news flash

February 2012

QFIs- THE NEW BLOCK OF INVESTORS

Keeping in line with the slew of measures for larger participation in Indian bourses, the Government of India has permitted a new category of overseas investors to invest in the Indian secondary market. This major policy decision was announced vide a press release dated January 1, 2012 by the Ministry of Finance and comes on the heels of liberalization of foreign investment by foreign investors in mutual funds in India.

The Reserve Bank of India has issued circular bearing no. 66 dated January 13, 2012 ("**RBI Circular**") to functionalize the above policy and to formulate the Scheme for Investment by Qualified Foreign Investors in equity shares ("**Scheme**"). Accordingly, the RBI Circular, issued under Sections 10(4) and 11(1) of the Foreign Exchange Management Act, 1999, provides that "Qualified Foreign Investors" ("**QFIs**") are henceforth permitted to directly purchase on repatriation basis, equity shares of Indian companies listed/to be listed on Indian stock exchanges. The Securities and Exchange Board of India ("**SEBI**") has also issued a circular, bearing no. CIR/ IMD/FII&C/3/2012 dated January 13, 2012 ("**SEBI Circular**") to enable QFI investment under the Scheme.

The terms and conditions under which QFIs may acquire shares of Indian companies in compliance with the RBI Circular and SEBI Circular are as summarized below:

- **Who is a QFI?**

  A QFI is a person resident in a country (other than India) that is compliant with Financial Action Task Force (FATF)[1] standards and that is a signatory to International Organization of Securities Commission's (IOSCO's) Multilateral Memorandum of Understanding (MMOU)[2]. It also specified that a QFI cannot be a SEBI registered Foreign Institutional Investor (FII) or a sub-account holder.

  Only those entities whose ultimate/ end beneficial ownership is not resident in India are allowed to open demat accounts as QFI under this Scheme.

[1] http://www.fatf-gafi.org/pages/0,3417,en_32250379_32236869_1_1_1_1_1,00.html
[2] http://www.iosco.org/library/index.cfm?section=mou_siglist

contd...

- **What are the securities that QFIs can transact in, under the Scheme?**

QFIs can invest in:

- equity shares of listed Indian companies on recognized stock exchanges;
- equity shares in public issues of Indian companies;
- equity shares by way of rights shares, bonus shares or equity shares on account of stock split/ consolidation or equity shares on account of amalgamation, demerger or such corporate actions.

- **Are there any limits on investment by QFIs?**

The individual and aggregate investment limits for QFIs are 5% and 10% respectively of the paid up capital of the Indian company. The investment limits are applicable to each class of equity shares having separate and distinct ISIN. These limits are over and above the FII and NRI investment ceilings prescribed under the Portfolio Investment Scheme for foreign investment in India. QFI investments in an Indian company must also fall within the sectoral caps, if any, under the extant FDI policy. QFIs, DPs and the Indian companies receiving the investment are jointly and severally responsible to ensure the adherence to the above limits.

- **What is the mechanism for transacting in shares by QFIs under this Scheme?**

- QFIs can open only one dedicated demat account with a qualified Depository Participant ("**DP**") for investment in equity shares under the Scheme. For this purpose, the DP requires to carry out necessary KYC due diligence and obtain appropriate declarations and undertakings from QFIs.
- QFIs must open trading accounts with one or more SEBI registered stock brokers.
- The DP will open a separate single rupee pool bank account with a designated AD Category-1 Bank, exclusively for the purpose of investments by each QFI in equity shares in India. QFIs will not be allowed to open any bank account in India.
- Each QFI must place a purchase / sale order with the DP mentioning the name of the company and ISIN, number of equity shares, name of the stock broker and the DP in turn will forward the same to the SEBI registered stock broker with whom QFI has opened its trading account.
- The DP must ensure that the shares are purchased on behalf of the QFI within five working days from the date of instruction (including the date of credit of funds to the single rupee pool bank account) and credited into its demat account on the pay-out date.
- In case of QFI participation in public issues, the DP must make the application on behalf of such QFI and remit the money to the issuer company.

- **What are the restrictions on the mode of payment and utilization of funds by QFIs for shares acquired under the Scheme?**

- The QFI must remit monies into the separate single rupee pool bank account maintained by the DP with an AD Category- I bank by foreign inward remittances through normal banking channels. If the DP fails to purchase equity for the QFI within the five working days from the date of instruction the funds require to be immediately repatriated back to the QFI's designated overseas bank account.
- Sale proceeds of existing investments (including through buy-back or other like corporate actions) made by QFIs under this Scheme must be credited and dividends on existing shares may, at the option of the QFI, also be credited into the single rupee pool bank account, for being repatriated to the QFI's designated overseas bank account within five working days from the receipt of sale proceeds (including the day of credit into the single rupee pool bank account). In the alternate, such proceeds may be utilized for fresh purchases of equity shares under this Scheme, within five working days as above. The

DP is responsible to deduct the applicable tax at source on account of profits or gains or dividends or any other income accruing to or received by QFI before making any reinvestment/ repurchase or repatriation/ remittance to QFI, and to remit and report the same to the relevant tax authorities.

