

GIFT City Express

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RELIEF FOR NRI, OCI AND RI INVESTORS: SEBI ALLOWS INCREASED PARTICIPATION IN GIFT IFSC BASED FPIs

- SEBI approves regulatory framework for increased participation of specified investors in IFSC based FPIs.
- IFSCA issues a circular for facilitation of such investments.

INTRODUCTION

The Securities and Exchange Board of India ("SEBI") in its board meeting held on April 30, 2024, ("Board Meeting") approved the regulatory framework for increased participation by Non-Resident Indians ("NRIs"), Overseas Citizens of India ("OCIs") and Resident Indian ("RI") individuals (NRIs, OCIs and RIs, together read as "Permitted Investors") in the corpus of Foreign Portfolio Investors ("FPIs") based out of the International Financial Services Centres ("IFSC") in India, which are regulated by the International Financial Services Centres Authority ("IFSCA"). Pursuant to the Board Meeting, SEBI issued a Press Release¹ ("PR") elaborating upon the approvals made during the meeting. Subsequently, IFSCA released a circular on May 02, 2024 ("IFSCA Circular"), and now a circular from SEBI laying down the specifics is awaited.

A Consultation Paper² ("CP"), inviting comments from the public was also released by SEBI on this subject in August last year.

CURRENT REGULATORY FRAMEWORK

The SEBI (Foreign Portfolio Investors), Regulations, 2019³ ("FPI Regulations"), read with the Master Circular for FPIs, Designated Depository Participants ("DDPs") and Eligible Foreign Investors ("EFIs")⁴ ("Master Circular") broadly regulate FPIs and govern FPI investments in India. Under the current framework, the Permitted Investors are not eligible to be FPI applicants, although they are permitted to be constituents of FPIs subject to compliance with the following conditions:

Individual and Aggregate Cap: While the contribution of a single NRI/OCI/RI is capped at less than 25% of the total corpus of the FPI, the aggregate contribution has been restricted to below 50% of the FPI corpus.

Control: Permitted Investors are barred from exercising control⁵ over the FPI, subject to certain conditions, including if the FPI's manager is appropriately regulated and registered as a non-investing FPI with SEBI.

APPROVED REGULATORY FRAMEWORK

SEBI approved the availability of 100% contribution limit for Permitted Investors investing in an FPI based out of IFSC, subject to the condition that the copies of Permanent Account Number ("PAN") cards of all such Permitted Investors, identified on a look through basis, along with their economic interests in the FPI are submitted with the respective DDP. In case the individual does not have a PAN, then a declaration to the effect, along with the copies of prescribed identity documents, viz., Indian passport, OCI Card, Aadhaar Card, etc. ("ID Documents"), should be furnished to the DDP by the FPI. ("Route 1")

- Alternatively, IFSC based FPIs have the option of not providing any of the above-mentioned documentation if they fulfill the following conditions ("Route 2"): The IM satisfies the FME eligibility requirements, as specified by SEBI.
- The IM takes the investment decisions independently, with no say of the investors.
- The contributions are pooled in a single FPI vehicle, with no side vehicles.
- The FPI should have a common portfolio, with the investors having *pari passu* and *pro rata* rights in the FPI.
- The FPI should have at least 20 investors and none of the investors should hold more than 25% stake in its corpus.
- The FPI should not invest more than 20% of its corpus in the equity shares of a single Indian investee company.
- The IM should be an AMC of a SEBI registered mutual fund, sponsored by an RBI regulated bank or its IFSC based subsidiary/branch.

ADDITIONAL DISCLOSURE REQUIREMENTS

SEBI, vide a circular dated August 24, 2023⁶ ("Additional Disclosure Circular"), mandated certain objectively identified FPIs to provide granular details of all entities holding any ownership, economic interest, or exercising

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control in the FPI, on a full look through basis, up to the level of all natural persons, without any threshold, to their respective DDPs. The Additional Disclosure Circular and the Standard Operating Procedure (“SOP”) issued pursuant to it, prescribe the conditions for identification of FPIs required to make the additional disclosures. They further specify the list of exemptions that may be availed by identified FPIs for not submitting additional disclosures.

