

# Regulatory alert: SEBI issues operational guidelines for implementation of the new FPI regulations

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## Summary

Securities and Exchange Board of India (SEBI) has issued the operational guidelines (Guidelines) for foreign portfolio investors (FPIs), designated depository participants (DDPs) and eligible foreign investors (EFIs) in order to implement the revised FPI Regulations 2019 notified on 23 September 2019. The Guidelines replace all existing circulars, FAQs, operating guidelines and other guidelines issued by SEBI on this subject.

The Guidelines are broadly segregated into five sections:

1. FPI registration-related activities
2. Know your client (KYC) requirements for FPIs
3. Investment conditions/restrictions on FPIs registered under the SEBI (FPI) Regulations, 2019
4. Issuance of offshore derivative instruments (ODIs) by FPIs under the SEBI (FPI) Regulations, 2019
5. Guidelines for participation/functioning of EFIs in the International Financial Service Centre (IFSC)

## Background

SEBI had notified<sup>1</sup> the SEBI (Foreign Portfolio Investor) Regulation, 2019 (hereinafter referred to as 'new regulations'). The new regulations considered the recommendations of the Working Group constituted under the chairmanship of Mr. H. R. Khan to review and redraft existing SEBI (Foreign Portfolio Investors) Regulations, 2014 (hereinafter referred to as 'erstwhile regulations').

In order to operationalise the regulations, SEBI has now issued Guidelines for FPIs, DDPs and EFIs. This alert discusses the key highlights of the Guidelines.

## Part A – FPI registration-related activities

### Re-categorisation of FPIs in the new regulations

- The new regulations had re-categorised FPIs into two categories<sup>2</sup>: Category I and II. The process of re-categorisation of existing FPIs registered under the erstwhile regulations shall be as under:

Existing FPI registered under the erstwhile regulations as	Deemed* registration in the new regulations
Category-I FPI	Category-I FPI
Category-III FPI	Category-II FPI
Category-II FPI	Either as Category-I FPI or Category-II FPI depending on the eligibility criteria met by such FPIs

<sup>1</sup> Vide Notification dated 23 September 2019

<sup>2</sup> Instead of the three categories as stipulated by the erstwhile regulation

\*It has also been clarified that there will be no deemed re-categorisation of registration for eligible entities from Category-III in the erstwhile regulations to Category-I FPI under the new regulations.

- No incremental fee is payable upon deemed re-categorisation.
- Re-categorisation shall be done by the National Securities Depository Limited (NSDL) in consultation with the respective DDPs.
- After deemed registration as mentioned above, an FPI desirous to get itself re-categorised from Category-II FPI to Category-I can request DDP along with requisite information, documents and payment of applicable fees.

### **Manner of processing of FPI applications by DDPs**

- The Guidelines provide detailed guidance for processing of FPI applications by DDPs.
- It states that a DDP may continue to accept in-transit FPI applications received in Form A under the erstwhile regulations for a period of 90 days from date of issuance of these Guidelines.
- However, the DDP may satisfy itself on any incremental due diligence requirement to process the application under the new regulations.

### **Appropriately regulated entities<sup>3</sup> investing on behalf of clients**

- Appropriately regulated entities are permitted to undertake investments on behalf of their clients as Category-II FPIs. In such a case, Category-II FPI registration under the new regulations shall be granted subject to the specified conditions.
- This investment activity is permitted in addition to proprietary investment done by the FPI through its separate registration as a Category-I FPI.

### **Requirement for segregated portfolios to provide declaration of beneficial owner (BO)**

- FPIs having segregated portfolio(s) are required to provide BO declaration for each fund/sub-fund/share class/equivalent structure that invests in India.

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<sup>3</sup> Such as banks, merchant banks, asset management companies, investment managers, investment advisors, portfolio managers, insurance and reinsurance entities, etc.

- Existing FPIs with segregated portfolio are required to provide BO details for each fund/sub-fund/share class/equivalent structure that invests in India at the time of continuance of registration or within six months from the date of notification of the New Regulations, whichever is later.



