MEMO# 29035

May 28, 2015

ICI Global Letter to SEBI on Key Indian Regulatory Issues for Cross-Border Portfolio Investments

[29035]

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TO: INTERNATIONAL OPERATIONS ADVISORY COMMITTEE No. 16-15
SECURITIES OPERATIONS ADVISORY COMMITTEE RE: ICI GLOBAL LETTER TO SEBI ON KEY INDIAN REGULATORY ISSUES FOR CROSS-BORDER PORTFOLIO INVESTMENTS

On May 11, 2015 we submitted a letter to the Securities and Exchange Board of India ("SEBI") addressing five regulatory policy issues that continue to pose challenges for US registered investment companies and similar non-US regulated funds that invest (or seek to invest) in India. In the letter, we explain that the regulatory certainty and clarity we seek will improve investor confidence, enhance the regulated funds' investment experience, and promote cross-border portfolio (non-controlling) investment in India.

The following five issues are covered: (1) the requirement to invest in Indian securities at least five percent of the corpus of a new mutual fund or sub-fund which does not meet the "broad-based" criteria at the time of seeking registration as a Foreign Portfolio Investor ("FPI"); (2) the multi-share class pre-approval requirement; (3) Indian regulatory and tax issues related to fund reorganizations in the home country; (4) the margin requirements for investments in Government Securities ("G-Secs"), and (5) the reinvestment rules for G-Secs purchased using limits obtained at auction.

The issues and our proposed solutions are summarized briefly below.

1. The broad-based fund requirement for a new fund. A new fund or sub-fund that does not meet the broad-based requirement from day one and proposes to invest in Indian securities is required to meet an additional condition of investing at least five percent of its corpus in Indian securities until it satisfies the broad-based test. If the new fund does not meet the broad-based condition within six months of procuring its registration, it then needs to register as a Category III FPI, as opposed to the preferred Category II FPI. The minimum five percent investment criterion is not a workable solution for many Regulated Funds because the fund may have dedicated a percentage lower than five percent of its corpus towards Indian investments and changing that allocation is neither desirable nor feasible.

Request: We request that SEBI authorize Designated Depository Participants (“DDPs”) to adjust the five percent requirement downward, on a case-by-case basis, depending on the investment objective and strategy of a particular regulated fund. In addition, we request that SEBI provide one year for a new regulated fund to meet the broad-based criterion instead of the current six month period.

2. The multi-share class pre-approval requirement. Even under the new FPI regulations, regulated funds are required to obtain prior approval if they desire to add a new share class. SEBI has delegated the responsibility for granting approvals for additional share classes to DDPs. Obtaining such an approval (previously granted by SEBI) has, at times, taken a relatively long time, e.g. up to one month. This requirement impedes the launch of a new share class of a regulated fund and can have detrimental ramifications for a regulated fund, its investors, and its investment firm sponsor.

Request: We request that SEBI allow regulated funds to make a declaration – either as part of the FPI application process or subsequently – stating that a common portfolio of securities, including any Indian securities, is maintained across any and all classes of shares issued by the regulated fund (e.g., they do not operate segregated pools of capital) and thereafter only require such funds to provide notice to SEBI, or a DDP, upon the launch of a new share class.

3. Fund reorganizations. In order to address business and corporate governance issues, US mutual funds may elect to reorganize their legal structure. Such a reorganization typically involves shifting a trust from one US State to another, or converting a corporate structure to a trust structure. These reorganizations are not being done for tax reasons. In several cases of reorganizations SEBI treats the restructured regulated fund as a new FII/FPI and requires the new regulated fund to obtain a new FII/FPI license. Obtaining a new license imposes an unnecessary administrative and cost burden on the fund. In addition, there are tax issues and tax leakages that are suffered by the fund due to the reorganization (which we describe below and have also raised with the tax authorities).

Request: We request that in the case of a simple name change, a change in state domicile, or change in corporate form SEBI permit the FII/FPI license to be migrated to the restructured fund when certain conditions are met. We also previously wrote to the Indian tax authorities highlighting the Indian tax issues faced by our members in fund reorganizations and we are following up with them to have the matter resolved.

4. The margin requirements for investments in Government Securities. Regulated funds that are not located in Asia face operational hurdles in terms of meeting Indian margin requirements and the timing of the margin payments with respect to G-Secs.

Request: As an alternative, we request that, the Irrevocable Payment Commitment rules currently in force which are extended only to the purchase of shares and convertible debentures be extended to transactions in G-Secs as well. This would significantly reduce the hurdles faced by regulated funds.

5. Re-investment of proceeds received on sale or maturity of Government Securities. SEBI has in the recent past issued a circular [1] that has summarized clarifications regarding the investment limits for G-Secs and the manner in which proceeds from sale or maturity of G-Secs should be reinvested. While SEBI has relaxed the requirements pertaining to investment in Government Securities, in practice, the reinvestment rules have significant negative consequences for foreign investors, such as regulated funds, that have purchased

G-Secs using limits obtained at an auction.

Request: We request that SEBI revise the current reinvestment guidelines, in order to allow FPIs that have purchased G-Secs using limit to freely reinvest proceeds from the sale or maturity of those securities without having to go through the auction process should the debt utilization rate change, provided that they do so within a specified period of time.

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Attachment

endnotes

[1] Circular No CIR/IMD/FIIC/19/2014 dated October 9, 2014.
