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**THE FPI REGULATIONS 2019: NEW REGIME AND RELAXATIONS**

**1. INTRODUCTION**

In order to address the requirements of the evolving securities market, the Securities and Exchange Board of India (“SEBI”) had constituted a working group under the chairmanship of Dr. Harun R. Khan to review the regulatory framework for foreign portfolio investors (“FPIs”).

Based on the recommendations of the working group, SEBI has notified the SEBI (Foreign Portfolio Investors) Regulations, 2019 (the “**Regulations**”) on September 23, 2019, in supersession of the SEBI (Foreign Portfolio Investors) Regulations, 2014.<sup>1</sup>

In addition to consolidating various guidelines and circulars issued over the years, the Regulations have also refreshed and updated the regulatory regime for FPIs in terms of registration, classification as well as investment conditions.

**2. KEY ASPECTS**

The key changes are discussed below.

**2.1. Eligibility for Registration as a Foreign Portfolio Investor**

Since the inception of the foreign institutional investors’ regime in India, ‘broad based’ criteria, in which at least twenty investors were required to establish a fund, had been one of the conditions to be complied by a fund desirous of making investments in India.

Over a period of time, SEBI had granted various relaxations from this condition. Keeping in mind the evolved regulatory framework and to reduce complexities for the funds, the Regulations have now removed this requirement completely, and the focus has shifted to ‘appropriately regulated’ fund or investment manager and identification of beneficial ownership.

Further, entities incorporated or established in international financial services centre are also deemed to have met the jurisdiction criteria for seeking registration as FPI. However, all other FPI eligibility conditions have to be fully met for such entities as well as their beneficial owners.

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<sup>1</sup>[https://www.sebi.gov.in/legal/regulations/sep-2019/securities-and-exchange-board-of-india-foreign-portfolio-investors-regulations-2019\\_44436.html](https://www.sebi.gov.in/legal/regulations/sep-2019/securities-and-exchange-board-of-india-foreign-portfolio-investors-regulations-2019_44436.html)

Putting an end to regulatory uncertainty regarding non-resident Indians, overseas citizens of India and resident individuals holding stake in an FPI, the Regulations also expressly permit non-resident Indians or overseas citizens of India or resident Indian individuals to be constituents of the applicant provided they meet conditions specified by the SEBI.

## 2.2. Categories of Foreign Portfolio Investors

The previous framework provided for a risk based classification of FPIs into three categories. Category I investors consisted of heavily regulated entities such as government and government-related investors and were considered as low-risk investors. Category II investors were less regulated and considered medium-risk investors and category III investors were least regulated and therefore considered as high-risk investors.

The KYC norms/compliance burden had accordingly varied, the least burden being on category I investors and maximum burden being on category III investors.

The Regulations now provide for FPI registration under two categories. Category-III has been done away with, while some entities have been moved to category II and few entities have been moved from category II to category I.

The following entities have been added to category-I:

- (a) pension funds and university funds;
- (b) appropriately regulated entities such as insurance or reinsurance entities, banks, asset management companies, investment managers, investment advisors, portfolio managers, broker dealers and swap dealers;
- (c) entities from the Financial Action Task Force (“FATF”) member countries if they are appropriately regulated funds, or unregulated funds whose investment manager is appropriately regulated and registered as a category I FPI, or university related endowments of such universities that have been in existence for more than 5 years;
- (d) an entity (i) whose investment manager is from the FATF member country and such an investment manager is a category I registered FPI; or (ii) which is at least seventy-five per cent owned, directly or indirectly by another entity, eligible for registration under (a), (b) and (c) and such an eligible entity is from a Financial Action Task Force member country:

Provided that such an investment manager or eligible entity undertakes the responsibility of all the acts of commission or omission of the applicants seeking registration under this sub-clause.

Entities in (a) and (b) were eligible for registration under category II under the previous regime.

The Regulations have classified category II FPIs as appropriately regulated funds or other investors not eligible under category I FPIs such as endowments and foundations; charitable organizations; corporate bodies; family offices; individuals; appropriately regulated entities investing on behalf of their client; and unregulated funds in the form of limited partnership and trusts.

