



भारतीय प्रतिभूति  
और विनियम बोर्ड  
*Securities and Exchange  
Board of India*

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IMD-DoF1/PMS/ SP/JK/ 27296/2012  
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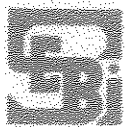
Mr. Vinith Rao  
Senior Vice President and Head India  
Fund Services, HSBC Securities Services, India,  
Plot No. 139-140 B, Western Express Highway,  
Sahar Road Junction, Vile Parle (East),  
Mumbai- 400 057.

Dear Sir,

**Sub: Request from HSBC Securities Services for interpretative letter under SEBI (Informal Guidance) Scheme, 2003 - Guidance in relation to proposed structure and transaction flow to address regulatory requirements for a Portfolio Manager.**

1. This has reference to your letter dated September 29, 2010 seeking informal guidance under the SEBI (Informal Guidance) Scheme, 2003. The Interpretative Letter has been sought by HSBC Securities Services on the following issues:-
2. In your letter under reference you have, inter alia, represented as under:
  - a. The Portfolio Manager (PM) shall appoint a custodian 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.
  - b. Segregated demat accounts of the PM's clients are opened and maintained with a Depository Participant (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')
  - c. The PM's clients grant Power of Attorney (PoA) to the PM to operate their segregated demat accounts with DP. The PM, in turn, grants PoA to the Custodian to operate the segregated demat accounts with the DP. The PM

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also grants PoA to the Custodian to operate the transitory pool demat accounts with the DP.

- d. 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.
- e. 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.
- f. 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 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 is as under:**

- i. The PM executes trades at the pool level on T day and instructs the Custodian for settlement with the Exchange Clearing Corporation (ECC).
- ii. 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 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.

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iii. 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 payout from the ECC on T+2 day. The Custodian debits the pool demat account and credits the pool cash account for the day in and pay out respectively.

iv. 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 Holding of the segregated demat accounts of the PM's clients from the DP and reconciling the holding with securities holding at the pool level on a cumulative basis.

v. 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.

3. Based on the above facts, you have sought our guidance on the following points:

- a. Are the proposed structure and transaction flow in compliance with Regulation 16B of SEBI (Portfolio Managers) Regulations, 1993 (PM Regulations)?
- b. Are the proposed structure and transaction flow in compliance with Regulation 15, 16 and 17 of SEBI (Custodian of Securities) Regulations, 1996 (Custodian Regulations)?
- c. 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?

4. We have considered the submissions made by you, in your letter under reference and without necessarily agreeing to your views our comments on the issues are as under:

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Query (a)

- i. In terms of Regulation 16B of the PM Regulations, it is the discretion of the portfolio manager to appoint or not a custodian where the asset under management is less than rupees five hundred crore. Further, PM Regulations mandates segregation of each clients' funds and portfolio of securities and keep them separately from his own funds.
- ii. In the proposed structure, the portfolio manager (PM) appoints a Custodian registered with SEBI for the pool of assets belonging to the PM and both cash and demat accounts are maintained with the Custodian in the names of the pooled portfolios. Further, segregated demat accounts of the PM's clients are opened and maintained with a Depository Participant (DP) as stated in the proposal which is broadly in accordance with the PM Regulations.
- iii. From the above structure, the appointment of a Custodian by the PM is only in respect of for the pooled portfolio of securities. Since the PM's obligations to maintain segregated client account is met through the DP route, pooling of clients accounts for the purpose of appointment of a custodian does not violate any of the relevant provisions of PM Regulations. Further, in terms of the circular dated 23/6/2009, PM is required to maintain a separate bank account in respect of all his clients.

Query (b)

- iv. Regulation 15 of Custodian Regulations states that no custodian of securities shall assign or delegate its functions as a custodian of securities to any other person unless such person is a custodian of securities.
- v. From the proposed structure/transaction flow, it is understood that the Custodian has an agreement with the PM and is obliged 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.
- vi. The Regulation necessitates a Custodian to keep custody of the securities of PM's clients if total asset under management is 500 hundred crore rupees or more. From the transaction flow, it is observed that all the activities starting from the purchase of securities till the sale of securities including keeping track of the corporate benefits are carried out by the Custodian. Hence there is no assignment / delegation of functions of the Custodian.
- vii. Regulation 16 of Custodian Regulations mandates a custodian to open a separate custody account for each client in the name of the client whose securities are in its custody and assets of one client shall not be mixed with

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those of another client. Regulation 17 of Custodian Regulations mandates every custodian to enter into an agreement with each client on whose behalf it is acting as custodian and such agreement, inter alia, shall provide matters stated therein. As stated in point (ii) above, there is pooling of assets belonging to the clients of PM whereby cash and demat accounts are maintained in the names of pooled portfolios by the PM. The custodian is not under a direct obligation to keep custody of the PM's client's securities. From the proposal, it is observed that the Custodian by virtue of having entered into an agreement with the PM is under an obligation to provide all the custodial services to the PM and not to its clients. Further, the PM's clients specify the Custodian's bank account as the bank account on their demat account opening form for receiving the cash corporate benefits. Further, the address on the PM's clients segregated demat accounts with the DP 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.

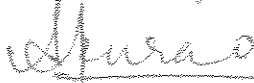
Thus, from the above structure, it is observed that effectively PM is the client of the custodian and the custodian renders its services as a custodian to the PM and holds the pooled accounts of the PM's clients as assets of the PM. This structure apparently does not violate the requirement of PM's segregation of clients demat account as the arrangement is basically for and limited for payment in settlement of cash and deliverable.

Query (c)

viii. In respect of query (c), the applicant has sought guidance - whether the limitation in the responsibility and liability of the Custodian as explained in the proposed structure is within the regulatory framework of Custodian and PM Regulations. In this regard, as the guidance sought by applicant is general in nature and does not point out specific limitation, no comments on this aspect are necessitated at present.

5. This position is based on the representation made to the division in your aforesaid letter. Different facts or conditions might require a different result. This letter does not express decision of the Board on the questions referred.
6. You may note that the above views are expressed only with respect to the clarifications sought and do not affect the applicability of any other law or requirement.

Yours faithfully,

  
Sanjay Purao