

Business Standard

Private bank route for foreign portfolio investors may be non-starter

Seems unlikely to elicit significant interest from investors after Sebi's decision to keep NRIs out

Ashley Coutinho | Mumbai March 27, 2018 Last Updated at 06:43 IST



The Securities and Exchange Board of India's (Sebi's) decision to disallow resident Indians, non-resident Indians (NRIs) and those under the Overseas Citizen of India (OCI) category from investing through private banks has put cold water on this route.

Sebi, in a recent circular, says private banks may invest on behalf of clients. This was in line with a consultation paper issued last June and a significant departure from the earlier position that banks only be allowed to do proprietary trade.

The relaxation was based on two conditions. One, that details of beneficial owners be provided when required by regulators. Two, no secrecy arrangement with the investors and all required legal

arrangements that any secrecy law or confidentiality clause not impede disclosure of beneficial owner details, whenever required by Indian regulators.

The new guidelines were expected to bring sizable investment into India, especially from NRIs. “That is now unlikely, given that investors from countries other than India are likely to be a much smaller minority,” said a person on condition of anonymity. A section of participatory note investors were also expected to migrate to this route for derivative trades.

At present, an NRI may invest in India through offshore funds if one is not the beneficial owner. “To bar an entire investor class from accessing India seems harsh. Considering it is a formal vehicle set up by banks, investment vehicles should not be treated any differently than a fund,” said Richie Sancheti, head of investment funds practice at Nishith Desai Associates. He adds that concerns about round tripping or the quality of money coming to India could have been addressed by pushing for better Know Your Customer (KYC) rules.

DAMPING DEMAND

- Sebi has allowed private/ merchant banks to invest on behalf of clients
- Earlier, banks could only do proprietary trades
- Resident Indians, NRIs and OCIs, however, cannot invest through this route
- The relaxation was expected to bring in sizeable investment into India, especially from the NRIs
- NRIs can invest into India via offshore funds, provided they are not the beneficial owner
 - Banks' omnibus structure to be treated like a fund and investment cannot be one-to-one
- Private banks offer customised services to clients as most follow a unique strategy



The regulator has also clarified that the collective investment vehicle of the bank (other than for Overseas Direct Investment) be broad-based and there be a common portfolio for all investors. Broad-based here implies more than 20 investors, with none owning more than 49 per cent stake. In other words, while permitting an omnibus structure from an investment standpoint, Sebi appears to think it has to be treated like a fund and investment cannot be made on a one-to-one basis.

Typically, private banks offer customised services to clients; they prefer a unique strategy for investment. According to experts, mandating a broad-based collective investment vehicle and a common portfolio for all clients has taken away much-needed flexibility and dampened investor interest in the route.

“What appears a relaxation is actually a development of no consequence to most overseas private banks. Allowing such banks to offer a better range of structured products will rekindle the interest in this route,” said Suresh Swamy, partner at consultancy PwC.

Private and merchant banks that are regulated by an “appropriate regulator” are classified as Category-II Foreign Portfolio Investors (FPIs). Large private banks include the likes of Citi, Credit Suisse and BNP Paribas.

Money laundering or round tripping has been a concern of the regulator in recent years. In 2014, Sebi had introduced rules mandating FPIs issuing p-notes to send a monthly disclosure report on the portfolios. The regulator then mandated that anti-money laundering rules (AML) be applicable to p-note holders, in addition to regular KYC. Earlier, a p-note holder had to adhere to KYC or AML norms of their home jurisdiction.