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Markets regulator implements amendments to FPI access norms

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The Securities and Exchange Board of India (SEBI) on 15 February notified certain amendments to the SEBI (Foreign Portfolio Investors) Regulations, 2014, by way of a circular, which effected several reforms to facilitate participation of foreign portfolio investors (FPIs) in the country's capital markets. Some of the important changes introduced are as follows:

Simplification of procedure for change in local custodian. FPIs will not need the prior consent of SEBI to change local custodians and designated depository participants (DDPs). The amendment recognizes that registered FPIs access the Indian securities market through global custodians. In such a scenario, the FPI appoints the global custodian, which in turn appoints a local/sub-custodian in India. Operationally, the global custodian represents all its FPI clients and engages with the local custodian. Having regard to this, SEBI has decided to permit a change in local custodian without its prior consent. The new local custodian/DDP must be permitted to rely on a letter issued by the global custodian regarding the change in local custodian of its FPI clients. However, the transferor local custodian/DDP will need to provide a no objection certificate to the transferee local custodian/DDP for change of local custodian.

Free of cost transfer of assets. Free of cost (FOC) transfer of assets was permitted for FPIs under the erstwhile position, in situations where the transferor and transferee FPIs have exactly the same beneficial owners. However, any such requests for an FOC transfer of assets by the FPI along with list of securities intended to be transferred, were required to be forwarded by DDPs to SEBI for approval.

As per the amendments, such requests can now be processed directly by DDPs in cases where there is a multiple investment managers (MIM) structure. However, any FOC request for non-MIM structure that arises out of a complex restructuring exercise or mergers must be forwarded by DDPs to SEBI for approval.

Certain other changes had been discussed and referred to in the past consultation papers released by SEBI, but amendments in respect of such changes have not been introduced by way of the circular. Some of the significant proposals in this regard are:

Rationalization of 'fit and proper' criteria for FPI registration. As per the current eligibility criteria laid down for registration of FPIs under the FPI Regulations, an FPI is required to establish that: (i) it is authorized by its memorandum of association and articles of association or equivalent documents, or the agreement to invest on its own or on behalf of its clients; (ii) it has sufficient experience, good track record, is professionally competent, financially sound and has a generally good reputation of fairness and integrity; (iii) the grant of certificate to the applicant is in the interest of the development of the securities market; and (iv) it is a fit and proper person based on the criteria specified in Schedule II of the SEBI (Intermediaries) Regulations, 2008.

The proposal discussed in a December 2017 press release was to amend the regulations to provide that entities seeking registration as a category I or category II FPI would only need to comply with (iv) above. Another important change proposed is to cast the obligation on the FPI as well to ensure that it meets the "fit and proper" criteria at all times, as opposed to the position under the extant regulations, as per which the obligation for ensuring compliance with the eligibility criteria is cast on the DDP alone.

Simplification of 'broad based criteria' requirements. If an FPI applicant has a bank as an underlying investor, such FPI will be deemed to be broad based for the purpose of FPI regulations as a bank is considered to be an institutional investor. In the press release, it was proposed to extend this rationale in other cases, where applicant funds have other institutional investors such as sovereign wealth funds, insurance/reinsurance companies, pension funds, exchange traded funds as their underlying investors.

The press release discussed a proposal to provide open-ended funds registered as category II FPIs a time period of three months to regain broad based status if their number of investors falls below 20. This enables such entities to continue their operations and bring in new investors that will enable them to fulfil the broad-based criteria within the given timeframe.

The business law digest is compiled by Nishith Desai Associates (NDA). NDA is a research-based international law firm with offices in Mumbai, New Delhi, Bengaluru, Singapore, Silicon Valley, Munich and New York. It specializes in strategic legal, regulatory and tax advice coupled with industry expertise in an integrated manner.