

# Legal Contradictions FII Framework

**NIPFP-DEA  
Program on Capital Flows**

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# Sense of the Terrain

- Active FII presence preceded regulations
  - SEBI Act amended in 1995 to regulate FIIs
  - Legacy of registration under GOI Guidelines
- Exchange controls overlap securities laws
  - FIIs regime started under FERA, now FEMA
- FDI policy overlaps FII regime
  - Special carve-outs for FIIs in certain sectors
- General imprecision in drafting Indian law
  - Multi-lingual people communicating in English

# Legislative Contradictions

- Originally FIIs were purely portfolio traders
  - Purchases and sales on exchanges
  - Not more than 10% stake in any company
- Market sales now free for any non-resident
  - Free market purchase is the only charm left
- FIIs also allowed primary subscription
- FII status does not negate FDI privileges
  - “Portfolio” investor policy concept gets fuzzy

# Legislative Contradictions

- Special sectors entail separate FII limit
  - DTH sector permits 20% FDI and 29% FII
- Renewed accent on “institutional” status
- Policy gyrations send confusing signals
  - “broad-based fund” – from 50 investors to 20
  - maximum single owner limit from 10% to 49%
  - “regulated entity” for P-Notes (2004 to 2008)
- Unstated policy mars registration process
  - Individuals, hedge funds, brokers, “reputation”

# Legislative Contradictions

- Regulation of Participatory Notes messy
  - P-Notes as old as FII framework; but regulations amended in 2004
  - Overhauled in September 2007, but actually amended only in May 2008
  - New definition regulates only P-Notes issued against securities “held” by the FII
  - Sub-accounts banned from issuing P-Notes
  - NRIs, OCBs discriminated against
  - “know-your-client” requirements ambiguous

# Legislative Contradictions

- No role clarity for securities custodians
  - Not charged with compliance akin to merchant bankers in IPOs, open offers
  - However, expected to play gate-keeper role
- Circulars travel beyond the regulations
  - Courts have struck down and imposed costs
- Sub-accounts are separate entities
  - Insistence that FIIs should ensure compliance makes life unpredictable

***THANK YOU***

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