

THE ECONOMIC TIMES

Tougher hedge fund norms may hit India too

24 Oct 2009, 1530 hrs IST, Reeba Zachariah, TNN

BALACLAVA (MAURITIUS): Life could become tougher for hedge funds and private equity firms, with the European Union and US policy makers considering stricter regulations for the trillion dollar industry.

The watchdogs are aiming to fill in the gaps in the system and have called for greater transparency in the funds' investment style, periodic disclosure of portfolio, besides limiting their aggressive leverage.

The proposal, if implemented, could impact India too, say industry observers. This is because most of the funds that invest in India are from these countries. Also, it would limit domestic private equity funds' ability to raise money from the overseas market as US and European investors are the biggest subscribers, said Vikram Shroff of law firm Nishith Desai Associates.

At a recent private equity seminar organised by the government of Mauritius, Securities and Exchange Board of India's executive director Usha Narayanan said the market regulator always encouraged registered foreign entities to India.

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However, she added that the EU proposal may impact funds flowing through tax-efficient jurisdictions as the directive restricts the ability of marketing of Alternative Investment Fund Managers (AIFM) domiciled outside.

Mauritius is the favourite gateway of PE firms to route their investments to India because of attractive tax rules. PE investments in India in 2008 stood at a little over \$11 billion.

The proposal has sparked intense debate among fund managers, with some strongly criticising the approach. Speaking at the seminar, Jean-Marc Goy, counsel for international affairs of Luxembourg's Commission de Surveillance du Secteur Financier (CSSF), said: "While Luxembourg supports the aim of the proposal (European directive on AIFM), we believe that the proposal has to be improved in a number of fields." CSSF supervises Luxembourg's financial sector. In Luxembourg, the directive would cover 1,811 investment funds, which manage assets worth €395 billion.

The attempt to regulate AIFM follows their alleged involvement in disharmonising the global financial system. Late last year, Bernard Madoff, through his Ponzi scheme, duped thousands of investors. Recently, Galleon hedge fund founder Raj Rajaratnam was arrested in relation to an insider trading case.

One of the EU rules includes funds adhering to caps on leverage (borrowing capital against their holdings for faster and quicker returns). Narayanan said leveraging is not considered a major issue as foreign funds were not permitted to borrow in India but the regulator is conscious of the impact that sudden withdrawal of leveraged funds can

have on the Indian market.

The new EU regulations, according to international media reports, could cost hedge funds and PE firms as much as €3 billion to adhere to the new standards.

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