- **How can the shares acquired by QFIs be sold under this Scheme?**

QFIs are allowed to sell the equity shares so acquired by way of sale:

- Through recognized brokers on recognized stock exchanges in India; or
- In an open offer in accordance with the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011; or
- In an open offer in accordance with the SEBI (Delisting of Securities) Guidelines, 2009; or
- Through buyback of shares by a listed Indian company in accordance with the SEBI (Buyback) Regulations, 1998.

- **Are there any other limitations on QFIs investments made under the Scheme?**

- QFIs must satisfy the KYC norms prescribed by SEBI and obtain a Permanent Account Number ("PAN") from the Income Tax authorities.
- Any acquisition of shares under this Scheme shall also be subject to relevant and applicable SEBI guidelines/regulations.
- Pricing as per applicable SEBI guidelines.
- All transactions must be in equity shares only on the basis of taking and giving delivery of shares purchased or sold. Each transaction by QFI will be cleared and settled on gross basis.
- The same set of ultimate/ end beneficial owner(s) are not allowed to open more than one demat account as QFI. In case of any direct/ indirect change in structure or beneficial ownership of the QFI, it must be bought to the notice of its DP, forthwith. The DP will then re-assess the eligibility of that QFI afresh.
- The DP can open a demat account for the QFI only after ensuring compliance with all the requirements as per Prevention of Money Laundering Act, rules and regulations, FATF standards and SEBI circulars issued in this regard, from time to time and shall also ensure that QFI comply with all these requirements on an ongoing basis.
- Every QFI can transact only through one designated overseas bank account and such overseas bank account which QFI has designated for the purpose must be based in a country which is compliant with FATF standards and is a signatory to MMOU of IOSCO.
- Equity shares held by a QFI must be free from all encumbrances including pledge or lien at all times.
- QFI cannot issue offshore derivatives instruments/ participatory notes. A declaration and undertaking to this effect is be obtained by the DP from the QFI.

Analysis:

Until now, foreign investors could invest in the market only as a Foreign Institutional Investor or a Foreign Venture Capital Fund, duly registered and administered by SEBI. Even before the advent of the Scheme, it was possible for foreign investors not intending to be registered as a Foreign Institutional Investor or a Foreign Venture Capital Fund, to acquire Indian stocks, through P-notes or as a sub-account of an FII. While P-notes have been the subject of much regulatory scrutiny, an investor investing as a sub-account would have still been required to register with SEBI and in both instance, the investments would have been made only through the medium of the Foreign Institutional Investor.

Under this Scheme, the foreign investors now have another option for investing in listed company, enabling them with direct access to trade in Indian stocks. Transactions of QFIs under the Scheme are, for all purposes to be treated at par with that of Indian non-institutional investors with regard to margins, voting rights, public issues etc. However, as part of the regulator's system of checks and balances, QFIs are required to be residents of jurisdictions which are compliant with the Financial FATF standards and are signatories to the MMOU of the IOSCO. SEBI has also, in order to ensure the participation of genuine investors, imposed vast responsibilities on the DPs to conduct exhaustive KYC checks and to be satisfied from its due diligence that the QFI is truly eligible to avail the Scheme. Further, QFIs are also prohibited from issuing offshore derivative instruments such as P-Notes notes. This Scheme is likely to attract greater foreign investment it offers a less regulated avenue for investment. The current Scheme does not require registration of a QFI with the SEBI and has cast the onus and responsibility of regulation of a QFI on the DP. In light of the same, it is expected that the DPs will take note of its detailed obligations and perform them ably so that the Scheme is implemented to achieve its intended objectives in letter and spirit.

Disclaimer

For further clarifications, you may write to the capital markets team, comprising of Ryna Karani at rkarani@almtlegal.com, Dhanya Menon at dmenon@almtlegal.com and Rajat Bopaiah at rbopaiah@almtlegal.com.

ALMT Offices

Mumbai:
4th Floor, Express Towers,
Nariman Point,
Mumbai 400-021
India
Tel: +91 22 4001 0000
Email: mumbai@almtlegal.com

Bangalore:
2 Lavelle Road,
Bangalore 560 001
India
Tel: +91 80 4016 0000
Email: bangalore@almtlegal.com

New Delhi:
506 DLF Courtyard,
Saket,
New Delhi 110 017
India
Tel: +91 11 4944 5566
Email: delhi@almtlegal.com

London
DowGate Hill House,
14-16 DowGate Hill,
London EC4R 2SU
United Kingdom
Tel: +44 020 7332 2367
Email: london@almtlegal.com