

**GOVERNMENT OF INDIA
FINANCE
LOK SABHA**

STARRED QUESTION NO:321

ANSWERED ON:16.12.2011

PARTICIPATORY NOTES

Bhadana Shri Avtar Singh;Meena Shri Raghuvir Singh

Will the Minister of FINANCE be pleased to state:

- (a) the salient features and objectives including the norms for investment through Participatory Notes (PNs);
- (b) whether any violations have been noticed in investment/futures trading by the Foreign Institutional Investors (FIIs) through PNs and hedge funds accounts;
- (c) if so, the details thereof alongwith the stipulated time for disclosure of investment to the Securities Exchange Board of India (SEBI) made by the FIIs through various routes;
- (d) the mechanism to control the total exposure in the futures trading taken by FIIs through their various sub-accounts; and
- (e) the corrective action taken in the matter?

Answer

MINISTER OF THE STATE IN THE MINISTRY OF FINANCE (SHRI PRANAB MUKHERJEE)

(a) to (e): A statement is placed on the Table of the House.

Statement referred to in the reply to Lok Sabha Starred Question No.321 (a to e) by Shri Raghuvir Singh Meena and Shri Avtar Singh Bhadana, Members of Parliament, for 16th December, 2011 regarding 'Participatory Notes'.

An Offshore Derivatives Instrument (ODIs)/ Participatory Notes (PNs) in the Indian context, is a derivative instrument issued in a foreign jurisdiction by a Foreign Institutional Investor (FII) or one of its associate entities which has Indian securities as the underlying instrument. The underlying instrument can also be a basket of securities with a mix of Indian and securities of other jurisdictions. The investor in PN has neither the ownership of the Indian securities nor any voting rights. Investors in foreign jurisdictions invest in PNs for several reasons including price fluctuations in the underlying securities.

According to Regulation 15(A) of the Securities and Exchange Board of India (SEBI) Regulations, 1995, PNs can be issued only to those entities which are regulated by the relevant regulatory authority in the countries of their incorporation and are subject to compliance of 'Know Your Client' norms. Down-stream issuance or transfer of the instruments can also be made only to a regulated entity. Further, the FIIs who issue PNs against underlying Indian securities are required to report the issued and outstanding PNs to SEBI in a prescribed format. In addition, SEBI can call for any information from FIIs under Regulation 20(A) of the SEBI (FII) Regulations concerning off-shore derivative instruments issued by it, as and when and in such form as SEBI may require.

FIIs issuing PNs are required to submit monthly reports to SEBI. These reports require the communication of details such as name and constitution of the subscribers to PNs, their location, nature of Indian underlying securities etc.

Further, FIIs can issue PNs to regulated entities only and are further required to submit an undertaking which states that they have not issued PNs to Non-Resident Indians (NRIs)/ Resident Indians.

SEBI has noticed certain suspected cases of violations in the reporting of figures relating to ODIs/ PNs. In the last three years (2008-09, 2009-10 and 2010-11), three such cases were noticed. In two of these cases, SEBI after investigation took punitive action against them. The case of the third entity is under adjudication.

According to the extant provisions, FIIs are required to report ODIs/ PNs positions on a monthly basis.

Exposure in the derivatives market for different classes of market participants, including FIIs through their sub accounts, is regulated through position limits. The Stock Exchanges monitor and enforce these position limits on a daily basis.