

Investment Management Department, Division of Funds-1
Securities and Exchange Board of India
SEBI Bhavan, Plot No. C4-A, G Block
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64192

29 September 2010

✓ Kind Attention: Ms Maninder Cheema, Deputy General Manager

5/10 M(MT)

Madam

Request for an interpretive letter under Securities and Exchange Board of India (Informal Guidance) Scheme, 2003

In accordance with the SEBI (Informal Guidance) Scheme, we request an interpretive letter in connection with a proposed structure and transaction flow to address the regulatory requirements for a Portfolio Manager (herein after referred to as PM) to appoint a Custodian [as stated in Regulation 16B of SEBI (Portfolio Managers) Regulations, 1993] and for the PM to maintain segregated demat accounts for its clients [as inferred from Regulation 16(8) of SEBI (Portfolio Managers) Regulations, 1993 and SEBI Circular no: IMD/DOF I/PMS/Cir-4/2009 dated June 23, 2009].

We have explained the proposed structure and the proposed transaction flow below.

Proposed Structure

- 1) The PM appoints a Custodian (registered as a Custodian of Securities with SEBI) for the pool of assets belonging to resident Indian clients of the PM. Accordingly, cash and demat accounts are maintained with the Custodian in the names of the pooled portfolios.
- 2) Segregated demat accounts of the PM's clients are opened and maintained with a Depository Participant (herein referred to as DP) who may or may not be registered with SEBI as a Custodian of Securities. Also, demat accounts in the names of the pooled portfolios are opened and maintained with the DP (referred to as "transitory pool demat accounts").
- 3) The PM's clients grant Power of Attorney (herein after referred to as PoA) to the PM to operate their segregated demat accounts with the DP. The PM, in turn, grants PoA to the Custodian to operate the segregated demat accounts with the DP. The PM also grants PoA to the Custodian to operate the transitory pool demat accounts with the DP.

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- 4) The PM's clients specify the Custodian's bank account as the bank account on their demat account opening form with the DP for receipt of cash corporate benefits. The PM's clients will not specify their own bank account on their demat account opening form with the DP as the account to receive cash corporate benefits. This is to ensure that the PM and the Custodian can monitor the receipt of cash corporate benefits, and the cash is available for the PM to invest. The address on the PM's Clients' Segregated Demat Accounts (with the DP) on the Depository Participant Module will be the PM's address or the Custodian's address to facilitate the collection of cheques for cash benefits on behalf of the clients.
- 5) The Custodian has an agreement with the PM and is obligated to provide custodial services only to the PM. The Custodian acts as a custodian for only those securities which are held in the demat accounts with the Custodian which are in the names of the pooled portfolios.
- 6) There is no agreement between the Custodian and the PM's clients as they are maintaining only segregated demat accounts with the DP. The Custodian does not act as a custodian for the securities which are held in these accounts. The Custodian does not act as a custodian for the securities which are held in the demat accounts with the DP which are in the names of the pooled portfolios i.e. the transitory pool demat accounts. The Custodian shall not be liable for any acts of the DP. The Custodian will not be liable for any expenses/losses incurred by the DP for maintenance of depository accounts of the PM or the PM's clients. The DP will be responsible for the risks arising out of its performance, non-performance, acts of omission or commission, fraud and default.

Proposed Transaction Flow

- 1) The PM executes trades at the pool level on T day and instructs the Custodian for settlement with the Exchange Clearing Corporation (herein after referred to as ECC).
- 2) For purchase of securities,
 - (a) The Custodian checks for cash availability in the pool cash account and confirms its obligation to the ECC on T+1 day.
 - (b) The Custodian effects cash pay-in to the ECC and receives securities pay-out from the ECC on T+2 day. The Custodian debits the pool cash account and credits the pool demat account for the pay-in and pay-out respectively.
 - (c) The Custodian transfers securities from the pool demat account with the Custodian to the transitory pool demat account with the DP and instructs the DP to transfer the securities in the transitory pool demat account with the DP to the segregated demat accounts of the PM's clients with the DP on T+2 day.

3) For sale of securities,

- (a) The Custodian instructs DP to transfer securities from the segregated demat accounts of the PM's clients with the DP to the transitory pool demat account with the DP and subsequently transfer the securities from the transitory pool demat account with the DP to the pool demat account with the Custodian on T day.
- (b) The Custodian checks for securities availability in the pool demat account and confirms its obligation to the ECC on T+1 day.
- (c) The Custodian effects securities pay-in to the ECC and receives cash pay-out from the ECC on T+2 day. The Custodian debits the pool demat account and credits the pool cash account for the pay-in and pay-out respectively.

4) As a value added service to the PM, the Custodian provides a daily reconciliation service to the PM which involves the Custodian receiving Daily Statement of Holdings of the segregated demat accounts of the PM's clients from the DP and reconciling the holdings with securities holdings at the pool level on a cumulative basis

5) The Custodian tracks corporate benefits declared by various companies and calculates entitlements at the pool level. Cash benefits such as dividend are credited directly by the issuing companies to the bank account mentioned in the download of Beneficial Owners data from the depository, which is the Custodian's bank account. Scrip benefits such as bonus are credited by the issuing companies directly to the segregated demat accounts of the PM's clients.

