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» Significant Developments to the SEBI (Foreign Institutional Investors) Regulations, 1995

Securities Exchange Board of India (SEBI), has its vide Notification dated May 22, 2008 has amended SEBI (Foreign Institutional Investors) Regulations, 1995 to include the policy measures which it had announced on October 25, 2007. Some of the key terms of the amendment are as follows:

- Sub-Account redefined: The amendment has redefined sub-account to mean □any person resident outside India, on whose behalf investments are proposed to be made in India by a foreign institutional investor and who is registered as a sub-account under these regulation□; Impact: The definition of sub-account prior to amendment was an inclusive definition. By the amendment, sub-account has been clearly defined in terms of the criteria of □residence outside India□ and □registration as a sub-account□.
- Track Record of newly established funds: In case of a newly established fund seeking registration as FII, the track record of the investment manager of the fund who has promoted it may be taken into consideration. Such investment manager must furnish the details in respect of disciplinary action, if any, taken against it; Impact: Newly established funds can now get registration as FII based on the track record of investment manager as against the previous rigid criteria of track record of the applicant.
- The following unregulated entities to be considered: University funds, endowments, foundations, charitable trusts and charitable societies may now be considered for registration as FII even though they are not regulated by a foreign regulatory authority. However, the grant of registration will be subject to the condition that they have been serving public interest. Impact: The removal of requirement of being a regulated entity will ease registration process for these entities. The criteria of whether an applicant serves public interest or not provides a wide discretionary leeway to SEBI in the registration process.
- New category of FII applicant: A new category of applicant i.e. □Sovereign Wealth Fund□ has been introduced and the □Nominee Company□ and □Power of Attorney holder□ category has been omitted;
- Broad Based criteria revised: The □broad-based□ criterion has been modified to include entities having at least 20 investors, no single individual investor holding more than 49%

(instead of 10% at present). An institutional investor can now hold upto 49% (instead of 10% at present) in a broad based fund without being subject to the condition of itself being a broad based fund.

Impact: In view of the extended limits, it will be easier to constitute a broad based fund e.g. a fund can now be registered as FII even with 3 investors viz. two institutional investors holding 49% each and one individual investor with a holding of 2%.

- Removal of restriction on Overseas Corporate Bodies (OCBs): OCBs were hitherto ineligible for investing as sub-accounts or FIIs. The amendment has removed this restriction and they may now invest as FIIs or their sub-accounts.

Impact: The change would widen the universe of eligible FII investors and promote FII investment in the Indian stock market which has shown a substantial decline in the year 2008.

- Registration made perpetual until suspended or cancelled: FII and sub-account registrations have been made perpetual, subject to payment of fees unless suspended or cancelled by the Board. All registrations granted prior to the commencement of this amendment are deemed to be permanent, unless suspended or cancelled by SEBI. All registrations granted prior to this amendment are required to file information in Form A and Form AA, as the case may be, atleast three months prior to the expiry of the period of certificate or within three months from such commencement, whichever is later;

Impact: The extension of validity of registration from three years to perpetuity will reduce compliance costs and time for FIIs and their sub-accounts.

- Sub Account verification by FII: FIIs applying on behalf of a proposed sub-account applying under the foreign corporate category, are required to verify necessary details and documents and satisfy themselves about the identity of the proposed sub-account after applying their know your client procedure;

- New Category of Sub Account applicant: The categories of sub account applicants have been revised as follows:

- broad based fund or portfolio which is broad based, incorporated or established outside India;
- proprietary fund of a registered foreign institutional investor;
- foreign corporate - which has been defined to mean a body corporate incorporated outside India which fulfills the following conditions:- (i) its securities are listed on a stock exchange outside India; (ii) it has asset base of not less than two billion US dollars; (iii) it had an average net profit of not less than fifty million US dollars during the three financial years preceding the date of the application;
- foreign individual- has been defined to mean a foreigner who fulfills the following conditions:- (i) has a net worth of not less than fifty million US dollars; (ii) holds the passport of a foreign country for a period of at least five years preceding the date of application; (iii) holds a certificate of good standing from a bank; (iv) is the client of the foreign institutional investor or any other entity which belongs to the same group as the foreign institutional investor, for a period of at least three years preceding the date of the application;
- university fund, endowment, foundation, charitable trust or charitable society who are eligible to be registered as a foreign institutional investor under these regulations.

- Impact: The eligibility criteria for foreign corporate and foreign individuals have been made rigid and hence one is not likely to see many applications under this category.

- Restrictions for NRIs: A Non-Resident Indian (NRI) is not eligible to apply for sub-account

registration.

Impact: Prior to the amendment, NRIs were ineligible to invest either as a FII or a sub-account. After the amendment, SEBI has vide its Press Release dated May 28, 2008 stated that an asset management company, investment manager or advisor or an institutional portfolio manager set up and/ or owned by NRIs shall be eligible to be registered as FII subject to the condition that they shall not invest their proprietary funds.

