Sebi tightens P- note norms

Capital market regulator Securities and Exchange Board of India (Sebi) on Thursday tightened rules on issue of participatory notes (P- notes) to bring in more transparency and curb misuse of the investment route used by foreign investors not registered in India. Sebi also made it mandatory for the top 500 listed companies to have a policy for declaring dividends to investors.

To set a better handle on the ultimate beneficiary of P- note, Sebi has said Indian know your customer (KYC) or anti- money laundering rules (AML) will be applicable to P- note holders. Earlier, a P- note holder had to adhere to KYC or AML norms of just their home jurisdiction. Sebi has also issued curbs on transferability of P- notes between two foreign investors. It has also increased the frequency of reporting by P- note issuers.

P- notes, or off- shore derivatives instruments (ODIs), allow foreign investors to take exposure to Indian stocks without registering with Sebi. These instruments are issued by foreign portfolio investors (FPIs) registered with Sebi.

Currently, around 10 per cent of foreign flows are through the P- note route. The tightening follows concerns raised by a Supreme Court- appointed Special Investigations Team (SIT) on black money.

The purpose of the measures is to enhance transparency and control over issuance of P- notes, Sebi said.

Easing of entry- related norms for foreign investors has reduced their dependence on the P- note route. At the peak in 2007, around half of foreign flows into the Indian market happened through P- notes.

The new rules could make P- notes costly for investors, which could impact flows coming into India.

Sebi board decision follows extensive discussions with issuers. It will ensure more transparency in KYC and all related transactions, Economic Affairs secretary Shaktikanta Das tweeted.

“It is the requirement to keep track of transfers of Pnotes that could be cumbersome and impose transaction costs. One isnt sure how many abusive P- notes indeed get transferred. So, Im not sure this is warranted going by the potential benefits compared to the costs imposed,” said Somasekhar Sundaresan, partner at law firm J Sagar Associates.

As of March 2016, the equity assets under custody (AUC) stood at ? 2.23 lakh crore, 10 per cent of the total FPI AUC of about ? 19 lakh crore.

Morgan Stanley, Goldman Sachs, JP Morgan and Credit Suisse are among the biggest P- note issuers on the Indian market. Experts said the changes will increase the onus on the issuers. " The new norms are in line with suggestions made by the SIT in its July 2015 report. These changes will not only make the route difficult to access India market but also make it more expensive.

Pnote issuers will have to put in place a robust mechanism to track end beneficial owner," added Suresh Swamy, partner –tax & regulatory (financial services), PwC India.

Under the dividend disclosure policy, companies will have to state criteria based on which they will or will not pay dividends to their shareholders.

Companies will have to state the use of retained earnings in case they don't wish to pay dividends.

At present, it is not mandatory under any regulations for companies to declare dividends or to even have a policy, although a handful of companies have voluntary formulated a policy for doling out dividends.

"This will provide more certainty to investors and to some extent takes away the power of Indian promoters to distribute dividend depending on their personal needs for money," said J N Gupta, former executive director, Sebi.

In a relief to stock exchanges, Sebi also did away with the requirement of transferring aquarter of their profits towards settlement guarantee funds (SGFs). Sebi also said it will issue a consultation paper seeking changes to the Infrastructure Investment Trusts (InVIT) regulations. Just like real estate investment trusts (Reits), InVITs are investment vehicles through which investors can take exposure to income generating infrastructure projects. Sebi had introduced regulations on InVITs and Reits two years ago but there haven't been any issuances yet.

Sebi board also approved changes to consent rules to provide more clarity to its officers in approaching such cases.

The regulator also proposed changes to the Sebi Act to provide its officer more discretion to impose appropriate penalties on wrongdoers. The need for the change occurred after the Supreme Court in the matter of Roofit Industries had asked Sebi to levy maximum monetary penalties and not use discretion.

The decisions were taken by the Sebi board, which met in Mumbai on Thursday.

(Business Standard)