In case of non-submission of BO details within six months, the FPI shall not be allowed to make fresh purchases till the time it is compliant with the said requirement.

- It has been clarified that funds investing in India include those with sub-funds or separate classes of shares or equivalent structure with segregated portfolio for such sub-funds or separate classes of shares or equivalent structure. The assets and liabilities across such sub-funds or separate classes of shares or equivalent structure may be ring-fenced from each other as directed by the FPI.

## Reclassification in case of non-compliance with applicable eligibility requirements

- If an FPI registered under a particular category/sub-category fails to comply with applicable eligibility requirements, it shall promptly notify this change to its DDP to be reclassified under the appropriate category/sub-category.
- The concerned DDP/custodian shall not allow (block) such FPI to make fresh purchases till additional KYC requirements (if any) are complied with. However, such FPI shall be allowed to continue to sell the securities already purchased by it within 180 days of blocking.

## Part B – KYC for FPI

### KYC documentation requirements

- An FPI applicant is required to provide KYC-related documents based on the category under which it is registered.
- The details are as under:

### Applicant related

S. no.	KYC documents	Category -I	Category -II
1	Constitutive documents	Required	Required
2	Proof of address	Required	Required
3	PAN	Required	Required
4	Board resolution	<b>Not required</b>	Required
5	FATCA/CRS form	Required	Required
6	Form/KYC form	Required	Required

### Authorised signatory related

S. no.	KYC documents	Category -I	Category -II
7	List of Signatures	Required	Required

### Ultimate beneficial owner (UBO) related

S. no.	KYC documents	Category -I	Category -II
8	List of UBO including the details of intermediate BO	Required	Required
9	Proof of Identity	<b>Not required</b>	Required

- In this regard, *inter alia* it has been clarified that for non-PAN related KYC documents (including KYC form), a local custodian can rely on KYC carried out by another entity of the same financial group<sup>4</sup> which is regulated and coming from a Financial Action Task Force (FATF) member country, where KYC is carried out as per their home jurisdiction standards, subject to obtaining of an undertaking and other specified documents.

### Identification and verification of BOs

- The mechanism for identification and verification of BO as prescribed by way of

earlier circular has been re-iterated and consolidated under the Guidelines.

- KYC registration agencies (KRAs) need to ensure security of personal information of BO including senior managing official (SMO) of FPI and make such information available to intermediaries only on a 'need to know basis' using a secured authentication method<sup>5</sup>.



<sup>4</sup> Like a global custodian or investment manager

<sup>5</sup> Wherein an intermediary can access the information from KRA using the authentication (similar to one-time password "OTP")

after the KRA gets confirmation from the FPI or its global custodian or investment manager

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## Part C - Investment conditions/restrictions on FPIs registered under the new regulations

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SEBI has consolidated a list of circulars prescribing the list of permissible investments and its limits and certain other clarifications which include:

### Off-market transfer of securities

In addition to the permissible off-market transactions specifically prescribed under the new regulations, SEBI has brought in the following clarifications:

- FPIs shall be permitted to request for 'off market' transfers of assets between FPIs operating under the multiple investment managers (MIM) structure<sup>6</sup>. The request should be made to the DDPs who will in turn process the requests at their end. Further, any such approvals for 'off-market' transactions by the DDP shall be without prejudice to the taxation provisions.
- FPI are permitted to sell off-market **unlisted, illiquid, suspended, and delisted shares** in accordance with the pricing guidelines for such sale as per the FEMA rules.

### 'To be listed' shares

- FPIs have been permitted to acquire 'to be listed' shares pursuant to initial public offer (IPO), follow-on public offer (FPO), rights issue, private placement or shares received through involuntary corporate actions including a scheme of a merger or demerger.

### Short sale of securities

- FPIs are not permitted to short sell in Indian markets except as allowed under Securities Lending & Borrowing (SLB) or any other framework specified by SEBI.
- Further, sale against open purchases is not permitted for FPIs, and FPIs can sell such securities only after their settlement.

