

## Foreign Portfolio Scheme: A strange kind of treatment

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The Securities and Exchange Board of India (Sebi), in its circular of April 10, in the process of clarifying 'Know Your Client' (KYC) norms, denied non-resident Indian (NRI)/resident institutions from managing global funds under the Foreign Portfolio Investment (FPI) scheme — 'white' category. In the meantime, non-Indians are allowed to manage such funds. This affects billion-dollar portfolio investments into India. The problem with the circular is that, instead of clarifying the KYC norms, it has discriminated between foreign institutions and NRI-resident institutions.

The circular uses the identification of 'beneficial ownership' to carry out KYC exercises. Unfortunately, it ends up restricting investments and management rights of NRI-resident institutions such that, if there is any fund to be promoted or controlled by them for attracting global investment, it would be ineligible for investment in India as FPI. The circular, however, allows the same pooling vehicle to be set up by other foreigners or foreign institutions.

Today, many reputed NRI-resident institutions manage billion-dollar foreign portfolios estimated at about \$30 billion and above. These will simply be debarred, as they don't fall in this 'white' category.

Prime Minister Narendra Modi recently asserted India's need to promote Indians becoming global players by managing global assets. The circular goes against this tenet leading to NRI-resident institutions winding up their investments altogether.

The solution would be to remove this discrimination by allowing NRI-resident institutions to manage global portfolios with the same degree of KYC, and within the same investment and management parameters as applied to the other foreign investors.

The circular seems to be a departure from a usual healthy practice followed by Sebi to consult stakeholders prior to any major policy change. Sebi has issued a clarification under its FAQs (frequently asked questions), encouraging regulated entities owned by NRI resident institutions to register as FPI for the purposes of acting as investment manager for other foreign portfolio investors.



Numerous Indian fund managers have also set up asset management companies and pooling vehicles abroad, with the due approval of Sebi and other regulators, raising money for investments.

The circular, effectively, bars them. It also imposes institutional and broad-based funds, investing from 'high risk jurisdictions', to undertake full KYC, which other jurisdictions will not be subject to. This leads to a situation where NRIs will be restricted to 10% holding, while 'whites' will be allowed with a much stiffer KYC disclosure.

It is unclear on what basis the jurisdictions are classified as 'high risk jurisdictions'. It seems more perception-based than process. It can have political consequences at a time when India needs friendly neighbours. Mauritius has objected to its being branded as a 'high-risk jurisdiction'. Being a member of the International Organisation of Securities Commissions (IOSCO), it has tax and investment treaties with India for exchange of information, besides having the most cooperative jurisdiction with high levels of anti-money laundering laws.

It is recommended that the list should uniformly be followed and issued by the government, being ideally benchmarked to inter-governmental bodies for enjoying a global consensus.

One needs to resolve these 'beneficial ownership' issues. There is no other avenue than the FPI route for NRI-managed pooling vehicles to invest in India. Many of such billion-dollar investments would otherwise be denied access.

The circular is also counter-intuitive to Govt's efforts to promote the domestic fund management industry. Section 9A of the Income-Tax Act incentivises NRI fund managers to relocate to India, and have Indian asset managers manage foreign pools of capital without creating permanent establishments.

Sebi also brought in changes to enable Indian asset managers to avail of Section 9A of the Income-Tax Act.

Although this requires substantial changes, conditions are such that no one is able to utilise it fully. One needs to do so, by building a robust legal and tax ecosystem.

Sure, applying KYC norms of highest international standards must be followed before permitting any foreign investment into India. A complete embargo on funds managed by Indian residents and NRIs is, however, unwarranted and unnecessary. Given the confusion that the circular creates, it would be better if this move is reconsidered.

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