

Note

REGISTRATION OF FII AND FII SUB-ACCOUNT IN INDIA



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The purpose of this Note is to briefly summarize the procedural aspect of registering as a foreign institutional investor and a sub-account. This Note should not be construed as detailed legal advice or opinion from Vinod Kothari & Company



Note

PREAMBLE

The Securities and Exchange Board of India (Foreign Institutional Investor) Regulations, 1995 (“**FII Regulations**”) provides for registration of a foreign institutional investors¹ (“**FII**”) and sub-accounts². An FII registered with SEBI is permitted to make investments either on its own behalf or on behalf of its sub-account. Application shall be made to Securities and Exchange Board of India (“**SEBI**”) for registration of FII and FII sub-account.

I. REGISTRATION REQUIREMENTS FOR FII AND SUB-ACCOUNT REGISTRATIONS

1. Eligibility criteria for FII registration

The FII Regulations provides for the following, which are eligible to apply for registration as a FII:

- 1.1 An institution established/incorporated outside India as a pension fund, mutual fund, investment trust, insurance company or reinsurance company;
- 1.2 Foreign governmental agencies, sovereign wealth funds, foreign central banks, international / multilateral organizations or their agencies;
- 1.3 An asset management company, investment advisor / manager, bank, institutional portfolio manager established and incorporated outside India and proposing to make investments in India on behalf of broad based funds and proprietary funds, if any;
- 1.4 A trustee of a trust established outside India and proposing to make investments in India on behalf of broad based funds³ and proprietary funds, if any;
- 1.5 University funds, endowments, foundations, charitable trusts or charitable societies.

2. Factors considered by SEBI in granting FII registration

¹ “Foreign Institutional Investor” means an entity established or incorporated outside India which proposes to make investment in India in securities and which is registered as a FII in accordance with the Securities and Exchange Board of India (Foreign Institutional Investor) Regulations, 1995.

² “Sub-Account” means any person resident outside India, on whose behalf investments are proposed to be made in India by a foreign institutional investor and who is registered as a sub-account under these regulations.

³ “broad based fund” means a fund, established or incorporated outside India, which has atleast 20 investors, with no single individual investor holding more than 49% of the shares or units of the fund. Provided that if the broad based fund has institutional investor(s) , it shall not be necessary for the fund to have twenty investors. Provided further that if the broad based fund has an institutional investor who holds more than 49% of the shares or units in the fund, then the institutional investor must itself be a broad based fund;



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While considering an application for FII registration, SEBI will particularly give importance to the following in relation to the applicant:

- 2.1 Track record, professional competence, financial soundness, experience, general reputation of fairness and integrity.
- 2.2 If the applicant is a newly established fund, the track record of the investment manager of the fund who has promoted it may be taken into consideration and such investment manager shall furnish the details in respect of disciplinary action, if any, taken against it.
- 2.3 Foreign regulatory authority regulating the applicant provided that university funds, endowments, foundations, charitable trusts and charitable societies may be considered even though they are not regulated by a foreign regulatory authority.
- 2.4 The legal form of the applicant, i.e. whether the applicant is any one of those stated in Paragraph 1 above.
- 2.5 While considering the application from University funds, endowments, foundations, charitable trusts or charitable societies, SEBI shall additionally consider the following:
 - (a) Whether the applicant has been in existence for atleast 5 years;
 - (b) Whether it is legally permissible for the applicant to invest in securities outside the country of its incorporation or establishment;
 - (c) Whether the applicant has been registered with any statutory authority in the country of its incorporation or establishment;
 - (d) Whether any legal proceeding has been initiated by any statutory authority against the applicant; and
 - (e) Whether the applicant has been serving public interest;
 - (f) Whether the grant of certificate to the applicant is in the interest of the development of the securities market;
 - (g) Whether the applicant is a fit and proper person. The criteria which may be considered include integrity, reputation and character, absence of convictions and restraint orders and competence including financial solvency and network.

