Panel weighs options to let in more foreign investors

By Rajesh Abraham Jun 23 2010 , Mumbai

A working group set up by the government on foreign portfolio investments is likely to recommend that broadbased funds be allowed to directly enter the Indian stock market.

The committee, headed by U K Sinha, chairman & managing director of UTI Asset Management, is in the final stages of drafting its report, a person privy to the development said.

According to him, the committee may suggest that individual investors and even foreign institutional investors (FIIs) with a protected cell company or a segregated portfolio company structure be also let in.

These structures have several cells within the same fund vehicle that may represent distinct investment objectives. A cell within such a company has its own assets and liabilities as well as capital, dividends and accounts. This helps its fund manager to market a single fund, which can have different investment plans for different investors.

While broadbasing the type of investors that are allowed entry, the committee may also recommended tighter ‘know your customer’ (KYC) norms to allay fears of round-tripping and money laundering by Indians, the person said.

Current rules allow FII categories such as asset management companies, pension funds, mutual funds, investment trusts as nominee companies, incorporated/institutional portfolio managers or their power of attorney holders, university funds, endowment foundations, charitable trusts and charitable societies. Hedge funds, if regulated in their home country, are also allowed.

The Securities & Exchange Board of India
(Sebi) recently asked FIIs not to follow the special structures that the committee now considers permitting. FIIs have also been told to declare that they are not multi-class share vehicles (MCVs) in constitution or a similar structure. Simply put, FIIs have to declare that their investments contain only single-class shares.

The committee may be more flexible than Sebi in its approach to these classes of FIIs, as long as they abide by tougher KYC norms and stronger exchange control measures.

Several hedge funds and other investors – who wish not to get into the hassles of tighter regulations – are already investing in the Indian market through participatory notes (PNs). The committee, however, will not recommend a ban or place other restrictions on PNs.

Legal firm Nishith Desai Associates, in a report, commenting on the Sebi move on FIIs in those special structures, had said: “A blindfolded blanket ban on FIIs and genuine investors may not be the correct remedy”.

Despite satisfying the broadbased fund criteria at the entity level, if a fund vehicle does not have the flexibility to pursue dedicated investment strategies for identified investors, it goes against the essence of broadbasing, as the investment does not represent the interest of all investors, the person quoted earlier said.

The terms of reference of the committee also include a review of the existing policy on foreign inflows, including those from foreign venture capital investors and private equity entities. It is also tasked to suggest ways to rationalise the rules to encourage foreign investment.

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