Response submitted to SEBI: naveens@sebi.gov.in
03 July 2016

Respectfully submitted on behalf of members of EMPEA, the global industry association for private capital in emerging markets

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To: Mr. Naveen Sharma

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Comments and Suggestions of EMPEA on the consultation paper for public comment on amendments to SEBI (Portfolio Managers) Regulations, 1993 pursuant to the introduction of Section 9A in the Income Tax Act, 1961

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Introduction

EMPEA welcomes the opportunity to provide c**omments and suggestions on the consultation paper for public comment on amendments to SEBI (Portfolio Managers) Regulations, 1993 pursuant to the introduction of Section 9A in the Income Tax Act, 1961** (June 2016) and submits this response on behalf of its members.

EMPEA is the non-profit global industry association for private capital[1] in emerging markets. Founded in 2004, EMPEA has over 340 member firms with offices in more than 100 countries including many in India. Member firms include investment fund managers, development finance institutions[2], endowments, family offices, foundations, funds-of-funds, government agencies, insurance companies and pension funds, and industry advisors. Together EMPEA's members control or manage over US$1 trillion of assets. EMPEA seeks to be a thoughtful, neutral and objective voice; its industry research is deep and respected; and its training and educational programs are sought out for their strength and impact.

EMPEA's members share EMPEA's belief that private capital is a highly suited investment strategy in emerging markets, delivering attractive long-term investment returns for global investors and promoting the sustainable growth of companies and economies. EMPEA supports its members' activities through authoritative intelligence, conferences, networking, education and advocacy. For more information, please see www.empea.org.

Since EMPEA is an industry association and not itself an investor, we have not attempted to answer all the questions posed. We believe that other associations, including the Indian Venture Capital Association ("IVCA"), with whom EMPEA has a close and collegial relationship, may be better placed to answer the questions that we do not address below. However, we do believe that the amendments are positive and designed to support the continued investments of Eligible Investment Funds operating outside of India, including many of our members, encourage offshore fund managers to consider relocation to India and, thereby, will improve the competitiveness of India as a jurisdiction of choice for (Indian and foreign) private fund managers.

Our members are engaged across emerging markets including in Emerging Asia, Emerging Europe, Africa, the Middle East and Latin America.

EMPEA stands ready to provide whatever further contribution to this work SEBI might find helpful, including attending meetings and contributing further materials in writing.

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1 "Private capital" encompasses private equity and venture capital and adjacent investment approaches including infrastructure, real assets, private credit and institutional quality impact investing.

2 Including International Finance Corporation, Asian Development Bank and the European Bank for Reconstruction and Development, as well as the British (CDC), French (PROPARCO), Dutch (FMO), German (DEG), Finnish (Finnish Fund for Industrial Cooperation), Belgian (BIO), Norwegian (Norfund)

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and Swedish (Swedfund) development finance institutions.

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Executive Summary

In summary, **we strongly support the proposed amendments and believe that they will support the continued investments of Eligible Investment Funds ("EIF") operating outside of India, encourage offshore fund managers to consider relocation to India and, thereby, will improve the competitiveness of India as a jurisdiction of choice for (Indian and foreign) private fund managers. In addition, we have reviewed the response prepared by the AZB Partners. We support and second that response.**

Responses

1. At the outset, we welcome SEBI's initiative in proposing a regime for 'eligible fund managers' and 'eligible investment funds' under the SEBI (Portfolio Managers) Regulations, 1993 ("**Regulations**"). We have reviewed the consultation paper for public comment on the proposed amendments to SEBI (Portfolio Managers) Regulations, 1993 pursuant to the introduction of Section 9A in the Income Tax Act, 1961 ("**Consultation Paper**"), and this letter sets out our suggestions on certain aspects of the regulations as proposed by SEBI in the Consultation Paper, along with our rationale for the same.

2. Set out below are our responses to the questions raised in Paragraph 3.6.2 of the Consultation Paper:

   i. Is there any provision identified under Para 3.5 that needs to be applied to the Eligible Fund Managers ("**EFM**")?

