

CONSULTATION PAPER FOR PUBLIC COMMENTS

AMENDMENTS TO SEBI (PORTFOLIO MANAGERS) REGULATIONS, 1993 PURSUANT TO INTRODUCTION OF SECTION 9A IN THE INCOME TAX ACT, 1961

1.0 Objective

1.1 The objective of this consultation paper is to seek comments from the public for the purpose of laying down an enabling framework for the registration of Eligible Fund Managers to manage Eligible Investment Funds pursuant to insertion of Section 9A in the Income Tax Act, 1961.

2.0 Background

2.1 The Hon'ble Finance Minister while presenting the Union Budget for the year 2015-16 announced:

“The present taxation structure has an inbuilt incentive for fund managers to operate from offshore locations. To encourage such offshore fund managers to relocate to India, I propose to modify the Permanent Establishment (PE) norms to the effect that mere presence of a fund manager in India would not constitute PE of the offshore funds resulting in adverse tax consequences.”

2.2 Subsequently, the Income Tax Act, 1961 has been amended by inserting Section 9A in the Act (popularly known as ‘Safe Harbour Norms’). This section inter-alia provides that fund management activity carried out through an **Eligible Fund Manager** located in India acting on behalf of an **Eligible Investment Fund** shall not constitute business connection in India of such fund subject to the fund and the fund manager meeting certain specified conditions mentioned therein. As per Section 9A of Income Tax Act, 1961:

2.2.1 **Eligible Investment Fund (EIF)** is a fund established or incorporated or registered outside India, which collects funds from its members for investing it for their benefit and fulfils following conditions namely:

a) *the fund is not a person resident in India;*

- b) *the fund is a resident of a country or a specified territory with which an agreement referred to in sub-section (1) of section 90 or sub-section (1) of section 90A has been entered into;*
- c) *the aggregate participation or investment in the fund, directly or indirectly, by persons resident in India does not exceed five per cent of the corpus of the fund;*
- d) *the fund and its activities are subject to applicable investor protection regulations in the country or specified territory where it is established or incorporated or is a resident;*
- e) *the fund has a minimum of twenty-five members who are, directly or indirectly, not connected persons;*
- f) *any member of the fund along with connected persons shall not have any participation interest, directly or indirectly, in the fund exceeding ten per cent;*
- g) *the aggregate participation interest, directly or indirectly, of ten or less members along with their connected persons in the fund, shall be less than fifty per cent;*
- h) *the fund shall not invest more than twenty per cent of its corpus in any entity;*
- i) *the fund shall not make any investment in its associate entity;*
- j) *the monthly average of the corpus of the fund shall not be less than one hundred crore rupees:*
Provided *that if the fund has been established or incorporated in the previous year, the corpus of fund shall not be less than one hundred crore rupees at the end of such previous year;*
- k) *the fund shall not carry on or control and manage, directly or indirectly, any business in India or from India;*
- l) *the fund is neither engaged in any activity which constitutes a business connection in India nor has any person acting on its behalf whose activities constitute a business connection in India*

other than the activities undertaken by the eligible fund manager on its behalf;

*m) the remuneration paid by the fund to an eligible fund manager in respect of fund management activity undertaken by him on its behalf is not less than the arm's length price of the said activity **Provided** that the conditions specified in clauses (e), (f) and (g) shall not apply in case of an investment fund set up by the Government or the Central Bank of a foreign State or a sovereign fund, or such other fund as the Central Government may subject to conditions if any, by notification in the Official Gazette, specify in this behalf.*

2.2.2 Subsequently, in the Union Budget 2016-17, above mentioned clause (b) and clause (k) have been announced to be modified as under:

“(b) the fund is a resident of a country or a specified territory with which an agreement referred to in sub-section (1) of section 90 or sub-section (1) of section 90A has been entered into or is established or incorporated or registered in a country or a specified territory notified by Central Government in this behalf.”

“(k) the fund shall not carry on or control and manage, directly or indirectly, any business in India”

The amendments will take effect from 1st April, 2017 and shall apply to the assessment year 2017-18 and subsequent assessment years.

2.2.3 **Eligible Fund Manager (EFM)** is any person who is engaged in the activity of fund management and fulfils the following conditions:

a) the person is not an employee of the eligible investment fund or a connected person of the fund;

- b) the person is registered as a fund manager or an investment advisor in accordance with the specified regulations;*
- c) the person is acting in the ordinary course of his business as a fund manager;*
- d) the person along with his connected persons shall not be 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.*

2.3 Further the government issued Income Tax (5th Amendment) Rules, 2016 on March 15, 2016 providing guidelines for the application of Section 9A.