[The proposed structure and transaction flow have been schematically explained in the annexure to this letter]

Guidance Sought

We request your guidance on the following:

1. Are the proposed structure and transaction flow in compliance with Regulation 16B of SEBI (Portfolio Managers) Regulations, 1993?
2. Are the proposed structure and transaction flow in compliance with Regulation 15, 16 and 17 of SEBI (Custodian of Securities) Regulations, 1996?
3. Is the limitation in the responsibility and liability of the Custodian as explained in the Proposed Structure within the regulatory framework of SEBI (Custodian of Securities) Regulations, 1996 and SEBI (Portfolio Managers) Regulations, 1993?

We will be pleased to provide any clarification on our request, if required. We look forward to your guidance.

As required by the SEBI (Informal Guidance) Scheme, 2003, a Cashier's Order for INR 25,000 is enclosed with this letter.

Yours faithfully



Vinith Rao
Senior Vice President and Head, India
Fund Services, HSBC Securities Services, India

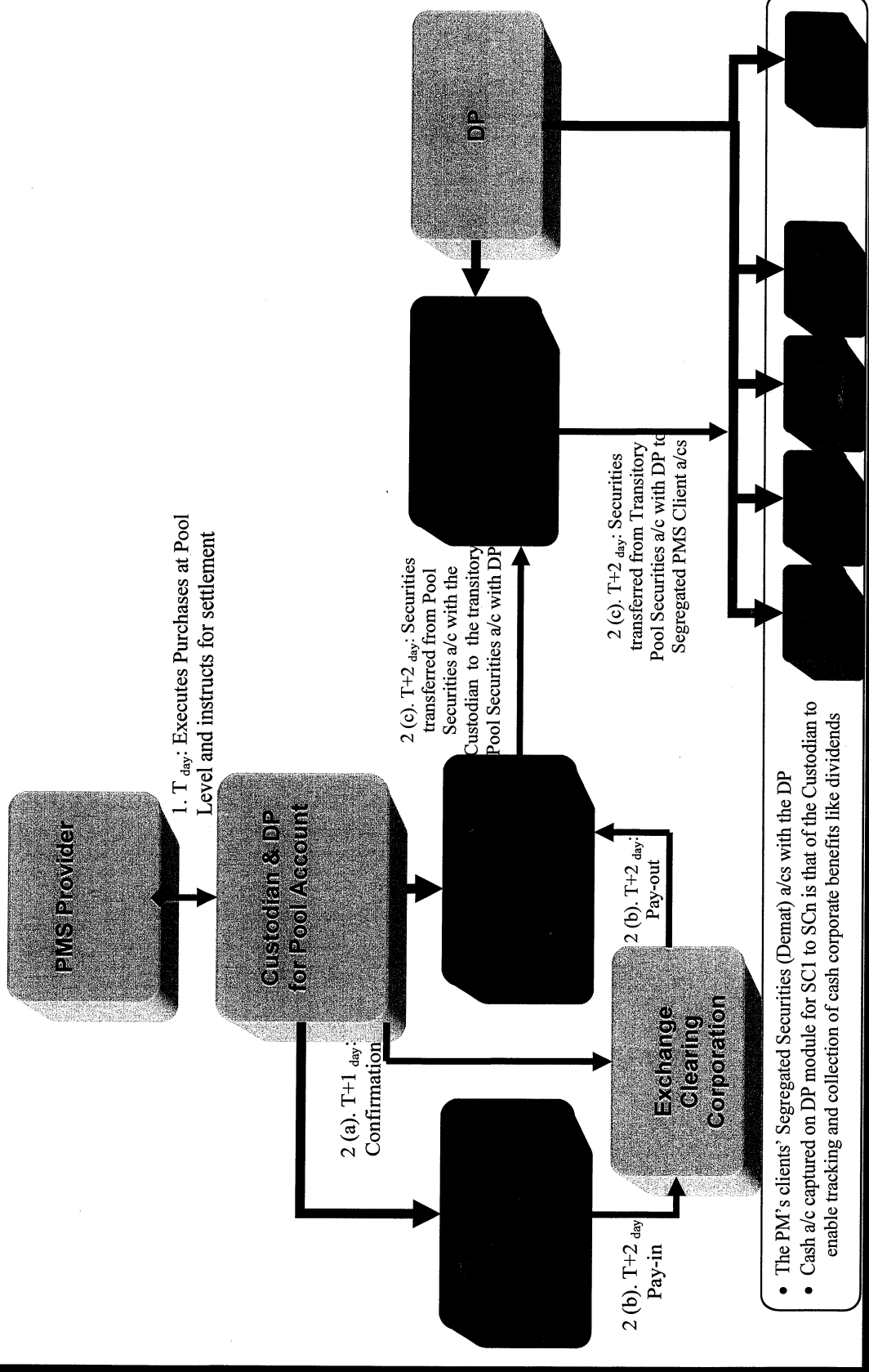
Encl:

(1) Annexure A and (B)

(2) Cashier's Order number 008674 for INR 25,000 favouring "Securities and Exchange Board of India"



Annexure A: Purchase of Securities in the Proposed Model



Annexure A: Sale of Securities in the Proposed Model

