

Corpsec Hotline

September 15, 2006

AMENDMENTS TO SEBI FII REGULATIONS – LOWERING THE ENTRY BARRIER?

By way of a notification dated August 21, 2006, the Securities and Exchange Board of India (SEBI) has amended the SEBI (Foreign Institutional Investors) Regulations, 1995 to include insurance company, reinsurance company, investment manager or advisor, International or Multilateral Organization or an agency thereof, Foreign Governmental Agency and Foreign Central Bank among the existing categories of permissible FII applicants.

Amendments have also been made to the form of application for FII and sub-account registrations, as follows:

- As per the new form of application for sub-account registration, both the FII and the sub-account will have to give joint undertaking.
- The undertaking that “the income of the applicant is from known and legitimate sources” will now be applicable to the applicants applying for sub-account registration as a broad-based fund or proprietary fund of FII.

Implications:

These amendments are aimed at streamlining and simplifying the application process for FII and sub-account registration.

Some of the implications of these changes, as we see it, would be as follows:

- The introduction of new categories of FII applicants is a welcome move as it widens the scope of FII registration. This move is, to some extent also driven by the fact that most of the investors who are unable to fulfill the norms for FII registration invest through the offshore derivative route, on which SEBI and the RBI have been expressing some uneasiness from time to time. While SEBI has sought to partly address this issue by bringing in new class of FII applicants, nonetheless, SEBI's position on the hedge funds/hedge fund managers to register as FIIs still remains unclear. It appears that SEBI has decided to remain silent on this aspect for the time being, and the hedge funds will have no option but to continue to invest through the offshore derivative instruments route.
- One of the significant changes is allowing investment advisors to register as FIIs. Until now SEBI was not forthcoming in granting FII status to an investment advisor and required the FII applicant to play an active role in the management of the fund. However, now an investment advisor, who may only be making investment recommendations, would be able to get FII status. This should hopefully in our view clear up the embargo that was prevailing on registration of sub-accounts by FIIs who were not necessarily acting as managers to such sub-account.
- By introducing the joint undertakings, the SEBI has now made sub-accounts equally liable for the declarations / undertakings. This effectively means that the SEBI can now require the sub-accounts to furnish any information they need under the FII Regulations, thus obviating the need to first approach the relevant FIIs.
- One issue which remains un-addressed and would have hoped to be resolved is the issue related to NRIs and OCBs participating in the Indian markets through the FII route. By putting a restriction on all NRIs to invest through FII or as sub-account, it is putting persons of Indian origin who may be NRIs and may prefer investing through professional fund managers or advisors at a disadvantage as compared to other non-residents who can freely invest through the FII regime. Further, the concept of overseas corporate body has been done away with by the RBI and the RBI has clarified that any such entities formed by NRIs will be treated on par with foreign entity. In light of that, the reference to ‘overseas corporate bodies’ under the FII regulation imposes additional restrictions on entities which may be predominantly owned by NRIs. It is an issue which needs clear resolution and as the markets open up further for other non-resident investors, we would have expected the regulators to offer such benefits to the NRIs as well.

- **Suneet Barve & Kishore Joshi**
You can direct your queries or comments to the authors

Source: *SEBI notification dated August 21, 2006 available on www.sebi.gov.in*

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