2.4 One of the conditions stated in sub Section (4)(b) of Section 9(A) is that the EFM shall be registered as a fund manager or an investment adviser in accordance with the specified regulations. Further, the specified regulations have been defined to mean Securities and Exchange Board of India (Portfolio Managers) Regulations, 1993 (PMS Regulations) or the Securities and Exchange Board of India (Investment Advisers) Regulations, 2013 (IA Regulations), or such other regulations made under the Securities and Exchange Board of India Act, 1992 which may be notified by the Central Government.

2.5 In the backdrop of the CBDT notification on Safe Harbour norms, SEBI has had a series of interactions with various stake holders. During such meetings to discuss the enabling framework for registration of EFMs, it was observed that IA Regulations do not allow an investment adviser to handle funds and securities of its clients. Further, as advisory activity is also permitted under PMS Regulations, participants mostly expressed interest to be registered only under PMS Regulations. The participants also observed that certain provisions mentioned in PMS Regulations may not be feasible for portfolio managers pertaining to their fund management activities for eligible

investment funds. Therefore, amendments may be required in the existing PMS Regulations.

- 2.6** In view of the above, to enable EFMs to manage EIFs, as envisaged under the provisions of Section 9(A) of Income Tax Act, 1961, amendments to SEBI (Portfolio Managers) Regulations, 1993 are proposed.

3.0 Salient features of proposed amendments to SEBI (Portfolio Managers) Regulations, 1993

3.1 Inserting a new Chapter and its applicability

It is proposed to insert a new chapter in PMS Regulations viz. Chapter II-A “Eligible Fund Managers” which will apply to EFMs exclusively pertaining to their activities as portfolio managers to EIFs.

3.2 Procedure for an existing SEBI registered Portfolio Manager

An existing SEBI registered Portfolio Manager may be permitted to act as EFM under prior intimation to SEBI and subject to the fulfillment of specified conditions in Sub Section (4) of Section 9A of the Income Tax Act, 1961 and submission of certain declarations to SEBI.

3.3 Procedure for registration of an existing foreign based fund manager desirous of relocating to India or a fresh applicant

Such applicants may be granted registration as portfolio managers to act as an EFM subject to:

- 3.3.1** Meeting existing eligibility norms such as requirement of being a body corporate, having net worth of INR 2 Crores, appointment of Principal Officer and minimum two employees having requisite qualification and experience, etc.;

- 3.3.2** Payment of fees as specified in Schedule II of PMS Regulations;

3.3.3 Submission of declarations regarding its compliance with the provisions of Section 9 A of the Income Tax Act, any instructions /guidelines issued thereunder and requirements as specified by SEBI from time to time.

3.4 Obligations and Responsibilities of EFM

The EFM may be required to:

- 3.4.1 Satisfy the requirements specified under Section 9A Income Tax Act 1961 or any amendment, notification, clarification, guideline issued thereon;
- 3.4.2 Segregate funds and securities of EIFs from its other clients;
- 3.4.3 Maintain and segregate its books and accounts pertaining to its activities as a portfolio manager to EIFs and other clients;
- 3.4.4 Maintain any additional records as may be specified by SEBI and disclose the same as and when required;
- 3.4.5 Provide information to SEBI on a half-yearly basis such as name and jurisdiction of the EIF managed by it, assets under management of each EIF and its breakup according to the nature of services provided to it (discretionary, non-discretionary, advisory), any other information as may be specified by SEBI from time to time;
- 3.4.6 Comply with the Code of Conduct as specified under Chapter III of PMS Regulations;
- 3.4.7 Ensure compliance with the Prevention of Money Laundering Act, 2002 and rules and regulations prescribed thereunder, and circulars issued from time to time by SEBI;
- 3.4.8 Abide by the provisions of SEBI Act, regulations made thereunder and the circulars and guidelines issued or as may be specified from time to time.

