

Regulatory alert: SEBI overhauls FPI regulations

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Summary

The Securities and Exchange Board of India (SEBI), after considering recommendations of the working group set up under the chairmanship of Mr. H. R. Khan to review and redraft existing SEBI (Foreign Portfolio Investors) Regulations, 2014, has now notified the SEBI (Foreign Portfolio Investor) Regulation, 2019¹ (hereinafter referred to as the 'FPI Regulations 2019'). The FPI Regulation, 2019 comes into force with an immediate effect. Key changes made under the FPI Regulations 2019 include the following:

- Re-categorisation of FPIs in two categories instead of the erstwhile three categories
- Elimination of the broad-based eligibility criteria
- Relaxation in documentation and fulfilling KYC requirement for registration
- Rationalisation of the requirements for issuance and subscription of Offshore Derivative Instruments

Background

Foreign portfolio investors (FPI) have been investing in India under the SEBI (Foreign Portfolio Investor) Regulation, 2014.² The regulations underwent numerous changes over the years through circulars, operational guidelines, FAQs, etc. Therefore, a need was felt to undertake an extensive review of the existing FPI regime for consolidating and rationalising the FPI framework.

This led to setting up of a working group by Securities and Exchange Board of India (SEBI) under the chairmanship of Mr. H. R. Khan to review and redraft the existing SEBI (Foreign Portfolio Investors) Regulations, 2014. The working group submitted its report to SEBI on 24 May 2019.

Key highlights

The key amendment made by FPI Regulation, 2019 as compared with erstwhile regulations are as follows:

1. Re-categorisation of FPIs into two categories

FPI Regulation, 2019 now re-categorises FPIs into two categories - Category I and II as under (instead of the

three categories as stipulated by the erstwhile regulation)

Category I

Following FPIs are classified under Category I:

- Government and government-related investors, sovereign wealth funds, international or multilateral organisation or agencies³
- University funds and pension funds
- Appropriately regulated entities such as banks, insurance or reinsurance entities, asset management companies, investment managers/advisors, portfolio managers, broker dealers and swap dealers
- Entities from FATF member country which are as follows:
 - Appropriately regulated funds
 - Unregulated funds whose investment manager is appropriately regulated and registered as Category I FPI⁴

¹ vide the Notification dated 23 September 2019

² erstwhile under the SEBI (Foreign Institutional Investor) Regulation, 1995

³ including entities controlled or at least 75% directly or indirectly owned by such government or Government related investors

⁴ Provided that the investment manager undertakes the responsibility of all the acts of commission or omission of such unregulated fund

- University related endowments funds of universities in existence for more than 5 years
- Other entities which include:
 - Entities whose investment manager is from the FATF member country and such investment manager is registered as Category I FPI
 - Any entity of FATF member country of which at least 75% owned, directly or indirectly by another entity, which are eligible to be registered as Category I FPI

Category II

All other FPIs not eligible under Category I are eligible as a Category II FPI such as:

- Appropriately regulated funds not eligible as Category I FPI
- Endowments and foundations
- Charitable organisations
- Corporate bodies
- Family offices
- Individuals
- Unregulated funds in the form of limited partnership and trusts
- Appropriately regulated entities investing on behalf of their clients

The re-categorisation would provide significant relief and flexibility to FPIs mainly from KYC requirements perspective and relaxation from broad based criteria.

Existing FPIs registered with SEBI to be re-categorised by re-issue of certificates by their respective designated depository participants.

Central banks that are not members of the bank for international settlements would also now be eligible for registering as FPIs.

2. Removal of opaque structure condition

In the erstwhile framework, Designated Depository Participants (DDPs) were required to ensure that FPIs does not have an opaque structure⁵.

Given that the FPIs are required to provide information on their beneficial owners both on ownership as well as control basis, the opaque structure condition has been removed in the FPI Regulation, 2019.

3. Investments conditions and restrictions liberalised

The key amendment impacting investment conditions and restrictions applicable to FPIs are as under:

- The requirement of investment in shares, debentures and warrants issued by body corporate through primary and secondary markets is now done away
- Transactions between registered FPIs, who are multi investment manager structure of the same beneficial owner and have common PAN is now allowed without any approval
- Transactions to receive, hold and sell unlisted securities as referred at regulation 20(2) of FPI regulations, 2019 and transactions in unlisted securities received through involuntary corporate actions including a scheme of a merger or demerger. Such unlisted holdings to be treated as Foreign Direct Investments
- Purchase or sale transactions of illiquid or suspended or delisted securities permitted

4. Issuance of offshore derivatives instruments

FPI Regulation 2019 stipulates that FPIs registered as Category I FPI would be eligible to issue offshore derivative instruments to person eligible for registration as Category I FPI. However, such instruments are required to be issued after compliance with the 'know your client' norms as specified by the SEBI.

⁵ Opaque structure includes protected cell company, segregated cell company or equivalent, where the details of the ultimate beneficial owners are not accessible or where the beneficial owners are ring

fenced from each other or where the beneficial owners are ring fenced with regard to enforcement.

5. Offshore funds to invest only through FPI route

Earlier, offshore funds floated by Indian mutual funds could invest in the Indian capital markets on basis of no-objection certificate issued by SEBI⁶.

Now, such offshore funds would be required obtain registration as FPI within 180 days from the date of notification of FPI Regulation 2019, for investments in securities in India.

6. International Financial Services Centre (IFSC) related amendments

- Entities established/incorporated in the IFSC shall be deemed to be appropriately regulated entities
- Certain eligibility conditions applicable to FPIs not to apply to entities incorporated in IFSC

7. Surrender of FPI license

FPI Regulation, 2019 stipulates that an FPIs shall be deemed to have applied for surrender of its registration if:

- It does not pay the fees for continuance of registration within the prescribed due date **and**
- It does not have any cash or security balance

8. Process of divestment reviewed

Earlier, FPIs that no longer have valid registrations were required to seek approval for divestment of securities. This condition has been modified to mandate the FPIs to have an FPI registration if it has securities or derivative position in India.

Further, the FPI Regulation 2019 provides that the existing FPIs whose registration are not valid but are holding securities or derivatives position are allowed one year from the date of publication of FPI Regulation 2019 to sell securities or wind up their open positions in derivatives.

9. Revision in FPI registration fees

The registration fees have been revised as under:

Category	Earlier	Revised
Category I	Nil	USD 3,000*
Category II	USD 3,000	USD 300
Category III	USD 300	Not applicable

* The registration fee would not be payable by international or multilateral agencies such as World Bank and other institutions eligible for privileges or immunities from payment of tax and duties.

Our comments

The FPI Regulations are primarily in line with the expectations of the market participants. The amendments made in the FPI Regulations are a welcome move as it liberalises investment conditions and eligibility criteria thereby resulting in easy market access for FPIs.

While certain entities based out of non-FATF compliant countries may not be eligible for registration as Category I FPI, removal of the broad-based criteria for FPIs will provide comfort to a lot of funds, who after formation, could not meet the stringent conditions. Further, rationalisation of norms for issuance and subscription of offshore derivative instruments would create opportunity for FPIs to service clients favoring those instruments.

⁶ in terms of SEBI (Mutual Funds) Regulations, 1996

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