INTERNATIONAL FINANCIAL SERVICES CENTRES AUTHORITY

Fourteenth Authority Meeting held on 24th March 2023

Gist of Agenda item: Amendment to International Financial Services Centres Authority (Fund Management) Regulations, 2022

1. Objective

This memorandum seeks approval of the Authority to notify the amendment to International Financial Services Centres Authority (Fund Management) Regulations, 2022 with respect to handling of client funds for Portfolio Management Services in IFSC.

2. Background

2.1. The IFSCA (Fund Management) Regulations, 2022 (hereinafter referred to as "Regulations"), inter alia, provide that a Fund Management Entity (FME) registered with IFSCA as a Registered FME (Non-Retail) or as a Registered FME (Retail) may provide Portfolio Management Services (PMS) in IFSC. Chapter VI of the Regulations provides for the regulatory framework for PMS in IFSC.

2.2. With respect to regulatory requirements prescribed at present for handling of client funds, the IFSCA has been in receipt of representations from industry participants, highlighting certain limitations specially in the context of an International Financial Services Centre.

2.3. Among the other requirements prescribed for PMS, Regulation 77, titled – "Dealing with Client Funds", provides the following under sub-regulation (2):

> "A portfolio manager shall keep the funds of all clients in a separate account to be maintained by it in a Banking Unit."

2.4. The said regulation requires the FME to pool its PMS clients' funds in a bank account maintained by it in an IFSC Banking Unit and therefrom make the investments on behalf of the PMS clients.

2.5. The ability to pool clients' funds in a dedicated bank account offers operational convenience to the FME as it is required to manage only a single bank account for all investments and maintain the records thereof. While operationally convenient, certain limitations of the present requirement have been observed, as discussed in subsequent paragraphs.

3. Limitations of present requirement

3.1. The limitations or challenges of the present requirement are listed below:

3.1.1. **Requirement of pooling of funds**

Some clients, while desirous of availing PMS of an IFSC based FME, are reluctant to part with their money until an order is placed by the FME for deployment of funds. While this reluctance has been highlighted by the market participants for the institutional clients, individual clients could also be unwilling to transfer their funds to a FME's pool account for the purpose of availing PMS from the FME.

3.1.2. **Jurisdiction-specific restrictions for investments**

Foreign investors investing in India are generally required to open a separate bank account for investments in India. Therefore, such investors, if desirous of availing PMS of an IFSC based FME, would be constrained as they would not be able to pool their funds in the FME's bank account in IFSC, as per the present requirement. The presence of similar requirement of having a bank account in the same jurisdiction for investment may be pertinent for other foreign jurisdictions as well.

3.2. A possible solution to the limitations posed by the present requirement is to clarify that the clients may maintain separate bank accounts and the FME may obtain authorisation from clients on their bank accounts. This shall not only align with the requirement of segregating each clients' funds from the FME's own funds as required under regulation 78(5) but shall also facilitate segregation of funds of each client and, thereby, bring more visibility to the client of his/her funds.

3.3. However, even if it is clarified that client availing the PMS of a FME may maintain a bank account in IFSC Banking Unit and authorise the FME to operate the same, it may still pose certain challenges / inconvenience. In many cases, opening a new bank account in a foreign jurisdiction such as GIFT-IFSC may require large institutional clients to obtain internal approvals, which may be challenging, especially if the clients have a pre-approved banking relationship with certain banks only and such banks are not present in IFSC. Further, for the clients which intend to invest in India or foreign jurisdictions, the funds from IFSC bank account of the client would largely be destined for investments into these jurisdictions. In such cases, the IFSC bank account of the investor would simply become an additional layer for routing the funds to the destination bank account, without adding any value to the client in the overall transaction.

4. Consultation Process

4.1. With a view to seek comments from the public, a Consultation Paper, placed at **Annexure I**, was placed on IFSCA website on February 15, 2023. Along with the salient details regarding the issue, the Consultation Paper also included a proposal and the draft text of amendment to IFSCA (Fund Management) Regulations, 2022 for operationalising the proposal.

4.2. In response, 15 comments have been received from various stakeholders. The comments received from the stakeholders and our analysis of these comments have been placed at **Annexure-II**. By and large, the commentators have appreciated the proposal with suggestions on certain drafting related changes for better clarity.

5. Proposed Amendment

5.1. In view of the limitations of the present requirement, proposal in the consultation paper and the comments received thereon, it is proposed that the funds of a client availing Portfolio Management Services (other than those availing only advisory services) may be maintained in-

(a) a specific bank account of the FME in a Banking Unit;
(b) a specific bank account of the client in a Banking Unit, a bank in India or a Foreign Jurisdiction; or
(c) any other manner as may be specified by the Authority.

5.2. However, when the funds are maintained in the specific bank account of a client, the FME shall ensure that it is duly authorised to operate the said bank account either by itself or through a custodian and that it shall provide the details of all such bank accounts including transactions carried out thereunder, to the Authority, whenever directed to do so.

5.3. The draft text of amendment proposed in this regard for PMS is placed in **Appendix – 1**.

6. Proposal

6.1. The Authority may consider and approve notifying the amendments to IFSCA (Fund Management) Regulations, 2022, as proposed in paragraph 5, in the Official Gazette, after carrying out changes, if any, of drafting and consequential nature.

6.2. The Authority is further requested to authorise the Chairperson to take such necessary, consequential and incidental steps as deemed appropriate to give effect to the decision of the Authority.

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