THE ECONOMIC TIMES
Business News › Markets › Stocks › News

Decoding the Sebi-FPI standoff: Will it hurt Indian fund managers overseas?

BY AMIT MUDGILL, ETMARKETS.COM | UPDATED: SEP 04, 2018, 01.54 PM IST

NEW DELHI: Foreign portfolio investors have long been a key driver of Indian stocks. But a large part of this money has an Indian connection: non-resident Indians (NRIs), overseas citizens of India (OCIs) and persons of Indian origin (PIOs) invest in Indian equities through the FPI route.

Market regulator Sebi in April stirred a hornet's nest there, when it asked Category II and III FPIs to provide list of their beneficial owners (BO) in a prescribed format within six months. As the deadline draw near, there is unease in the market.

FPIs, under the banner of Asset Managers' Roundtable of India (AMRI), are lobbying hard to get the proposed changes to KYC norms withdrawn. They claim some $75 billion FPI money will move out of India because of the regulatory move.

FPIs held about 23.8 per cent stake in BSE200 stocks, worth $408 billion as of June 30. This is more than double of $177 billion of BSE200 stocks they held in June 2012.

Sebi remains unmoved, and says the same is necessary under the prevention of money laundering norms.

"The circular issued by SEBI on the subject indicates that the genesis behind the new reporting requirement is curbing money laundering and preventing "round tripping" of funds. It appears that that this drive is to protect investors and to have a more regulated market. Where NRIs are the beneficial owners, SEBI may want such investors to invest directly in India using the Portfolio Investment Scheme route as against the FPI regime," said Nitesh Mehta, Partner for Tax & Regulatory Services at BDO India.

On Tuesday, the market regulator dismissed the FPI demand for withdrawal of the new KYC norm as "preposterous and highly irresponsible." FPI says the Sebi move will lead to disqualification of a number of foreign funds majorly controlled by non-resident Indians (NRIs), overseas citizens of India (OCIs) and persons of Indian origin (PIOs).

A large outflow at this stage may put tremendous pressure on the rupee, which is already down over 10 per cent this year, and also domestic stocks. The institutional category has been net sellers on Dalal Street to the tune of Rs 4,900 crore so far this year.

Last month, Sebi asked these funds to either square off positions or change ownership within six months from April 10, which is now revised to December 31. The regulator had also assured FPIs that the issues raised by them will be looked into by an expert panel.

The decision came after Sebi received representations from market participants, seeking review and additional time for complying with the guidelines.

Analysts say the matter could at the most generate a knee-jerk reaction. But they themselves are divided over the circular; some find it ambiguous.

What does the circular say

The Sebi circular says beneficial owner (BO), who ultimately owns or controls an FPI should be identified in accordance with rules on prevention of money-laundering.

It says foreign funds where one or more NRIs, OCIs and PIOs have controlling ownership interest of 25 per cent in case of a company and 15 per cent in case of partnership firm, trust & unincorporated association of persons, would be considered as BO.

Besides, the circular says any investment from "high-risk jurisdictions" would attract a lower threshold of 10 per cent for identification of BO.

For this, the market regulator has asked Category II and III FPIs to provide list of their beneficial owner (BO) in a prescribed format.

What analysts say

"At one go, all NRIs are treated as if they are doing money laundering, which is not appropriate," said Nishith Desai, Founder of Nishith Desai Associates Management.

Others say there are many NRI fund managers in Singapore, who get money from overseas to invest in India, as foreign individuals cannot do so directly.

“Suddenly, they are no longer eligible to run these funds. It is the strangest law,” Deepak Shenoy, Founder at Capital Mind told ET Now.

Why would a foreigner give money to someone who is non-Indian to manage a fund that invests in India, he asked.

Forget NRIs, even OCIs or persons of Indian origin cannot be a fund managers, which was very strange, because essentially you can never get rid of this tag, because you were born here and you are a person of Indian origin, Shenoy said.

At the time of writing of this report, the stock indices were down for fifth day running while the rupee ruled at a low of 71.34 against dollar.

Analysts watching the event say there is no panic among FPIs over the Sebi circular.

“If India remains an attractive investment destination for foreign investment flows, foreign investors will figure out other ways and means in terms of additional layering or in terms of how do you really comply,” said Vivek Mavani, an independent investment adviser.

Globally, funds do move across geographies and regulation is never a hurdle for investment flows.

“I am sure, Sebi will be pragmatic. Besides, investors are bringing in money because they do see merit of investing in India. Monday’s was probably a short-term knee-jerk reaction. I do not see any long-term implication like serious foreign outflow over the next few days or weeks,” Mavani said.

Mehta told ETMarkets.com that there are indications that there would be some changes incorporated in the reporting requirements to take cognisance of the issues and concerns raised by FPIs, especially having NRI linkages.

“While we wait for the updated reporting requirements, it is plausible that FPIs which are not able to comply with the reporting requirement may not be able to take additional positions in the Indian securities market. Probably, they may also be asked to unwind their positions, which can directly impact their investment and exit strategies and timelines,” Mehta said.

Quantifying the impact may not be correct at this juncture, especially after SEBI’s statement that it will be amending the reporting requirements, the expert said.