Further, the Regulations require that the offshore funds floated by Indian mutual funds, seeking to invest in securities in India, must be registered as a FPI.

### 2.3 Investment Restrictions

Previously, FPIs could only invest in 'shares, debentures and warrants of a company' which resulted in the exclusion of instruments issued by statutory bodies. To do away with the issue, the Regulations have substituted the word 'company' to 'body corporate'.

Certain securities such as treasury bills, commercial papers issued by an Indian company, rupee denominated credit enhanced bonds among others have been removed since they were already covered under instruments permitted by SEBI or RBI.

A previous circular by SEBI allowed FPIs to invest in real estate investment trusts, infrastructure investment trusts and units of category III alternative investment funds, which have also found its place in the Regulations.

Regulation 20(1)(g) of the Regulations provides that the investment may be in "*any debt securities or other instruments as permitted by the Reserve Bank of India for foreign portfolio investors to invest in from time to time*". This allows inclusion of new categories of debt instruments to be under the purview of the regulations without the requirement to have any amendments.

FPIs need not invest through a stock broker for the following securities:

- (a) transactions to receive, hold and sell unlisted securities to be listed and transactions in unlisted securities received through involuntary corporate actions such as a scheme of a merger in accordance with the provisions of the Companies Act, 2013 and SEBI guidelines or resolution plan under the Insolvency and Bankruptcy Code, 2016 or guidelines issued by the Government of India or RBI or any other regulator for a scheme of debt resolution;
- (b) transactions for transfer of right entitlements;
- (c) purchase or sale transactions of illiquid or suspended or delisted securities by a FPI;
- (d) transactions between registered FPIs, who are multi investment manager structure of the same beneficial owner and have common permanent account number;

The Regulations have changed the investment limit of a FPI or its investment group from '10% of total issued capital' to '10% of total paid-up equity capital on a fully diluted basis' of the company, making the requirement consistent with the regulations prescribed by the RBI.

## 2.4 General obligations and responsibilities of Foreign Portfolio Investors

The Regulations have removed the previous requirement of express declarations or undertakings as required by the designated depository participant, to reduce the regulatory burden.

Investor group for the purpose of 10% investment limit has been defined as “*multiple entities registered as foreign portfolio investors and directly or indirectly, having common ownership of more than 50% or common control*” and is considered as a single investor.

Upon crossing the 10% investment limit, the FPI or its investor group is required to disinvest within 5 trading days from the date of settlement of the trades. Upon failure to do the same, the investment will be considered as a foreign direct investment and the FPI or its investor group would not be allowed to make further portfolio investment in the company. This is consistent with the requirements prescribed by the RBI.

## 2.5 Prohibition against having an Opaque Structure

Previously, FPIs having an opaque structure were not allowed to make portfolio investments in India. An opaque structure was defined as

*“(i) 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, or (ii) where applicant or its investor(s) identified on basis of threshold for identification of beneficial owner have issued any bearer shares or maintain any outstanding bearer shares”.*

This prohibition on opaque structure was needed to be removed as

- (a) SEBI’s circular on September 21, 2018 mandated the disclosure of beneficial owners so the details of the ultimate beneficial owners were always accessible.
- (b) Further, even in India the assets or liabilities of one scheme are ring fenced against the other scheme of a mutual fund or alternative investment fund, however a prohibition against portfolio investments was imposed on the foreign entities having the same structure.

The Regulations have removed the prohibition against FPIs who have an opaque structure.

### **INDUSLAW VIEW**

The changes have been brought to bring a harmonized model of foreign investments under the FPI route to reduce the complexity of earlier regime and encourage growth in foreign portfolio flows into India.

The Regulations have relaxed the eligibility criteria for FPIs and have unlocked the route of foreign portfolio investment to a new set of entities by removing the broad based criteria and the prohibition on opaque structures.

The issue of FPIs getting stuck with their holding as they could not sell the same on the exchange, due to liquidity or credit of the securities has also been addressed by permitting FPIs to make off-market transfer of securities.

The Regulations simplify and expedite the registration process as well as bring ease in compliance requirements of FPIs.

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