Legal Update

Ways broadened for QFIs-Government sees more foreign money on the way

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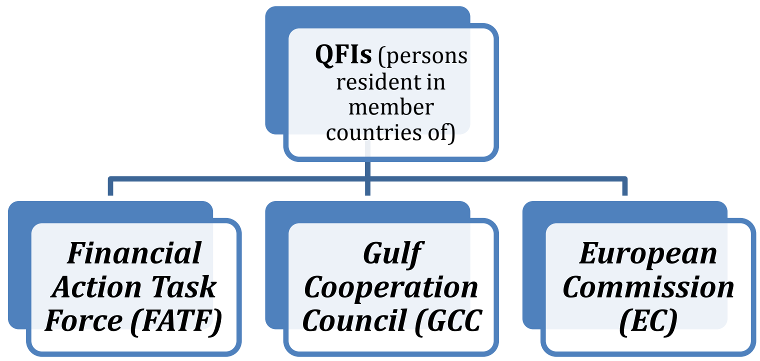
Budget 2011-12 opened up avenues for ***Qualified Foreign Investors (QFIs)*** to invest in **Indian Equity Mutual Funds schemes and in Mutual Fund debt schemes** that invest in infrastructure. Recently, in January, QFIs were granted general permission for investment under Portfolio Investment Scheme (PIS) and thus the new class of investors got a direct entry option in the **Indian Equity market**[1]. Now, ***the Ministry of Finance ("the Ministry")***, in pursuance of the announcement made in Budget 2012-13, has decided ***to permit QFIs to invest in corporate bonds in India***[2]***, simultaneously relaxing the earlier norms.***

With a view to rationalize the QFI scheme, the under-mentioned changes have been made in the scheme:

- **AMBIT OF QFIS WIDENED:**

  QFIs, under the present scheme, are persons non-resident in India but resident in a country that is compliant with *Financial Action Task Force (FATF) standards* and that is a signatory to International Organization of Securities Commission's (IOSCO's) Multilateral Memorandum of Understanding (MMOU). Therefore, persons from 34 member countries of FATF were eligible till now. *The definition of QFIs has now been widened to include residents from the countries of* **the Gulf Cooperation Council (GCC)** *and those of* ***the European Commission (EC)***[3].

[1] See our Legal Update on the topic: http://india-financing.com/note%20on%20direct%20access%20to%20QFIs%20in%20Indian%20Equity%20Market.pdf
[2] See Press Release by Ministry of Finance: http://finmin.nic.in/press_room/2012/Rational_QFI_Scheme.pdf
[3] Presently there are 6 member countries of GCC and 27 member countries of EC.



The intent behind the move is amply clear- the Government is keen on attracting *high net worth entities* from the above-mentioned jurisdictions.

➢ Investment in Corporate Bonds allowed:

QFIs have now got a new investment arena to channelise their funds into. As such, *the QFI framework would stand extended to all three important segments of the Indian Capital markets, i.e., Mutual Funds, Equity Market and Corporate Bond Market.* The extant scheme restricted the equity investments upto a maximum of 5% of the paid-up capital of the company (in case of total individual shareholding) and a maximum of 10% of the paid-up capital of the company (in case of total aggregate shareholding). ***The Ministry has prescribed a separate sub-limit of USD 1 billion for QFIs investment in corporate bonds and mutual fund debt schemes.***

➢ Relaxation in existing norms:

- Under the present scheme, QFIs are required to hold a dedicated demat account with a *SEBI registered qualified Depository Participant (DP) and* are not allowed to open a bank account. The amended scheme allows QFIs to open ***individual Rupee Bank Accounts with Authorized Dealers banks in India*** for receiving funds and making payment for transactions in securities they are eligible to invest. However, the bank account must be non-interest bearing.

- The present scheme required that funds remitted by QFIs for investments are to be transferred to their overseas bank accounts if such funds are not invested as permitted, in five working days of the receipt of funds in their accounts. ***Now, the restriction of 5 days has been done away with.***

➢ MORE TO COME:

- As per the Press release made by the Ministry, QFIs will be served with operational flexibility for appointing their custodians and brokers to route their investments, after **SEBI** issues a Circular in this regard.

- **Central Board of Direct Taxes (CBDT)** will come up with Clarifications on tax related issues for QFIs

RBI & SEBI are expected to issue relevant circulars incorporating the above changes, and for operationalising the budget announcement relating to QFI investment in corporate bonds and MF debt schemes within 7 days of the Press Release.

OUR TAKE ON THE LIBERALISATION:

The Press Release comes as thumbs up in all respects for QFIs. The periphery of the term QFIs has been increased which in turn will facilitate increased participation from such foreign entities. To add up, the Ministry has not only provided them with a new investment option in the form of corporate bonds, but also a separate sub-limit for making investments in such securities, i.e. two benefits in one shot. Since Corporate bonds are a safer investment option than the equity- it definitely can be seen as an alluring opportunity to the QFIs. Norms previously specified for QFIs have been relaxed to a great extent- opening of bank accounts will help convenient execution of transactions and the relaxation in the time limit for remittance of funds will help the investors curtail the high cost of transfer of funds. It is a full on liberalized approach-measures taken to make QFI scheme more attractive to potential investors and enhance flow of foreign capital into India, which has been a trend since recent past.

This attempt of the Government to ease up the entry and penetration of QFIs, that too in a phased manner is commendable; but there is more to come as regards regulatory aspects, e.g. taxation issues. Once addressed, there will be a lot more clarity in this regard. Let us wait and watch-what is in store of the Government for QFIs and for the foreign exchange reserves of the economy. For now-All is Well!