   Answer: *No*

   ii. Is there any other provision in the Regulations not mentioned in Para 3.5 that need to be exempted for Eligible Fund Managers?

   Answer: *Suggestions are set out in paragraph 3 of our comments below.*

   iii. Should the Code of Conduct specified under Schedule III of PMS Regulations be made applicable to Eligible Fund managers?

   Answer: *Yes.*

3. As required under paragraph 3.6.3 of the Consultation Paper, set out below are our comments on the Consultation Paper and the Regulations:

Sr. No.	Para Ref no.	Comment	Rationale
1.	Regulation 2	Insertion of new definitions in Regulation 2 as follows : "'Eligible Fund Manager' means any	Considering that Chapter IIA will be applicable to EFM, this

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Sr. No.	Para Ref no.	Comment	Rationale
		person who is registered with the Board as a portfolio manager under these Regulations and undertaking the management or administration of Eligible Investment Fund(s)". "'Eligible Investment Fund' means a fund established or incorporated or registered outside India which meets the criteria set out under Section 9A of the Income Tax Act, 1961, as amended from time to time.	is a proposed consequential change.
2.	Regulation 3A, Regulation 9	References to application form on grant of certificate and renewal of certificate to not apply to EFM.	Considering that Chapter IIA is applicable to EFM, this is a proposed consequential change.
3.	Regulation 16(A)	This regulation specifies that foreign portfolio investors ("**FPIs**") may avail services of a portfolio manager. Exemptions under PM Regulations proposed to be provided to an EFM managing an EIF should also be provided to an portfolio manager or an EFM managing Category I and Category II FPIs .	There could be possibilities that a FPI may not meet the EIF criteria and hence many not be managed by an EFM. In such situations, a portfolio manager could manage the FPIs under Regulation 16(A). To incentivize portfolio managers to manage FPIs (which are already registered with SEBI), and considering Cat I and Cat II FPIs are in a way akin to EIFs, we believe that the exemptions under PM Regulations should also be provided to Category I and a Category II FPIs.
4.	Regulation 16(7) And SEBI Circular IMD/DOF I/PMS/Cir- 4/2009 dated June 23, 2009	Regulations 16(7) : A portfolio manager is required to segregate each client's funds and portfolio of securities. Para 2 of SEBI Circular : "It is hereby clarified that portfolio managers may keep the funds of **all** clients in a separate	Certain clients (such as EIFs investing through the foreign direct investment (FDI) route) would not have a bank account in India

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		bank account **maintained by the portfolio manager** subject to the following conditions…" These obligations on the portfolio manager on keeping funds of 'all' clients in a separate bank account 'maintained' by the portfolio manager should be applicable only if the EIF has a bank account in India.	under the current foreign exchange regulations in India.
5.	Regulation 16B (1)	Every portfolio manager is required to appoint a custodian in respect of securities managed or administered by it. This requirement should be applicable to EFM only if a custodian is not otherwise appointed by the EIF under other laws in India applicable to the EIF. Where the EIF has already appointed a custodian in India, the requirement on the EFM should be to coordinate operations of the securities account of the EIF with the custodian appointed by the EIF	There could be instances where the EIF is also registered as a FPI. In such cases, the FPI or its global custodian would be required to 'appoint' the domestic custodian under the SEBI (Foreign Portfolio Investors) Regulations, 2014 ("**FPI Regulations**"). Hence the portfolio manager / EFM will not be able 'appoint' a custodian for the EIF/FPI.
6.	Regulation 18	If required by SEBI, every Portfolio Manager is required to submit half yearly un-audited financial results with SEBI with a view to monitor the capital adequacy of the portfolio manager. SEBI may consider providing a dispensation to the portfolio manager from submitting half yearly un-audited financial results. Instead, the portfolio manager could provide a certificate from a chartered accountant on the capital adequacy if requested by SEBI.	Every portfolio manager is required to submit a half yearly report with SEBI as per the format provided under SEBI circular IMD/DOF-1/PMS/Cir-1/2010 dated March 15, 2010. In Paragraph 2 of the Half Yearly Report, the portfolio manager is already required to provide details of the capital adequacy / net worth of the portfolio manager as on September 30 / March 31. Considering the intent