For FPIs based out of IFSC, SEBI has approved the following criteria for identifying the FPIs required to make the additional disclosures.

| S. No. | Objective criteria applicable to FPIs based out of IFSC | Objective criteria applicable to other FPIs |
|--------|---------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------|
| 1 | FPIs holding more than 33% of their Indian equity Assets under Management (AUM) in a single Indian corporate group. | FPIs holding more than 50% of their Indian equity AUM in a single Indian corporate group. |
| 2 | FPIs along with their investor group holding more than INR 25,000 crore of equity AUM in the Indian markets. | FPIs that individually, or along with their investor group, holding more than INR 25,000 crore of equity AUM in the Indian markets. |

NDA VIEWS

The extent of participation of NRIs/ OCIs in an FPI has been a topic of constant debate. The ones advocating for their greater participation argue that they should get a fair share of the investment pie given to the overseas investors, while the ones on the opposite side cite historical instances of untapped money flowing into India and market manipulation activities. Be that as it may, none would disagree that if the restricted monies of the NRIs/ OCIs are permitted to flow into the Indian listed market, it would certainly benefit the already bullish Indian listed market.

As regards the merits of the proposals approved by SEBI and the resulting IFSCA circular, while it provides more than a silver lining to the NRIs/ OCIs, the relaxation comes at its own costs and misses. For instance, an FPI in GIFT IFSC would be required to obtain an FME registration and a Cat III AIF license as well. Interestingly, the Ministry of Finance has exempted non-resident investors (including NRIs/OCIs) of certain Cat III AIFs from obtaining a PAN, where such investors do not earn any income in India, other than the income from investment in the CAT III AIF in GIFT IFSC. Thus, the identification condition imposed by SEBI does not seem to be in consonance with what is generally applicable to NRIs/ OCIs. Moreover, since such KYC requirement is irrespective of the participation threshold of an NRI/ OCI, it goes beyond the normal requisites of the typical KYC done on an FPI wherein the BO identification and disclosure is required.

SEBI has also mandated the PAN/ ID Documents submission of the NRI/OCI/RI individuals identified on a look through basis, i.e., if the participation in an FPI is through entity(ies). The PR stipulates that if the FPI feeder entity is majority contributed/owned/controlled by NRIs/OCIs/RIs, then full disclosure of all such NRIs/OCIs/RIs would be required. We believe that a more effective way would have been to see the contribution/ control/ ownership at the FPI level and not the feeder level. Further, how to look at minor aggregate investments through several feeder entities, and how to track and disclose NRI/OCI/RI participation in a listed feeder entity would have to be seen.

Few conditions provided for exemption from the disclosure requirements, viz., investor broad basing and having a blind pool structure with no co-investment rights, seem to give a flavor that the FPI fund should be one akin to a public retail fund. Further, the investment diversification criterion is not aligned with the IFSCA framework for funds categorized as Cat III AIFs. Moreover, the foregoing requirement under the PR and IFSCA Circular seem to say different things. Additionally, the condition for the IM to be an RBI regulated bank’s sponsored AMC closes the door for a significant number of FPIs intending to receive NRI/OCI capital.

Lastly, since the IM would be a Registered FME in GIFT IFSC, we believe that IFSCA, similar to what has been done for portfolio managers, family investment funds, etc. should come out with lighter touch regulations for Registered FMEs who launch schemes registered as FPIs. Such regulations can be included as a separate chapter within the FME Regulations.

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You can direct your queries or comments to the authors.

¹https://www.sebi.gov.in/media-and-notifications/press-releases/apr-2024/sebi-board-meeting_83115.html

²https://www.sebi.gov.in/reports-and-statistics/reports/aug-2023/consultation-paper-on-permitting-increased-participation-of-non-resident-indians-nris-and-overseas-citizens-of-india-ocis-into-sebi-registered-foreign-portfolio-investors-fpis-based-out-of-int-_75915.html

³https://www.sebi.gov.in/legal/regulations/aug-2023/securities-and-exchange-board-of-india-foreign-portfolio-investors-regulations-2019-last-amended-on-august-10-2023-_75747.html

⁴https://www.sebi.gov.in/legal/master-circulars/dec-2022/master-circular-for-foreign-portfolio-investors-designated-depository-participants-and-eligible-foreign-investors_66356.html

⁵Regulation 2(1)(f) of the FPI Regulations defines 'control' to include the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of shareholding or management rights or shareholders agreements or voting agreements or in any other manner.

⁶https://www.sebi.gov.in/legal/circulars/aug-2023/mandating-additional-disclosures-by-foreign-portfolio-investors-fpis-that-fulfil-certain-objective-criteria_75886.html

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