### Investment by FPIs through primary market issuances

- As per the new regulations, the purchase of equity shares of each company by a single FPI<sup>7</sup> shall be below 10% of the total paid-up equity capital on a fully diluted basis of the company.
- Compliance with the above requirement shall be ensured by the registrar and transfer agents (RTAs) who shall use the Permanent Account Number (PAN) of the FPI for checking at the time of finalisation of the basis of allotment during primary market issuances. Further, to ensure

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<sup>6</sup> With the same PAN issued by the Income Tax Department

<sup>7</sup> Including its investor group

compliance with the requirement by the investor group, the RTAs shall obtain validation from the depositories. It has been clarified that bids by FPIs under the MIM structure having the same PAN may not be treated as multiple bids.

### Transfer of right entitlement

- FPIs shall ensure that the transfer of right entitlements is at market price or fair value, as applicable.

### FPIs' investment in debt securities

- FPIs are eligible to invest in corporate debt issues which are 'to be listed' without any end-use restrictions as applicable to unlisted debt securities. However, where the listing does not happen within 30 days or the issue is not meeting the end-use restrictions, the FPI is required to immediately dispose of such investment to either a domestic investor or the issuer.
- It has been clarified that investments by FPIs in debt-oriented mutual fund schemes are to be considered as investments in corporate debt.

### Allocation of corporate debt limit

- The mechanism for allocation of the corporate debt limit prescribed by way of various circulars has been re-iterated and consolidated under the Guidelines.

## Position limits available to FPIs for stock and stock index derivative contracts

### Position limit available to FPIs for stock derivative contracts

FPI category	Market-wide position limit (MWPL)
<b>Category-I</b>	20%
<b>Category-II</b> (other than FPIs in sub-category individuals, family offices, corporates)	10%
<b>Category-II</b> (in sub-category individuals, family offices, corporates)	5%

### Position limit available to FPIs for stock index derivative

FPI category	Position limit
<b>Category-I*</b>	<b>Higher of (per exchange)</b> <ul style="list-style-type: none"> <li>INR 500 crore or</li> <li>15% of total open interest of market in index futures</li> </ul>
<b>Category-II</b> (other than FPI in sub-category individuals, family offices, corporates)	<b>Higher of</b> <ul style="list-style-type: none"> <li>INR 300 crore or</li> <li>10% of total open interest</li> </ul>
<b>Category-II</b> (in sub-category individuals, family offices, corporates)	<b>Higher of</b> <ul style="list-style-type: none"> <li>INR 100 crore or</li> <li>5% of total open interest</li> </ul>

The above limits continue to apply separately for equity index futures and equity index options for all categories of FPIs in accordance with the current mechanism.

\* In addition, Category-I FPIs shall take exposure in equity index derivatives subject to the following limits:

- Short positions in index derivatives<sup>8</sup> not exceeding (in notional value) the FPI's holding of stocks
- Long positions in index derivatives<sup>9</sup> not exceeding (in notional value) the FPI's holding of cash, government securities, T-bills and similar instruments

### Participation of FPIs in the currency derivative segment and position limits for currency derivative contracts

- FPIs are permitted to trade in the currency derivative segment of stock exchanges subject to the below mentioned position limits. The gross open positions of the FPIs across all contracts in respective currency pairs shall not exceed the below mentioned limits:

#### USD-INR currency pair

FPI category	USD-INR
Category-I and Category-II (other than individuals, family offices and corporates)	Higher of: <ul style="list-style-type: none"> <li>• 15% of the total open interest, or</li> <li>• USD 100 million</li> </ul>
Category-II (in sub-category individuals, family offices, corporates)	Higher of: <ul style="list-style-type: none"> <li>• 6% of total open interest, or</li> <li>• USD 10 million</li> </ul>

#### EUR-INR currency pair

FPI category	EUR-INR
Category-I and Category-II (other than individuals, family offices and corporates)	Higher of: <ul style="list-style-type: none"> <li>• 15% of the total open interest, or</li> <li>• EUR 50 million</li> </ul>
Category-II (in sub-category individuals, family offices, corporates)	Higher of: <ul style="list-style-type: none"> <li>• 6% of total open interest, or</li> <li>• EUR 5 million</li> </ul>

