broadbased criteria and if yes, such sub-accounts may be put at a disadvantage vis-à-vis other broadbased sub-accounts registered without such conditions," said Kishore Joshi of the law firm Nishith Desai Associates.

The three-month breather, given on a case-to-case basis, follows other relaxations in issuance of participatory notes - a derivative instrument where the underlying securities are shares traded in India. While the PN route is less expensive than sub-accounts and gives anonymity to investors, sub-accounts could be a more useful vehicle for real-time trades.

At the height of the bull run in November 2007, Sebi had clamped down on PNs. FII inflow, which dropped immediately following the restrictions, took a bigger hit some months later when the subprime virus began to spread across markets.

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