3. Eligibility criteria for sub-account registration



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The FII Regulations provides for the following, which are eligible to apply for a sub-account registration:

- 3.1 a broad based fund⁴ or portfolio which is broad based, incorporated or established outside India; or
- 3.2 proprietary fund of a registered FII; or
- 3.3 a foreign corporate⁵; or
- 3.4 a foreign individual⁶; or
- 3.5 University fund, endowments, foundation, charitable trust or charitable society that are eligible to be registered as an FII.

4. Factors considered by SEBI in granting registration to sub-account

While considering an application for registration of sub-account, SEBI will particularly give importance to the following in relation to the applicant:

- 4.1 Whether the applicant falls in any of the categories specified in Paragraph 3 above.
- 4.2 Whether the applicant is a fit and proper person. The criteria which may be considered include integrity, reputation and character, absence of convictions and restraint orders and competence including financial solvency and network.
- 4.3 The FII through whom the sub-account is applying for registration must (a) hold a valid license with SEBI; and (b) be authorized to invest on behalf of the sub-account.
- 4.4 Whether the applicant and the FII through whom the application is made, have submitted joint undertakings in the prescribed Form AA of the FII Regulations.

⁴ “broad based fund” means a fund, established or incorporated outside India, which has atleast 20 investors, with no single individual investor holding more than 49% of the shares or units of the fund. Provided that if the broad based fund has institutional investor(s) , it shall not be necessary for the fund to have twenty investors. Provided further that if the broad based fund has an institutional investor who holds more than 49% of the shares or units in the fund, then the institutional investor must itself be a broad based fund;

⁵ A sub-account applicant in the foreign individual category must (a) be a foreigner with a net-worth of not less than USD 50 million; (b) hold the passport of a foreign country for a period of at least 5 years preceding the date of application; (c) hold a certificate of good standing from a bank; and, (d) be a client of the FII or any other entity which belongs to the same group as the FII, for a period of at least 3 years preceding the date of the application.

⁶ A sub-account applicant applying under the “foreign corporate” category must (a) have its securities listed on a stock exchange outside India; (b) have an asset base of not less than USD 2 billion; and (c) have an average net profit of not less than USD 50 million during the 3 financial years preceding the date of the application.



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- 4.5 The sub-account has paid the prescribed registration fees.

Note: The registration process for a sub-account can be initiated either simultaneously with the application for registration as a FII or subsequently thereafter. There is no limit on the number of sub-accounts that may be registered under a single FII. Non-resident Indians are expressly prohibited from seeking registration as a sub-account.

II. REGISTRATION FORM, TIME AND FEE

1. FII Registration: Documents, Form, Registration Fees and Time

- (a) *Form A* (as attached) must be filled and submitted by the applicant seeking registration as an FII
- (b) *Documents required* to be submitted with the FII application include:
 - (a) a certified copy of the relevant clause of the organizational documents or the agreement authorizing the applicant to invest on behalf of its clients; and
 - (b) audited financial statements / annual report for the previous financial year, (period covered shall not be less than 12 months)
- (c) A *fee* of USD 5,000 payable by a Draft drawn in favor of 'Securities and Exchange Board of India' payable in New York, is required to be paid. Please note that a fee of USD 5,000 is required to be paid by the FII for every block of 3 years after grant of registration during which the registration subsists. The fee shall be paid at least one month before expiry of the period of 3 years.
- (d) The outer limit of *time taken by SEBI* to grant registration is prescribed as 3 months.

2. Sub-account Registration: Documents, Form, Registration Fees and Time

- (a) *Form AA* (as attached) must be filled and submitted by the applicant seeking registration as a sub-account.
- (b) *Documents required* to be submitted with the sub-account application include documents in relation to sub-paragraphs 3.1, 3.3, 3.4 or 4.3 above (as applicable).
- (c) A *fee* of USD 1,000 is required to be paid along with the application for registration of the sub-account. A registered sub-account must pay USD 1,000 for every block of



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3 years for which the FII, through whom it makes investment in the Indian securities market, pays its fees.