- Investment by FII/Sub Account: FII and Sub Accounts are now allowed to invest in units of scheme floated by Collective Investment Schemes. Where investment is made by FII or Sub accounts in equity shares of an unlisted company and they continue to hold the shares after IPO, such shares shall be subject to a lock-in for the same period, if any, as applicable to shares held by a foreign direct investor.
- Offshore Derivative Instruments: Offshore derivative instrument has been defined to mean any instrument, by whatever name called, which is issued overseas by a FII against securities held by it that are listed or proposed to be listed on any recognised stock exchange in India, as its underlying;
- FII seeking to issue or deal in Offshore Derivative Instruments (ODIs) directly or indirectly should satisfy the following conditions:
 - ODIs should be issued only to persons regulated by appropriate foreign regulatory authority. In case of any ODI issued by or on behalf of FIIs before the commencement of this amendment and held by unregulated entities , such ODI shall be cancelled, redeemed or closed out by the issuing FII, before March 31, 2009;
 - ODIs should be issued in compliance with Know Your Client (KYC) norms;
 - A FII should ensure that no further issue or transfer is made of any ODI issued by or on behalf of it to any person other than a person regulated by an appropriate foreign regulatory authority;
 - No ODIs should be issued by or on behalf of a FII with derivatives tradable on any recognized stock exchange in India as underlying. All ODIs issued with derivative tradable as underlying shall be cancelled, redeemed or closed out by the issuing FII, before the March 31, 2009;
 - Where the total value of the outstanding ODI issued by a FII or a sub-account as on the September 30, 2007 is more than 40% of its assets under custody, further ODIs may be issued only in lieu of ODIs which are cancelled or redeemed or closed out. Subject however to the condition that the amount raised through such further issuance of ODI shall not exceed the amount of ODIs cancelled or redeemed or closed out and that additional ODIs instruments may be issued against the bonus shares allotted in respect of the equity shares against which offshore derivative instruments are already in existence;
 - Where the total value of ODI issued against securities held by a FII or a sub-account as on September 30, 2007 is less than 40% of its assets under custody as on that date, further issuance of ODI in any period of 12 months shall not exceed 5% of the total value of its assets under custody. Subject to the condition that such further issuance shall not result in the total value of offshore derivative instruments exceeding 40% of the assets under custody;
 - From the commencement of the amendment, sub-accounts shall not issue any ODI directly or indirectly. Any ODI issued by a sub-account before such commencement shall be cancelled or redeemed or closed out by March 31, 2009;
 - Where ODIs issued by or on behalf of a sub account are outstanding as on

September 30, 2007 and steps have been taken by the sub-account to obtain registration as a foreign institutional investor as on the date of commencement of this amendment, (e) and (f) above shall apply as if the sub-account were a foreign institutional investor on the said date;

- assets under custody on a particular date, in relation to a FII or a sub-account, means the value of assets of the FII which are in custody of its custodian.
- person regulated by an appropriate foreign regulatory authority has been defined to mean and include the following, namely:- (i) any person that is regulated/supervised and licensed/registered by foreign central bank;(ii) any person that is registered and regulated by a securities or futures regulator in any foreign country or state; (iii) any broad based fund or portfolio incorporated or established outside India or proprietary fund of a registered foreign institutional investor or university fund, endowment, foundation, charitable trust or charitable society whose investments are managed by a person covered by clauses (i), or (ii) above.
Impact: SEBI has explicitly incorporated the policy proposals mooted in its meeting on October 25, 2007 regarding issuance of ODIs. Before the amendment, ODIs could be issued to a wide category of entities meeting the regulatory requirements as specified in SEBI Circular No. IMD/CUST/13/2004 dated February 19, 2004. Under the aforesaid circular, an entity regulated by a foreign central bank or foreign securities/futures regulator was eligible but under the new definition dual test of regulated and registered has to be satisfied. Further, the following three categories specified in the aforesaid circular have been excluded from the ambit of eligible entities, that is, (1) entities which are members of securities or futures exchanges; or (2) entities incorporated in a jurisdiction that requires filing of constitutional and/or other documents with a registrar of companies or comparable regulatory agency; and (3) individuals or entities like trusts, funds, collective investment schemes, investment company or limited partnership whose investments are managed by such other regulated entities. Thus, the category of eligible persons has been narrowed by providing a narrow and exhaustive definition of person regulated by an appropriate foreign regulatory authority. In such a situation, persons holding ODIs by relying upon the aforesaid Circular but not falling within the new definition may have to close out their ODI investments.
- Application Forms amended: In light of the above amendments the Form A and Form AA have been changed.

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