

# KYC norms for Foreign Portfolio Investors enhanced by SEBI

## Summary

The Securities Exchange Board of India (SEBI) had issued circular in September 2012<sup>1</sup> and September 2013<sup>2</sup> prescribing risk-based documentation requirement for eligible foreign investors. In continuation to those circulars, SEBI has recently released a circular<sup>3</sup> with enhanced Know Your Client (KYC) norms for Foreign Portfolio Investors (FPIs). SEBI's circular outlines a detailed framework to identify and report beneficial owners of FPIs.

## Salient features of the circular

### A. Identification and reporting of Beneficial Owners

- The circular defines Beneficial Owner (BO) as 'Natural Person(s)' who owns or controls an FPI and is identified in accordance with Prevention of Money-Laundering (Maintenance of Records) Rules, 2005 (PMLA Rules).
- As per the circular, BOs of corporate or trust structure FPIs should be identified on controlling ownership interest and control basis. In case of partnership firm and unincorporated association of individuals, BO should be identified on ownership or entitlement basis.
- The materiality threshold for BOs of FPIs on controlling ownership interest basis shall be 25 per cent in case of company and 15 per cent in case of partnership firm, trust and unincorporated association of persons.
- For identification of BO in respect of FPIs coming from 'high-risk jurisdictions', a lower materiality threshold of 10 per cent is applicable. SEBI has directed the intermediaries

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<sup>1</sup> SEBI circular No CIR/MIRSD/11/2012 dated 05 September 2012

<sup>2</sup> SEBI circular No. CIR/MIRSD/07/2013 dated 12 September 2013

<sup>3</sup> SEBI circular No. CIR/IMD/FPIC/CIR/P/2018/64 dated 10 April 2018

to ensure compliance the with Master Circular<sup>4</sup> which also provides guidelines for identification of High Risk Jurisdictions.

- The materiality threshold to identify BO to be applied at the FPI level and next look through principal to be applied only for BO with holdings equal and above materiality threshold in the FPI.
- In case no material owner is identified in the FPI using materiality threshold for controlling ownership interest basis and control basis (for companies and trusts), the senior managing official shall be considered as the BO.
- FPIs set-up as companies/ trusts and represented by service providers like lawyers/ accountants, etc. will need to provide information of the real owners/ effective controllers of those companies / trusts.
- In case control is exercised by BO through means like voting rights, agreements, arrangement, etc., the same should also be specified. It is also clarified that BO should not be a nominee of another person.
- BO should not be:
  1. A person mentioned in United Nations Security Council's Sanctions List;
  2. From a jurisdiction which is identified in the public statement of Financial Action Task Force (FATF) as:
    - a. A jurisdiction having a strategic Anti-Money Laundering or Combating the Financing of Terrorism deficiencies to which counter measures apply; or
    - b. A 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.

## **B. Format for reporting of BOs**

- Category II and III FPIs are required to provide following information in respect of their BOs:
  - i. Name and address of the Beneficial Owner (ie. natural person)
  - ii. Date of Birth
  - iii. Tax Residency Jurisdiction
  - iv. Nationality

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<sup>4</sup> SEBI Master Circular No. CIR/ISD/AML/3/2010 dated 31 December 2010

- v. Whether acting along or together through one or more natural persons as group with their name & address
  - vi. BO Group's percentage shareholding/Capital/Profit ownership in the FPIs
  - vii. Tax Residency Number/ Social Security Number/ Passport Number
- The above information is required to be certified by FPI along with confirmation that there are no other BOs other than those reported.

The existing FPIs are given a period of six months from the date of this circular to provide information of BO in the prescribed format.

### **C. Indians as BO of FPIs**

- The circular clarifies that Non-Resident Indians (NRIs) /Overseas Citizen of India (OCI) and Resident Indians cannot be a BO of an FPI. However, an exception is given to an FPI promoted by NRIs/ OCIs if it is a category II investment manager of other FPIs and is a non-investing entity.
- All existing FPI structures which do not meet the above requirement of BO are prohibited to create fresh position in derivatives at the end of expiry of April 2018 derivative contracts. Hence, FPIs will have to unwind their position in derivative segment on or before 26 April 2018 if their BO are not in accordance with framework prescribed in the circular.
- A period of six months from the date of this circular has been provided to existing FPIs to align their structure in line with the circular or close their existing position in Indian securities market.

### **D. Bearer share structure**

- It needs to be ensured that FPI or their BOs identified on the basis of aforementioned thresholds have not issued any bearer shares, or
- If the legal constitution of FPIs or their BOs permit issue of bearer shares, then the FPIs shall certify that they have not issued, do not maintain and will not issue any bearer shares to their investors.

A period of six months from the date of this circular has been provided to ensure compliance with this requirement.

## **E. KYC Review**

Presently, KYC review is required as and when there is change in material information/disclosure. As per the circular, KYC review of FPIs should be on periodical basis based on risk categorisation of FPIs. KYC review of high-risk clients should be done on annual basis and for all other clients, KYC review should be conducted every 3 years.

## **F. KYC documentation for Category III FPI**

- It has been clarified that Audited Annual financial statement or a certificate from auditor certifying net-worth will suffice for 'Financial Data' which is required to be obtained from category III FPI. In case of new funds/companies/family offices, audited financial statement of promoter person may be obtained.
- It has been clarified that prospectus and information memorandum will be acceptable in lieu of official constitutional documents.

## **G. Exempted documents to be provided during investigations/ enquiry**

- As per circular dated 12 September 2013<sup>2</sup>, SEBI has exempted FPIs from furnishing certain supporting KYC documents depending on risk involved. It has been prescribed that FPIs should submit an undertaking to Custodians/DPP that the relevant documents would be provided upon demand by Regulators/ Law Enforcement Agencies.
- SEBI vide circular dated 12 September 2013 had exempted Category III FPIs from submission of proof of address of BOs, Senior Management and Authorised Signatories. Considering Category III FPIs are high-risk investors, SEBI has decided that a "declaration on letter head" be provided by FPIs.

A period of six months from date of this circular has been provided to ensure compliance with this requirement.

## **H. Clubbing of investment limit for FPIs**

- It has been specified that clubbing of investment limit for FPIs shall be on the basis of BO identified as per the circular.
- Accordingly, a period of six months from the date of this circular has been provided to ensure compliance by all existing FPIs whose clubbed investment in equity share of a company is not in accordance with Regulation 21(7).
- In respect of any future breach of clubbing limit, below two options are provided:

- The said investments shall be treated as Foreign Direct Investment from the date of breach, or,
- FPI in breach shall have to divest its holding within five trading days from the date of settlement of the trades to bring its shareholding below 10 per cent of the paid up capital of the company.

## Our comments

The circular came as a surprise considering recent circulars issued by SEBI wherein entry norms and compliance requirements were relaxed for foreign investors. Although the circular provides a detailed guideline for identification of BO, several terms used in the circular are open for interpretation.

Some of the issues that need further clarity from the Regulator are as under:

- Whether an investment manager (IM) will be considered as BO if it exercises control over management of an FPI, but does not hold any economic interest?
- Whether NRIs/OCIs can be appointed as senior management officials of an FPI if BO is not identified by ownership/control test?
- Whether NRIs/OCIs can be appointed as senior management official of an IM who exercises control over FPI?
- If custodian/DDP will be required to maintain their own list of high-risk jurisdictions, whether any further guidelines will be issued to avoid disparate lists by DDPs?



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