- (d) Prior to making an application for registration on behalf of a proposed sub-account being a foreign corporate, it is the FII's responsibility to verify and satisfy itself about the identity of the proposed sub-account through a "know-your-client" procedure.
- (e) The outer limit of *time taken by SEBI* to grant registration is prescribed as 3 months.

III. TYPES OF SECURITIES IN WHICH THE FIIs CAN INVEST:

The SEBI registered FIIs may invest in the following form of securities in India:

1. Primary and secondary market securities including shares, debentures and warrants of companies unlisted, listed or to be listed on a recognized stock exchange in India;
2. Units of schemes floated by domestic mutual funds, whether listed or not, units of scheme
3. Floated by a Collective Investment Scheme;
4. Dated Government Securities;
5. Derivatives traded on recognized stock exchanges;
6. Commercial paper;
7. Security receipts (issued under the SARFAESI Act);
8. Indian Depository Receipts.

IV. INVESTMENT RESTRICTIONS:

1. As per FEMA (Transfer and Issue of Security) Regulations, 2000 as amended from time to time, a registered FII may purchase shares and convertible debentures of an Indian Company under the Portfolio Investment Scheme, subject to the terms and conditions specified in Schedule 2 of the said regulations.
2. The total holding by each FII/SEBI approved sub-account of FII shall not exceed 10% of the total paid-up equity capital or 10% of the paid-up value of each series of convertible debentures issued by an Indian company and the total holdings of all FIIs/sub-accounts of



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FII's put together shall not exceed 24% of paid-up equity capital or paid up value of each series of convertible debentures.⁷

Provided that the limit of 24% referred to in this paragraph may be increased up to the sectoral cap/statutory ceiling, as applicable, by the Indian company concerned by passing a resolution by its Board of Directors followed by passing of a special resolution to that effect by its general body.

3. A domestic asset management company or portfolio manager, who is registered with SEBI as a FII for managing the fund of a sub-account may make investment under the Scheme on behalf of:
 - (a) a person resident outside India who is a citizen of a foreign state, or
 - (b) a body corporate registered outside India;

Provided such investment is made out of funds raised or collected or brought from outside through normal banking channel.

4. Investments permitted to be made under sub-paragraph 3 shall not exceed 5% (five per cent) of the total paid-up equity capital or 5% of the paid-up value of each series of convertible debentures issued by an Indian company, and shall also not exceed the over-all ceiling specified in sub-paragraph 2.

V. SPECIFIC TAX PROVISION UNDER THE INCOME TAX ACT, 1961:

1. **Section 115AC- Tax on income from bonds or Global Depository Receipts purchased in foreign currency or capital gains arising from their transfer:**
 - (a) Tax on income of non- resident received by way of interest or dividends (other than dividends referred to in Section 115-O) in respect of bonds or GDRs- @ 10%.
 - (b) Tax on income by way of long-term capital gains arising from the transfer of bonds or GDRs - @ 10%
2. **Section 115AD- Tax on income of Foreign Institutional Investors from securities or capital gains arising from their transfer.⁸**

⁷ For arriving at the ceiling on holdings of FII's, shares/ convertible debentures acquired both through primary as well as secondary market will be included. However, the ceiling will not include investment made by FII through off-shore Funds, Global Depository receipts and Euro-Convertible Bonds.



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- (a) Tax on income received (other than income by way of dividends) in respect of securities (other than units specified in Section 115AB)- @ 20%
 - (b) Short-term gain arising from transfer of such securities-In case of transactions chargeable to STT - @ 10%
 - (c) Short-term gain arising from transfer of such securities- In case of other transactions - @ 30%
 - (d) Income by way of long-term gains- @10%
3. **Section 9** (Income deemed to accrue or arise in India), **Chapter IX** (Double taxation relief) and **Chapter X-A** (GAAR) of IT Act, also applicable.

⁸ As per FII regulations, a sub-account granted registration under FII regulations shall be deemed to be registered as a FII with SEBI for the limited purpose of availing of the benefits available to FIIs under Section 115AD of the Income Tax Act, 1961.