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Sebi asks FIIs to monitor PN beneficiaries

ET Bureau, Jan 18, 2011, 05.43am IST

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MUMBAI: Capital market regulator the Securities and Exchange Board of India (Sebi) has put the onus on foreign institutions, which issue participatory notes, to keep a tab on the final beneficiary of this derivatives instrument. The move, which is part of the regulator to get foreign institutions to comply with 'Know Your Client' (KYC) requirements , follows instances where a couple of participatory note-issuing institutions failed to provide exact details of the ultimate beneficiary.

Indian regulators suspect that participatory notes, a derivatives instrument that allows foreigners to invest in Indian stocks without registering with the authorities here, are being misused to rig the stock market with unaccounted funds from overseas.

The securities market regulator, in a circular on Monday, directed foreign institutions to declare, in their regular report filings, that the person to whom the participatory note is issued and the beneficial owners, comply with the regulations.

"The revised undertaking has two effects, it technically removes the restriction on issuance of ODIs to non-resident Indians (NRIs) and introduces the concept of beneficial ownership for being compliant with Sebi regulations," said Divaspati Singh of Nishith Desai Associates.

Lawyers said the revised norms come on the heels of a plea by participatory note-issuing institutions that they should not be saddled with the obligation to report the transfer of beneficial ownership of an offshore derivatives instrument, as this is not within their control. Though these institutions have always been under an obligation to report any back-to-back issuance of participatory notes, Sebi, in this revised undertaking , has reiterated it.

"The concept of beneficial ownership has not been defined and could lead to a lot of confusion by opening up a Pandora's box of varied interpretations ," Mr Singh said.

In early 2010, Sebi had barred French bank Societe Generale (Soc-Gen) from dealing in offshore derivative instruments (ODIs) or participatory notes citing lapses on its report the details of the end-beneficiaries of participatory notes issued by it. Earlier, Sebi had directed Barclays not to issue fresh ODIs after it provided wrong information. Both the bans were revoked later by Sebi.

The regulator has also clarified on the reporting to be done when the offshore derivative instrument activity happens between two foreign institutional investors, in order to avoid double reporting. Sebi has also clarified about the reporting standards needed for participatory notes.

"If the exposure to Indian stocks in a particular Index is more than 20%, then disclosures for ODIs will have to be made. Also, custom baskets shall be mandatorily reportable , so long as they have an onshore hedge, irrespective of their Indian exposure," Mr Singh said.

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