#### GBP-INR currency pair

FPI category	GBP-INR
Category-I and Category-II (other than individuals, family offices and corporates)	Higher of: <ul style="list-style-type: none"> <li>• 15% of the total open interest or</li> <li>• GBP 50 million</li> </ul>
Category-II (in sub-category individuals, family offices, corporates)	Higher of: <ul style="list-style-type: none"> <li>• 6% of total open interest, or</li> <li>• GBP 5 million</li> </ul>

#### JPY-INR currency pair

FPI category	JPY-INR
Category-I and Category-II (other than individuals, family offices and corporates)	Higher of: <ul style="list-style-type: none"> <li>• 15% of the total open interest, or</li> <li>• JPY 2000 million</li> </ul>
Category-II (in sub-category individuals, family offices, corporates)	Higher of: <ul style="list-style-type: none"> <li>• 6% of total open interest, or</li> <li>• JPY 200 million</li> </ul>

FPIs are permitted to take position in the exchange-traded cross-currency futures and options contract subject to the below mentioned position limits:

<sup>8</sup> Short futures, short calls and long puts

<sup>9</sup> Long futures, long calls and short puts



FPI category	EUR-USD	GBP-USD	USD-JPY
Category-I and Category-II (other than individuals, family offices and corporates)	Higher of: <ul style="list-style-type: none"> <li>15% of the total open interest, or</li> <li>EUR 100 million</li> </ul>	Higher of: <ul style="list-style-type: none"> <li>15% of the total open interest, or</li> <li>GBP 100 million</li> </ul>	Higher of: <ul style="list-style-type: none"> <li>15% of the total open interest, or</li> <li>USD 100 million</li> </ul>
Category-II (in sub-category individuals, family offices, corporates)	Higher of: <ul style="list-style-type: none"> <li>6% of total open interest, or</li> <li>EUR 10 million</li> </ul>	Higher of: <ul style="list-style-type: none"> <li>6% of total open interest, or</li> <li>GBP 10 million</li> </ul>	Higher of: <ul style="list-style-type: none"> <li>6% of total open interest, or</li> <li>USD 10 million</li> </ul>

### Clarification regarding adherence to below 10% investment limit

- Where the investment by an FPI including its investor group exceeds 10% of the equity capital of a company on a fully diluted basis, such FPI must follow the extant FEMA rules in this regard.
- In such a case, if such FPI and its investor opt to treat their entire investment into the company as FDI, the FPI and its investor group shall not make any further portfolio investments in that company.
- The FPI/investor groups shall inform the respective custodian(s) of the choice who in turn shall report to SEBI, depository and the issuer.

- Such investments shall be treated as FDI subject to the norms prescribed by the Reserve Bank of India (RBI) from time to time.
- The FPIs and its investor group will be able to sell these securities only through the route as they were acquired, and appropriate reporting (i.e., LEC reporting) shall be made by the respective custodian.

### Write-off of securities held by FPIs

- The Guidelines prescribe a process for writing off securities which the FPIs (whose registration is not valid or who intends to surrender their registration) are not able to sell through a permitted off-market transaction of unlisted, illiquid, suspended and delisted shares.



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## Part D – Issuance of ODIs by FPIs under the new regulations

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### Conditions for issuance of ODIs

- FPIs shall not be allowed to issue ODIs referencing derivatives. Further, no FPIs shall be allowed to hedge their ODIs with derivative positions on stock exchanges in India.
- However, as an exception to the above, the following is permitted through a separate FPI registration of ODI issuing Category-I FPIs:
  - Derivative positions taken on stock exchanges for ‘hedging of equity shares’ held by it in India, on a one-to-one basis, and/or
  - An ODI issuing FPI may hedge the ODIs by referencing equity shares with derivative positions in Indian stock exchanges, subject to a position limit of 5% of market-wide position limits for single stock derivatives. The permissible position limit for stock index derivatives is higher of INR 100 crore or 5% open interest
- **Segregation of proprietary derivative investment and ODI hedging through derivatives:** An ODI issuing FPI which hedges its ODI only by investing in securities (other than derivative)

held by it in India cannot undertake proprietary derivative positions though the same FPI registration. Such FPI must segregate its ODI and proprietary derivative investments through separate FPI registrations under the same PAN.

