Legal Update

Direct Access to QFIs in Indian Equity Market-a step ahead in boosting foreign investment

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The Indian Government with a view widen the class of investors in the equity market, boost the domestic markets with foreign funds and in line with its liberal approach towards foreign investment, has come up with 'Scheme for Qualified Foreign Investors (QFIs) to invest in Equity Shares' vide RBI's Circular[1] and Press Release[2] dated January 13, 2012 .

Till now, only FIIs/sub-accounts and NRIs had direct access to Indian Equity Market. Though, the QFIs were previously permitted to invest in Indian Mutual Funds schemes in the Budget announcement 2011-12, but they did not have a direct entry option in the Indian Equity market. Now, vide SEBI's Circular dated January 13, 2012[3], *QFIs have been granted* ***general permission*** *for investment under Portfolio Investment Scheme (PIS) route similar to FIIs*.

To start with, QFIs 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). "The FATF compliant" criterion has been set in order to curb the inflow of black money into the country. The residential status is to be determined in accordance with the provisions of Income Tax Act. However, QFIs do not include Foreign Institutional Investors or sub-accounts registered with SEBI.

The Salient features of the new scheme are outlined below:

- *Eligibility Criteria*:
  - The QFIs should meet the prescribed *Know your Customer (KYC)* requirements and shall hold a PAN.
  - They are required to hold a dedicated demat account with a *SEBI registered qualified Depository Participant (DP)*. However, they are not allowed to open a bank account. Instead, a separate single rupee pool bank

[1] The RBI Circular RBI/2011-12/347 A. P. (DIR Series) Circular No.66 is available at: http://rbidocs.rbi.org.in/rdocs/Notification/PDFs/APD130112FS.pdf

[2] The RBI Press Release 2011-2012/1134 is available at: http://rbidocs.rbi.org.in/rdocs/PressRelease/PDFs/IEPR1134Q0112.pdf

[3] The SEBI Circular CIR/ IMD/FII&C/3/2012 is available at: http://www.sebi.gov.in/cms/sebi_data/attachdocs/1326453304731.pdf

account would be maintained by the DP with an AD Category- I bank in India for QFI investments.

- *Eligible Instruments*: The QFIs are allowed to invest only in equity shares of listed Indian companies and/or in equity shares of Indian companies which are offered to public in India**. *This means that the route is open for both primary and secondary market transactions***. The purchase of listed equity shares or the sale of shares held in the demat account is to be made only through SEBI registered stock brokers.

- *Eligible Transactions*: The QFIs have been permitted to acquire and hold equity shares by purchasing rights shares, or receiving shares on bonus issue, on stock split/consolidation, amalgamation, demerger or any other corporate action; to receive dividend on their holdings; or to tender their shares in the case of buy-back or in case of open offer made in pursuance of SEBI (SAST) Regulations or SEBI (Delisting of Equity Shares) Regulations. All these transactions are to be treated at par with that of Indian Non-institutional investors in respect of margins, voting rights, etc. and are subject to the investment limits imposed under the scheme.

- *Mode of Payment/Repatriation*:

    - The DP has to maintain a separate single rupee pool bank account with an AD Category-I bank in India for QFI investments under the Scheme.

    - DP has to purchase the equity as and when the instruction from the QFI is received, within five working days of the date of credit of funds to the single rupee pool bank account by way of foreign inward remittances through normal banking channels. Otherwise, the funds are to be immediately repatriated back to the QFI's designated overseas bank account.

    - The sale proceeds of the equity shares are to be received in this single rupee pool bank account of the DP and repatriated to the designated overseas bank account of the QFI within five working days of having been received in the single rupee pool bank account of the DP.

    - Dividend payments on shareholdings of QFIs can either be directly remitted to the designated overseas bank accounts of the QFIs or credited to the single rupee pool bank account. In latter case, the repatriation is to be done within five working days of the credit of such funds to the single rupee pool bank account.

- Fresh purchase of equity shares out of sale proceeds of equity shares or dividend is allowed provided that such purchase is made within five working days as specified.

➤ *Limits and restrictions on investments*:

- Total individual shareholding not to exceed 5% of the paid-up capital of the company at any point of time.
- Total aggregate shareholding not to exceed 10% of the paid-up capital of the company at any point of time.

  Both the limits are applicable to each class of equity shares having separate and distinct ISIN. The QFI shall divest the shareholding in case it breaches any of the prescribed limits. Further, the DP, the QFI, and the Investee Company are jointly and severally responsible to ensure that the limits are not breached.
- Issuance of offshore derivatives instruments/ participatory notes by the QFIs is NOT allowed.
- ***The limits shall be over and above the FII and NRI investment ceilings prescribed under the Portfolio Investment Scheme for foreign investment in India, but within the overall FDI sectoral caps under the existing Foreign Direct Investment (FDI) policy.***

➤ *Eligibility Criteria for Depository Participants*:

- Minimum paid-up capital of Rs. 50 crores.
- Should be either a clearing bank or a clearing member of any of the Clearing Corporations.
- Systems and procedures to comply with FATF standards and Prevention of Money Laundering Act.
- Appropriate arrangements for receipt and remittance of money with a designated Authorised Dealer (AD) Category - I bank
- Prior approval of SEBI before commencing the activities relating to opening of accounts of QFI.

- *Major Responsibilities of the Depository Participant:*
    - Provide on a daily basis, QFI wise, ISIN wise and company wise buy/sell information and any other transaction or any related information to their respective depositories on the same day.
    - Monitor the account of the QFI and ensure the maximum limit of 5% or 10%, as the case may be, is not breached at any time.
    - Place appropriate systems and procedures to monitor the above limit by using PAN and/ or other unique identity number of the QFI.
    - Publish a caution list, the company's name along with ISIN in case shareholding by QFIs reaches 8%. The same shall be informed by the depositories to the DPs and recognized stock exchanges having nationwide terminals.
    - Shall provide information to RBI in any manner and format required by it.

- *Modus operandi:*

    - For Purchase:
        - Instruction and purchase order/ instruction to make application for public issue from QFI to DP and remittance from designated overseas bank account of QFI to single rupee pool bank account of the DP
        - DP to forward the order to SEBI registered stock broker with which the QFI has a trading account. Funds received from QFI to be remitted to the broker/issuer company.
        - DP to ensure that the shares purchased are credited into the demat account of QFI on the pay-out date.

    - For Sale:
        - Instruction from QFI to the DP.
        - DP to place order for sale after verifying availability of equity shares in the demat account of QFI.

    While undertaking these transactions, the rules for repatriation should be adhered to.

The new step seeks to widen the class of investors in India, deepen the financial market, attract more foreign funds and reduce market volatility. Though the investment opportunity is attractive enough, yet the regulators have set strict norms so as to avoid any kind of lacuna in the schemes. Not only QFIs and DPs, the investee companies have been made responsible under the Scheme-this would pose an additional compliance requirement for investee companies as the companies will have to monitor the individual shareholdings of the QFIs under this route, i.e. a maximum of 5% of paid-up capital of the Company.

In 2011 there has been a net equity outflow of FIIs as against inflows in 2009 and 2010, so this scheme may bring trend reversal.