3.5 Non applicability of certain provision of PMS Regulations on Eligible Fund Managers

The EFMs shall comply with the applicable regulatory requirements of the jurisdiction of the EIFs and any condition of the disclosure document or prospectus or offer document and/or any relevant document of the EIFs. The EFM may be exempted from the following provisions of PMS Regulations with respect to EIF:

Regulation / Circular	Content	Rationale for non-applicability
14(1)(a), 14(1)(b) and Schedule IV	These regulations specify requirements of a contract between the portfolio manager and its clients and the contents of the contract respectively.	The terms of agreement between an EIF and an EFM may vary depending on the jurisdiction and business requirements of EIF.
14 (2)(a)	This regulation specifies the requirement of providing the Disclosure Document by the portfolio manager to the client at least 2 days prior to entering into agreement.	This may be governed as per the regulatory requirements of jurisdiction of EIF, if any.
15 (1A)	This regulation specifies the requirement of minimum investment that a portfolio manager can accept.	The EIF shall comply with the corpus requirements as specified under Section 9A(3)(j) of Income Tax Act, i.e. <i>'the monthly average of the corpus of the fund shall not be less than one hundred crore rupees'</i> .

15 (2)	This regulation specifies that the portfolio manager shall act in a fiduciary capacity with regard to the client's funds.	The relationship between the EFM and EIF may be governed as per the mutually agreed terms and the regulatory requirements of jurisdiction of EIF, if any.
15 (4A) and 15 (5)	These regulations specify the requirement on borrowing and lending of clients' securities and funds by the portfolio manager.	The lending and borrowing of clients' securities and funds by the portfolio manager may be governed as per the mutually agreed terms and the regulatory requirements of jurisdiction of EIF, if any.
16 (1)(b)	This regulation specifies that any renewal of portfolio fund on maturity of the initial period shall be deemed as a fresh placement.	Not required in this case.
16 (4)	This regulation specifies that the portfolio manager shall not enter into any speculative transaction.	The fund management of EIF funds by the EFM may be governed as per the investment objective of the fund, mutually agreed terms and the regulatory requirements of jurisdiction of EIF, if any.

20 (3)	This regulation specifies that the portfolio manager shall audit the portfolio accounts annually and provide the certificate to the client.	Audit of the portfolios of the EIF may be done as per the regulatory requirements of jurisdiction of EIF, if any.
21 (1), 21 (1A), 21 (2), 21 (3)	These regulations specify the various reports to be provided by the portfolio manager to the clients, like portfolio composition, transactions undertaken, corporate actions received, expenses, risks of the portfolio etc., and other requirements associated to client reporting.	The reports to be provided by the EFM to EIF may be governed as per the mutually agreed terms, if any.
Circular IMD/DF/13/2010 dated October 5, 2010	This circular specifies the requirements regarding fees and charges, including High Water Mark principle, Disclosure of fees and charges etc.	The fees payable by the EIF to the EFM may be governed as per the mutually agreed terms and the regulatory requirements of jurisdiction of EIF, if any.
Clause (1) of Circular IMD/PMS/CIR /1/21727/03 dated November 18, 2003	This circular specifies the measures to enhance the corporate governance of the portfolio manager. Clause (1) of the circular specifies that the portfolio manager shall disclose the	The disclosure of performance of the EFM with respect to its activities as a portfolio manager to the EIF may be governed as per the mutually agreed terms and

	performance of their portfolios to their clients and also provide comparison with a suitable benchmark index.	the regulatory requirements of jurisdiction of EIF, if any.
Point 5 of Annexure to Circular IMD/DOF-1/PMS/Cir-1/2010 dated March 15, 2010	This circular specifies the format for half yearly reporting by the portfolio manager to SEBI. Point 5 of the annexure to circular pertains to reporting of performance of Portfolio Manager.	A portfolio manager may not be required to report to SEBI its performance as an EFM.

3.5.1 However, the rest of the PMS Regulations shall be applicable to EFMs *mutatis mutandis*.

3.5.2 Notwithstanding anything mentioned above, the EIFs must always comply with the applicable Indian laws and regulations.

3.6 Public Comments

3.6.1 Public comments are invited on the consultation paper. Comments may be forwarded by email to naveens@sebi.gov.in or may be sent by post to the following address latest by **July 03, 2016**.

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3.6.2 Questions:

SEBI has put in detailed analysis in identification of the various provisions in the existing PMS Regulations that may hinder the genesis and development of fund management industry in India. In this regard, comments may be offered on following:

- I. Is there any provision identified under Para 3.5 that needs to be applied to the Eligible Fund Managers?
- II. Is there any other provision in the PMS Regulations not mentioned in Para 3.5 that need to be exempted for Eligible Fund Managers?
- III. Should the Code of Conduct specified under Schedule III of PMS Regulations be made applicable to Eligible Fund managers?

3.6.3 Comments should be given in the following format:

Sr. No.	Question No. / Para Ref. No.	Comment	Rationale

Issued on June 21, 2016