THE ECONOMIC TIMES
Mon, Sep 27, 2010 | Updated 08.26PM IST

24 SEP, 2010, 04.10AM IST, SUGATA GHOSH & REENA ZACHARIAH,ET BUREAU

Foreign funds seek delay in new rules

MUMBAI: Hundreds of foreign fund managers are knocking on the doors of the Indian capital market regulator for more time to fall in line with new rules that kick in from October 1, failing which they may have to pull out of the country.

SEBI had told foreign institutional investors (FIIs) and their sub-accounts—special purpose vehicles set up in tax havens like Mauritius to access Indian stock exchanges—to ensure that the money they manage is raised from several offshore investors and not from a single or a few investors.

The regulator had asked new sub-accounts that applied for registration and old ones whose licences came up for re-newal to give an undertaking that they woul stick to the new rule, which is aimed at curbing round tripping of money by rich Indians and NRIs who often use FIIs to play the Indian stock market.

500 a/cs under pressure

"But many are finding it difficult to fulfil the new norms... They will either wind up or ask for more time to wind up or ask for time to convert themselves into broadbased structures... It's not clear as yet whether SEBI will grant that," said Siddharth Shah, who heads funds practice at law firm Nishith Desai Associates.

Mr Shah, who is advising many FIIs on how to restructure their entities, feels that SEBI may take a case-by-case approach. According to market circles an custodian sources, more than 500 sub-accounts have come under pressure.

FIIs got 6 months to comply

Under a broadbased structure, each sub-account must have at least 20 investors, and no investor can contribute more than 49% of the pool, unless there ar institutional investors like pension funds, in which case the number can be less than 20.

But, for years, several sub-accounts have been functioning as multi-class entities where each registered sub-account runs mutiple cells pursuing different invest ment strategies. There have been regulatory concerns that once a multi-class share entity is registered, it can add new cells that can be used for round tripping.

Over the past one month, SEBI has also issued letters to FIIs and sub-accounts, reminding them to shut protected cell companies (PCC), which are similar to cells in a multi-class entity. They have been told that as PCCs, they cannot buy fresh securities.

Under the circum-stances, PCCs will have to reapply as new entities and may be forced to liquidate their investments if SEBI rejects their registration

SEBI, which felt that PCCs and multi-class structures not only went against the spirit of FII regulations but were ways to side-step rules, came out with the new directions in April, giving foreign investors six months to comply. But the latter need more time.

"There are legal and compliance issues and approvals from investors can take a long time. Global fund structures are different," said a senior official with a cus todian bank. He said some of the sub-accounts have already shut, but could not put a number to it. According to Akil Hirani, managing partner at law firm Majmuda & Co, "Although PCC vehicles specifi-cally exist in Mauritius, a number of non-Mauritius FIIs are also re-quiring to assess under their own statutes whether they fal under these definitions."

There are about 1,732 FIIs and 5,553 sub-accounts registered with SEBI. According to a senior stock broker, the demise of multi-class entities and PCCs will driv offshore investors to buy participatory notes—in-struments that allow offshore investors to trade in Indian shares..