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FOREIGN PORTFOLIO INVESTORS: SEBI MOVES A STEP CLOSER TO REFURBISHING FPI NORMS

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Introduction

In a bout of relief to foreign portfolio investors (FPIs), the Securities and Exchange of India (SEBI) in its board meeting on 21 August 2019 (Board Meeting) has given its nod of approval to the recommendations made by the HR Khan Committee report published on 24 May 2019 (Report) (Please see our ERGO on the Report here). This Newsflash deals exclusively with those aspects of the Board Meeting that are applicable to FPIs.

Impact of the Board Meeting on FPIs

The following are the key proposed changes highlighted in the Board Meeting minutes issued by SEBI:

1. *Broad-based criteria for Institutional Foreign Investors:* Since the categories of investors have been broadly split into two, instead of the earlier three categories for FPI registration, based on the regulated requirements of the relevant entities, a need was also felt to review the broad based criteria for regulated entities coming from compliant jurisdictions. Under the proposal, the broad-based eligibility criteria applicable to foreign institutional investors has been done away, with a view to simplify and expedite the registration process and bring about ease in compliance requirements for FPIs.

   Since during the registration process, substantial time was taken to ascertain whether the applicant entity fulfilled the broad-based criteria, the removal of the same is expected to fasten the registration process.

2. *Recategorisation of FPIs into 2 categories:* While the initial Report does not explicitly recommend the recategorisation of FPIs, in the Board Meeting, SEBI has indicated reorganising FPIs into two categories only, Category I and Category II FPIs. Such reorganisation may be based on a review of the risk profiling of the FPIs and could make a deep impact on the FPI regime.

   It appears that with the removal of the broad-based criteria (which was one of the most important criteria differentiating Category II and Category III FPIs), rationalisation of criteria would be necessary. Hence, all regulated entities would go under Category I and all others would fall under Category II thereby resulting in simplification for investors. However, one will have to wait for the fine print of the regulations to ascertain the extent of reclassification and its impact on the applicable investment restrictions, Qualified Institutional Buyer status, relief from indirect taxation, impact on FPI investments by NRIs and OCIs and other conditionalities.

3. *Rationalisation of Registration for Multiple Investment Manager accounts:* Registrations for Multiple Investment Managers (MIM) accounts has been simplified. Under the earlier regime, the same legal entity was required to obtain multiple registrations. As highlighted in the Report, the rationale behind this is that where an entity has already furnished details to a Designated Depository Participant (DDP) at the time of its registration and if there is no change, then the entity need not provide these details again for subsequent registration.

    The rationalisation of the registration for MIM accounts will reduce the registration timelines. University Funds and Family Offices who use MIM structures should welcome this move.

4. *Relaxation for Central Banks from Non-BIS Countries:* Central Banks of foreign countries that are not members of the Bank for International Settlements (BIS) will also now be eligible for FPI registration.

    The relaxation for Central Banks from Non-BIS Countries will ensure that Central Banks that are essentially Government related entities being low risk and long-term investors will also be eligible for FPI registration.

5. *IFSC deemed to meet jurisdiction criteria:* SEBI has clarified that FPIs set up in the International Financial Services Centre (IFSC) shall be deemed to meet the jurisdiction criteria under the FPI Regulations.

    The clarification on IFSC is in line with SEBI's overall endeavours to bring clarity and parity to the IFSC regime. This could pave way for IFSC based FPIs going forward and perhaps more onshoring of asset management.

6. *Simplification of KYC Documents:* Documentation requirements for KYC will be simplified. In this respect, the Report had suggested several steps *inter alia* reliance on group entities KYC for non-PAN related KYC documents, relaxation of self-certification of KYC documents, acceptance of certificate issued by DDP in favour of the FPI as address proof and verification of PAN by the DDP on the income tax department website for account opening. The details of such simplifications and extent of acceptance of the recommendations made under the Report can be assessed once the official revised regulations are released.

    The simplification of KYC should significantly reduce the processing time and other incidental hassles such as consularisation, etc.

7. *Off-market Transactions*: In order to enable FPIs to offload any unlisted, suspended or illiquid securities, SEBI has now permitted FPIs to transfer such securities off-market. While the Report proposed authorising such off-market transactions between FPIs and domestic investors only, SEBI seems to have provided further flexibility by giving a green light to such off-market transactions with foreign investors as well.

    Enabling FPIs to offload any unlisted, suspended or illiquid securities will allow FPIs to dispose of deadweight securities more easily, thereby providing increased liquidity and would do away with the need to get prior approval for off market transactions and possibly also result in the reduction of transaction costs.

8. *Offshore Funds by Indian Mutual Funds*: While the offshore funds (OFO) structures with a dedicated Indian mutual fund scheme have been defunct since almost a decade, in a possible attempt to officially do away with such

structures, the Report had recommended to make it compulsory for all OFOs floated by Indian Mutual Funds to obtain an FPI registration. As highlighted in the Report, this should imply that such offshore funds which invest in a scheme of a mutual fund, as well as such scheme of the mutual fund, must comply with the FPI Regulations.

The applicability of the being a '*broad based fund*' as per the SEBI (Mutual Fund) Regulations, 1996, *viz*, having at least 20 investors and no single investor holding more than 25% of the corpus of such OFOs, continues to remain unclear. One hopes that the detailed revised regulations will dispense the cloud of confusion around such structures.

9. *Rationaliation of Offshore Derivative Instruments*: While the Report included 4 recommendations pertaining to Offshore Derivative Instruments (ODIs), SEBI has very briefly only indicated rationalisation of requirements for issuance and subscription of ODIs. The Report sought clarity as to what is covered under the ambit of '*ODIs with derivative as underlying*', recommending that it be defined to mean ODIs hedged directly or indirectly on a one to one basis or portfolio basis in derivatives listed in India. The Report also proposed that ODIs hedged on portfolio basis should be included in ODI monthly statement and amendment of the monthly ODI reporting format and monthly ODI statement disseminated to SEBI.

While the regulator has been apprehensive about the usage of ODIs, the decision to rationalise the ODI framework could be aimed at reducing the arbitrage between the direct investment route and ODIs.

Conclusions

While it is difficult to comment on the extent of the real impact to the already jittery FPI industry, SEBI seems to have rolled it sleeves to overhaul the existing FPI regime and bring in a friendlier and less cumbersome set of regulations. The most striking announcement appears to be the reshuffling of the categories of the FPIs, which could, depending on how it pans out, have the potential of impacting the existing as well as future FPIs. It is imperative to bear in mind that these announcements are based on the minutes of the SEBI board meeting read with the Report and the granular details in the implementation of these decisions can be examined only after the amendment to the FPI Regulations have been notified.

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