MANAGED FUNDS ASSOCIATION

October 19, 2007

Mr. M. Damodaran, Chairman
Securities Exchange Board of India
Plot No. C4-A, "G" Block
Bandra Kurla Complex, Bandra (East)
Mumbai 400051
India

Re: Paper for discussion on Offshore Derivative Instruments – Comments

Dear Mr. Chairman:

Managed Funds Association ("MFA") respectfully submits this letter to the Securities and Exchange Board of India ("SEBI") in relation to the proposed policy measures set forth in the SEBI discussion paper on Offshore Derivative Instruments (Participatory Notes) (the "SEBI Discussion Paper").

Introduction

MFA is the voice of the global alternative investment industry. Its members include professionals in hedge funds, funds of funds and managed futures funds. Established in 1991, MFA is the primary source of information regarding hedge funds for policymakers and the media and the leading advocate for sound business practices and industry growth. MFA members represent the vast majority of the largest hedge fund groups in the world that manage a substantial portion of the over $1.67 trillion invested in absolute return strategies. MFA is headquartered in Washington, D.C., with an office in New York.

It is well recognized today that hedge funds, like banks and other financial institutions, are key participants in international financial markets. By participating in capital markets as risk seekers, hedge funds often provide critical liquidity, which can help reduce systemic risk and, at the same time, ensure the overall viability of the marketplace. In this sense, hedge funds often act as risk absorbers in markets by serving as ready counterparties to those wishing to hedge risk, especially when markets are volatile, thereby reducing pressure on market prices while increasing liquidity. In addition, hedge funds typically trade based on extensive research, which brings more accurate price information, and therefore price efficiencies, to the markets. Without the research and

commitment of capital by hedge funds, the markets potentially would have wider price spreads, as well as more pronounced pricing inefficiencies and illiquidity. Consequently, MFA believes, as do key policymakers, that this activity is beneficial to financial markets:

> ***"[Hedge funds'] rapid growth is one of the most important developments in U.S. financial markets in the past decade or so. Hedge funds vary widely in their investment strategies and in the types of risks they take. Overall, however, most economists agree that the rise of hedge funds has been a positive development for investors and for financial markets. They have stimulated an extraordinary amount of financial innovation in recent years; and, using many of these new financial tools, they have greatly enhanced the liquidity, efficiency, and risk-sharing capabilities of our financial system."*** Remarks by Ben S. Bernanke, Chairman, Board of Governors of the Federal Reserve System, at the New York University Law School, New York, New York (April 11, 2007).

Discussion of Proposed Policy Measures

As we have stated in our previous submissions to SEBI, many of MFA's members are important investors in India's capital markets. Consequently, MFA continues to support SEBI's efforts to promote the stability and integrity of the Indian stock market and appreciates SEBI's recent undertakings to open its markets to direct investment by hedge funds. However, we must join the International Swaps and Derivatives Association ("ISDA") in expressing significant concern about the measures proposed in the SEBI Discussion Paper.

The SEBI Discussion Paper proposes to abruptly eliminate or severely limit the ability of foreign investors that are not currently registered as Foreign Institutional Investors ("FIIs") to invest in Offshore Derivatives Instruments ("ODIs"), effective immediately. In addition the SEBI Discussion Paper proposes to require investors in ODIs to exit certain of their existing positions – regardless of their stated tenor – within 18 months. Given that ODIs represent for many institutional investors the sole means by which they can invest in India's capital markets, these proposals will not only restrict them from making further such investments but will also require them to terminate and withdraw existing investments from India (in many cases prior to maturity) and reallocate them to other markets.

The losses associated with unanticipated early termination of transactions of this kind are likely to be significant and will greatly compromise the legal and regulatory certainty perceived by investors in respect of future Indian investment. In addition such terminations could result in unintended price fluctuations in exchange-traded instruments as FIIs terminate and unwind their underlying positions.

The SEBI Discussion Paper proposals would also severely inhibit the ability of foreign investors to enter into derivative contracts with respect to the Indian markets in the same manner that is permitted in jurisdictions across the globe. Derivative contracts promote market efficiency and permit the influx of capital into areas that might not be available to all market participants. For a multitude of reasons, including tax, legal and business reasons, hedge funds, like other

institutional investors, seek the flexibility afforded by engaging in derivative transactions in order to manage their risks and returns most efficiently. By implementing the measures proposed in the SEBI Discussion Paper, the Indian markets may effectively be closed to a substantial pool of investors, thereby leading to greater, rather than diminished, market instability and inefficiency.

The concerns expressed above are exacerbated by the fact that, despite recent progress, it remains difficult for hedge funds to register as FIIs and invest directly in India. In particular the qualifications and standards that a hedge fund must satisfy in order to register as an FII remain unclear. Furthermore, the registration process can take several months during which there is little certainty as to whether an applicant will ultimately be granted FII status. Although there has been some encouraging discussion of streamlining the process for registration as an FII, no specific measures have been proposed in conjunction with the proposals set forth in the SEBI Discussion Paper.

New restrictions on indirect investment should be accompanied by a corresponding facilitation of direct investment. Specifically, there should be clear measures adopted to clarify applicable standards and expedite the FII registration process for hedge funds in order to ensure that hedge funds are not prohibited from investing for an extended time period due to administrative or technical reasons.

Conclusion

The measures proposed in the SEBI Discussion Paper are likely to present significant challenges to foreign investors in India's capital markets. If they are adopted abruptly, as proposed, they could result in major market dislocation and a rapid reallocation of capital to jurisdictions with more certain and flexible regulatory regimes. MFA therefore encourages SEBI to extend the time period for discussion of this topic with a broader group of market participants in order to fully assess the extent of the concerns that have been raised by market participants in response to these proposals.

MFA hopes that SEBI will consider the points discussed in this letter and would welcome the opportunity to engage in a dialogue regarding these important issues with SEBI going forward. Please feel free to contact me at 1.202.367.1140 with any questions or requests for additional information.

I look forward to seeing you in Tokyo and very much appreciate the wonderful reception you provided us in Mumbai.

Sincerely yours,

John G. Gaine
President