Further, an ODI issuing FPI cannot co-mingle its non-derivative proprietary investments and ODI hedge investments with its proprietary derivative investment or vice versa in the same FPI registration.

- **Timeline for compliance by FPI:** No fresh derivative positions which are not in compliance with the above requirements shall be allowed. FPIs shall have 90 days’ time<sup>10</sup> to comply with the above requirements. For this purpose, off-market transfer of asset/position will be allowed for FPIs intending to transfer assets/position from one FPI account to another FPI account.



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<sup>10</sup> From the date of publication of the Guidelines

- **Ineligible subscriber:** An ODI subscriber who became ineligible under the new regulation may continue to hold its existing position till 31 December 2020. No renewal/rollover of existing positions by such ODI subscribers shall be permitted, and fresh issuance of ODIs shall be made only to eligible subscribers.



### KYC norms for ODI subscribers and reporting of suspicious transactions

- ODI issuing FPIs are required to maintain at all time the prescribed KYC documents regarding ODI subscribers and make them available to SEBI on demand.
- ODI issuing FPIs are required to identify and verify the BOs in the ODI subscriber entities, as applicable to FPIs.
- Further, BO and intermediate shareholder/owner entity with holdings equal and above the materiality thresholds in the ODI subscriber need to be identified through a look-through basis.
- The KYC review shall be done on the basis of the risk criteria as determined by the ODI issuers as follows:
  - Yearly basis: In case of high-risk ODI subscribers
  - Once every three years: In case of all other ODI subscribers

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### Part E - Guidelines for participation/ functioning of EFIs in IFSC

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The Guidelines clarify that EFIs operating in an IFSC shall not be treated as entities regulated by SEBI. Further, any SEBI-registered FPIs proposing to operate in IFSC shall be permitted without any additional documentation and/or prior approval.

## Eligibility norms for EFIs

- EFIs are foreign investors who are eligible to invest in IFSC by satisfying the following conditions:
  - a) The investor is not resident in India
  - b) The investor is not resident in a country identified in the public statement of FATF as
    - a:– jurisdiction having strategic anti-money laundering or combating the financing of terrorism deficiencies to which counter measures apply, or
    - jurisdiction that has not made sufficient progress in addressing the deficiencies or has not committed to an action plan developed with the FATF to address the deficiencies
  - c) The investor is not prohibited from dealing in the securities market in India

## KYC norms

The KYC requirements prescribed under the SEBI circular for EFIs and FPIs operating in the IFSC have been re-iterated in the guidelines.

## Segregation of accounts

- FPIs, who presently operate in Indian securities market and propose to operate in IFSC also, shall be required to ensure clear segregation of

funds and securities. Custodians shall, in turn, monitor compliance of this provision for their respective FPI clients.

- Further, such FPIs shall keep their respective custodians informed about their participation in IFSC.

## Our comments

The Guidelines were keenly awaited after the notification of the FPI Regulation, 2019 and are in line with the expectations of the market participants and the recommendations by the HR Khan Committee. The Guidelines provide various procedural clarifications which would make new FPI norms more robust and transparent. The Guidelines have simplified registration and KYC requirements and provided more clarity on the KYC documents that need to be collected for each category of FPIs, resulting in ease of access for FPIs in India. The Guidelines remove the broad-basing requirement, remove opaque structure restrictions for FPIs, liberalise conditions for hedging ODIs and allow appropriately regulated entities to invest on behalf of their clients. However, some of the industry asks relating to removal of restrictions on majority NRI holdings in FPI funds and less favourable treatment for non-FATF member jurisdictions from the perspective of registering as Category-I FPI continue to remain.

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