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NRIs, foreigners likely to get easier market access

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INDIAN policy makers are working on a proposal to allow a set of overseas investors such as non resident Indians (NRIs), foreign firms and individuals to invest in the local stock markets by registering with foreign institutional investors (FIIs). The proposal on which the policy makers will have to take a call envisages entry into portfolio investment for these investors subject to a major condition. This will involve FIIs who register these investors as sub-accounts. The plan is to make FIIs responsible for any transgression of investment and regulatory norms in sub-accounts and to conduct all checks on the investors.

Securities market watchdog Sebi will have to rework its regulations relating to FIIs to facilitate these changes. Similarly, the Foreign Exchange Management regulations administered by the RBI will need to be tweaked in consultation with the government since NRIs are now allowed to invest only through Portfolio Investment Schemes.

The proposal to redefine and expand the criteria for sub-accounts of FIIs was discussed at Sebi's weekend board meeting, officials said. According to an official privy to the developments, the government has made it clear that the objective should be to ensure a minimum issuance of participatory notes (PNs) in the Indian markets. PNs are derivative instruments whose underlying securities are shares of Indian companies.

These are issued by FIIs registered here to investors who either want to trade anonymously or are unwilling to go for a direct registration. The issue of PNs has fuelled concerns of money laundering and round tripping — the practice of local money flowing out of the country and then coming back in the guise of foreign investment.

Policy makers say that if the aim is to keep PNs out — it is necessary to remove the distortions or the incentives which exist now for overseas investors to use such instruments.

NRI investment route's not tax-efficient now

SELECT overseas investors may get to invest in local stock markets by registering with foreign institutional investors (FIIs). The aim is to ensure a minimum issuance of participatory notes (PNs) in the Indian markets, an official privy to the development said. "Let more foreign portfolio investors come in. But we want investors operating under various umbrellas to come in through the front door and not through subterfuge," said a senior official.

As against PNs, 'sub-accounts' have to be registered with Sebi by non-residents on whose behalf investments are made in India by an FII registered with Sebi. Since Sebi is in no position to verify the antecedents of each of the PN investors, a sensible course would be to pin down the responsibility on FIIs, officials feel. Sebi's FII regulations will need to be revised as the responsibility of FIIs relating to sub accounts is regarded as a grey area. The existing norms of a broad based fund (which stipulates at least 20 investors with no investor holding more than 10 %) are expected to continue even if changes are carried out. The government has received representations to make NRI investments easier as the current route is not tax efficient vis-à-vis foreign investment coming into India via setting up FII sub account vehicle in a tax efficient jurisdiction. According to Punit Shah, partner, RSM & Co, "Permitting NRIs to invest through FII/sub-account route would be more tax efficient for the NRIs and will certainly enhance substantially the inflow of investments in India. Sebi should take a pragmatic view in the matter."

Investment by NRIs has become more difficult after overseas corporate bodies or OCBs were banned after the last stock market scam. However, letting 20 or more NRIs set up a sub-account on a discretionary basis — where the money will be managed by the FII and not the NRIs — has to be allowed, keeping in mind the present regulation that NRIs cannot hold more than 24% in a local company. Till now one of the reasons for not encouraging NRI subaccounts was to ensure that this investment cap is not breached.

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