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			under Regulation 18 is to monitor the capital adequacy, details of which are already being provided under the Half Yearly Reports, to substantiate the capital adequacy details, SEBI could consider accepting a certificate from the chartered accountant (as is done for registration / renewal applications), as opposed to requesting for half yearly un-audited financial results.
7.	Regulation 20(4)	As per this regulation the client may appoint a chartered accountant to audit the books and accounts of the portfolio manager relating to the client's transactions. We suggest that this requirement should not be made applicable to EFMs/ portfolio managers in their dealings with EIFs/FPIs.	As proposed for Regulations 20(3), this requirement under Regulation 20(4) should also be as mutually agreed between the parties and governed by the regulatory requirements of the jurisdiction of the EIF/FPI.
8.	Circular dated October 5, 2010 Cir. /IMD/DF/14/2010	Submission of monthly report by the portfolio manager to SEBI under paragraph 2 of the said circular. This requirement should be made half yearly or on an annual basis for EFMs/portfolio managers managing FPIs.	This is an inefficient and cumbersome requirement. Fund managers in other offshore jurisdictions are generally not subjected to such monthly reporting requirements to their regulators.
9.	March 15, 2010, paragraph 3.4 of Annexure	This circular sets out requirement(s) to provide list of approved stock brokers whose services are utilized for PMS activities and whether any of them were suspended.	This is an inefficient and cumbersome requirement. Fund managers in other offshore

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		We suggest that this requirement should not be applicable to EFMs/portfolio managers managing FPIs.	jurisdictions are generally not subjected to such monthly reporting requirements to their regulators.
10.	Circular dated June 28, 2006 - SEBI/IMD/CIR No.1/ 70353 /2006	This circular should not be applicable to the activities of the EFM /portfolio managers managing FPIs	Restrictions / requirements on investment decisions to be mutually agreed between the parties and to be subject to the regulatory requirements of the jurisdiction of the EIF/FPIs, as the case may be.
11.	Circular dated November 18, 2003 IMD/PMS/CIR/1/21727/03	This circular should not be applicable to the activities of the EFM /portfolio managers managing FPIs	Restrictions / requirements on investment decisions to be mutually agreed between the parties and to be subject to the regulatory requirements of the jurisdiction of the EIF/FPIs, as the case may be.

4. While our comments to the PM Regulations and the Consultation Paper are set out above, in our view, considering (a) this entire exercise is to attract and incentivize offshore fund managers to relocate to India, (b) most of the offshore fund managers manage offshore funds which are registered as FPIs, (c) there being certain inconsistencies between the requirements for an offshore fund to be categorized as an EIF and the requirements applicable to a FPI under the FPI Regulations, and (d) in the event certain eligibility requirements for being categorized as a EIF are not amended under Section 9A of the Income Tax Act, 1961 ("**IT Act**"), there being a very high possibility of many FPIs not being considered as EIF and therefore not be able to seek the tax benefits pursuant to Section 9A of the IT Act, we believe certain amendments would also be required to be made to Section 9A of the IT Act. Set out below are our brief comments on certain changes which should be made to section 9A of the IT Act that SEBI may consider sharing with the Ministry of Finance, Government of India:

Sr. No.	Section reference ("IT Act")	Comment	Rationale

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Sr. No.	Section reference ("IT Act")	Comment	Rationale
1.	Section 9A – (e)	Fund to have minimum 25 members who are not connected persons. This requirement is inefficient and excessively cumbersome and should be reconsidered.	As mentioned above, most of the entities seeking to take benefit as an 'EIF' would already be registered as a FPI under the FPI Regulations. The requirement is not aligned with the FPI Regulations. The threshold for a broad based fund under the FPI Regulations is having a minimum of 20 direct/ indirect investors. Evaluation would also be needed as to whether this criterion could be practically applied in a case of a master feeder structure. There appears to be no rationale for having a different threshold for EIFs and having such a 25 member threshold may not assist the regulators in achieving the stated objective for introduction of Section 9A.
2.	Section 9A – (f)	Requirement that any member of the fund along with connected persons to not have any participation interest, directly or indirectly, in the fund exceeding ten per cent is inefficient and excessively cumbersome and should be reconsidered	This requirement is not aligned with the criteria under the FPI Regulations. Under the FPI Regulations every broad based fund is required to have at least 20 investors and no investor holds in excess of **49%**. There appears to be no rationale for having a different threshold for EIFs.
3.	Regulation 9A – (g)	The requirement that the aggregate participation interest, directly or indirectly, of ten or less members along with their connected persons in the fund, to be less than fifty per cent is too cumbersome, inefficient and not aligned per comment 2 above and should be	On account of the other threshold of 10% interest in the fund set out above, and the minimum number of non connected members that is required, the practical implementation of

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		reconsidered.	such a threshold will become very difficult for any portfolio manager. Further evaluation would also be needed as to whether this criterion could be practically applied in a case of a master feeder structure.
4.	Section 9A – (h)	Currently the fund cannot invest more than twenty per cent of its corpus in any entity. This requirement/threshold should be made in line with applicable investment limits prescribed for persons resident outside India under the extant foreign exchange laws in India.	Considering the Government has recently done away with separate investment caps depending on the investment route taken by the foreign investors, in line with the same liberalization effort, the EIF should be subject to such investment limit as applicable to it under the extant foreign exchange laws in India.
5.	Section 9A – (i)	The requirement that the fund is not permitted to make any investment in its associate entity should be deleted.	There does not appear to be any rationale for such a restriction – no such requirement exists under the FDI Policy or under any FEMA regulations. By way of illustration, it is possible that an offshore fund ("A") invests in an Indian target company ("T"). This offshore fund A may also invest in an EIF ("B") managed by EFM, pursuant to which T and B would be associate companies. On account of the restriction currently set out under Section 9A, the EFM will not be permitted to invest in the target company T on behalf of the EFM even though its other investors do not have any exposure to such target T.

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			Further, the probability of an EFM having the capability to track the scope of EIF associate companies is highly constrained to the point of administrative impossibility. These restrictions are not aligned with, and may conflict with, the current regulatory regime applicable to FPIs and other foreign investors.
6.	Section 9A (j)	The monthly average of the corpus of the fund cannot be less than one hundred crore rupees. This corpus requirement is too restrictive and should be deleted.	This requirement is not present under the FDI Policy, FEMA or the FPI Regulations. Not many entities or FPI's would meet this requirement. Such a requirement is not aligned with, and may limit, the objective for introduction of Section 9A .
7.	Definition of EFM	The requirement that the EFM cannot be a connected person should be deleted.	Considering that, in global structures usually a fund manager is within the group, this would severely limit the applicability of this provision and should be deleted. Such a requirement is not aligned with, and may limit, the objective for introduction of Section 9A.
8.	Definition of EFM	The person along with their connected persons are not entitled, directly or indirectly, to more than twenty per cent of the profits accruing or arising to the eligible investment fund from the transactions carried out by the fund through the fund manager	The restrictions/ requirements on the fee is to be mutually agreed between the parties and should depend on the business requirements of the EFM/EIF. The rationale for why this provision appears in the definition is unclear and the requirement should be

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Sr. No.	Section reference ("IT Act")	Comment	Rationale
			deleted.
9.	Alternate Proposal	As an alternative to the proposals in paragraph 1 to 8 above, additional criteria can be inserted whereby a Category I and a Category II FPIs registered under the FPI Regulations are also considered as EIFs under Section 9A of the IT Act.	Category I and Category II FPIs are entities which are already registered with SEBI and accordingly should not be required to meet these additional criteria under Section 9A of the IT Act

5. Please do not hesitate in reaching out to the undersigned should you require any clarifications. Our contact details are as set out below:

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Yours sincerely,

For EMPEA

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