Regulatory Hotline

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STREAMLINING OF FPI FRAMEWORK: SEBI'S CONTINUED EFFORTS AND WHAT STILL REMAINS

BACKGROUND

In an attempt to facilitate the ease of doing business and to reduce the time taken for registration of Foreign Portfolio Investors ("**FPIs**") under the SEBI (Foreign Portfolio Investors) Regulations, 2019 ("**FPI Regulations**"), SEBI, in its board meeting held on December 20, 2022[1], has approved the simplification of certain procedural requirements for on boarding of FPIs. SEBI also recently released a Master Circular for FPIs, Designated Depository Participants ("**DDPs**") and Eligible Foreign Investors[2], wherein it collated the provisions of the operational guidelines and various circulars which were issued for FPIs.

APPROVALS BY SEBI

SEBI, in the board meeting permitted the DDPs to grant an FPI registration to an applicant based on the scanned copies of application forms and supporting documents. It is to be noted here that while granting of registration on the basis of scanned copies has been permitted, trading may only be activated post the verification of the physical documents. Previously, applicants were required to send both, scanned copies and physical documents of application forms and supporting documents to the DDP for procuring the FPI registration.

Further, making the registration process applicant friendly, DDPs have been permitted to accept digital signatures by FPIs, in accordance with the provisions of the Information Technology Act, 2000, for the execution of registration related documents. Prior to this introduction, applicants were required to sign the documents in wet ink and send the scanned and original copies to the DDP.

To reduce the physical movement of documents and the time taken for registration, authorized bank officials have been permitted to use SWIFT mechanism[3] for certification of copies of original documents submitted by FPIs.

Additionally, DDPs have been permitted to verify PAN through the CAF module available on their websites. This is expected to further reduce the time taken by DDPs for the opening of accounts. Earlier, DDPs could verify the PAN only after receiving a hard copy of the PAN from the applicant.

While earlier the FPI applicants were required to provide the complete details of the investor group constituents for the grouping of investors, the applicants have now been permitted to submit the unique investor group ID, generated by the NSDL portal, as it contains the details.

In addition to the above procedural changes, SEBI has also approved certain amendments to the various timelines provided in the FPI Regulations.

NDA VIEWS

The above steps by SEBI are a need of the hour for the FPI industry since the procedural leniencies proposed by SEBI would certainly aid the growing direct interest of foreign investors in the Indian listed market.

Having said the above, there still remain certain items that need the attention of SEBI, and we anticipate that SEBI or the FPI Advisory Committee[4] constituted by SEBI on August 5, 2022, would delve into these.

1. No general permission for off-market transfer

While the extant FPI framework allows off-market transfer of assets between FPIs operating under the MIM structure[5], permission has not been granted for transfer of assets between FPIs forming part of the same business group and / or investor group. Further, no general permission for off-market transfer has been granted to an FPI entity which wishes to relocate to another jurisdiction.

Thus, in a relocation scenario, the FPI entity may divest its shareholding in the investee company(ies) and post relocation, re-purchase the shares in the open market; and in the case of transfer of assets to a group entity, it may carry out such transaction through a block or a bulk deal only.

2. Ambiguity regarding declaration of Beneficial Owner by Control

There is no clarity while identifying the 'beneficial owner by control' under 'Annexure to CAF' form. While certain custodians require an applicant to identify only natural persons as the beneficial owner by control, others require the applicant to identify both, natural and artificial persons as beneficial owner by control. A clarification in this regard would be helpful and will bring uniformity across the table.

3. Ambiguity regarding scope of Material Change

Regulation 22(1)(c) of the FPI Regulations requires the FPIs to inform SEBI and DDP of any material change in information. In this regard, while paragraph 14(i) of Part A of the Master Circular specifies the broad parameters of 'material change', this at times causes confusion amongst the investors with regard to the ambit of disclosure of change required under the FPI Regulations and guidelines. For instance, it is unclear whether 0.1% change in the ownership of an investor would be considered a material change and therefore, required to be intimated to the DDP.

4. Investment caps on NRI / OCI investment

While Regulation 4(c) of the FPI Regulations subjects Non-Resident Indians ("**NRIs**") and Overseas Citizens of India ("**OCIs**") being constituents of an FPI to certain conditions, the Master Circular sets out individual and aggregate caps of 25% and 50% respectively on contribution by NRIs and OCIs into an FPI's corpus[6].Although, Schedule 3 of the Foreign Exchange Management (Non-debt Instruments) Rules, 2019 permits NRIs to invest in listed Indian entities under the PIS route, it caps the investments to 5% and 10% of the individual and aggregate exposures, respectively.

In light of the above investment cap and considering the increased Know Your Customer and due diligence measures casted upon any FPI, including NRIs and OCIs, by SEBI, we suggest that the threshold for NRI/OCI contribution in an FPI be increased or further relaxed. This will help India attract more forex from NRIs/OCIs.

5. Eligibility towards subscription to ODIs

While Regulation 21(1)(b) of the FPI Regulations permits 'persons eligible for registration as Category I FPIs to subscribe to Offshore Derivative Instruments ("**ODIs**"), there is no clarity on whether a Category II FPI registered with SEBI, but eligible for registration as a Category I FPI, may subscribe to ODIs, or such Category II FPI would have to first surrender its Category II license and then subscribe to ODIs.

The above are few of the ambiguities and limitations prevailing under the extant FPI regulatory framework, the resolution of which would further broaden the scope of having increased FPI participation in our ever-expanding listed space.

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You can direct your queries or comments to the authors

[1] PR No. 37/2022, available at https://www.sebi.gov.in/media/press-releases/dec-2022/sebi-board-meeting_66407.html

[2] Circular No. SEBI/HO/AFD-2/CIR/P/2022/175 dated December 19, 2022, Available at https://www.sebi.gov.in/legal/master-circulars/dec-2022/master-circular-for-foreign-portfolio-investors-designated-depository-participants-and-eligible-foreign-investors_66356.html

[3] SWIFT is the messaging network used by financial institutions such as banks to securely send and receive information, such as money transfer instructions to and from clients. The DDPs may use this mechanism to receive secure instructions of certification of copies of original documents from the applicants.

[4] The FPI Advisory Committee was constituted by SEBI on August 5, 2022 for the facilitation of FPI investments.

[5] Paragraph 3 (Off-Market transfer of securities), of Part C of the Master Circular.

[6] Paragraph 1 (ii) (Guidance for Processing of FPI applications by DDPs), of Part A of the Master Circular.

Scope of judicial interference and inquiry in an application for appointment of arbitrator under the (Indian) Arbitration and Conciliation Act, 1996

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