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SEBI Notifies A New Framework For Foreign Portfolio Investors

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The market regulator notified the new rules categorising foreign portfolio investors in two buckets as opposed to three today, besides easing norms for investment in offshore derivative instruments. To invest in Indian markets, FPIs need to register with the Securities and Exchange Board of India and were divided into three categories based on their risk profile and the consequent know-your-customer requirements. Category I included government entities. Category II included regulated broad-based funds. Endowments, charitable societies, foundations, family offices fell under Category III.

Following the board decisions last month, SEBI reduced the number of categories to two:

Category I will now include governments and government-related investors such as central banks, sovereign wealth funds; pension and university funds; regulated entities such as insurance entities, banks, portfolio managers, broker dealers and swap dealers etc.; entities from the Financial Action Task Force member countries which are appropriately regulated.

Most importantly, any entity whose investment manager is from a FATF jurisdiction or is at least 75 percent owned or controlled by any of the other entities that come under Category 1 will fall under this bucket.

This means funds based in Mauritius and Cayman Islands—which are not FATF jurisdictions—can also qualify as Category I as long as the above two conditions are met, Divaspati Singh, partner at Khaitan & Co., said.

Category II will include appropriately regulated funds not eligible as Category I FPI, endowments and foundations, charitable organisations, corporate bodies, family offices, individuals, appropriately regulated entities investing on behalf of their client, unregulated funds in the form of limited partnership and trusts etc.

As indicated by the SEBI board last month, the broad-based criteria for FPIs has been done away with. This will give comfort to a lot of funds, who especially soon after formation, could not meet the stringent conditions, Richie Sancheti, head of funds practice at Nishith Desai Associates, said. Broad-based fund is a fund, incorporated outside India, which has at least 20 investors, with no investor holding more than 49 percent of the shares or units of the fund. So far, foreign funds seeking registration with SEBI as Category II FPIs were required to meet the broad-based criteria.

FPIs will now look forward to clarity on the Know-Your-Customer requirements for these two categories, Sancheti pointed out. Will the KYC requirements ease for those FPIs that were so far categorised as II and III is a big question. Additionally, the tax implications for FPIs that were earlier in Category III but are now in Category II will also need clarification, Sancheti added.

Besides reducing the FPI categories, SEBI has also eased the conditions for investment in offshore derivative instruments.

So far, certain Category II FPIs and Category III FPIs weren't permitted to issue, subscribe or deal in offshore derivative instruments. ODIs are issued by FPIs overseas against securities held by them that are listed or proposed to be listed, as its underlying.

Under the new regulations, since the entities that'll qualify as Category 1 has been expanded, many more FPIs can issue ODIs. SEBI has also expanded the pool of entities ODIs can be issued to. The issuance can still be done only by Category I FPIs but unregulated funds with investments managers from a FATF member country can subscribe to ODIs—a departure from the position so far.

Interestingly, for better regulatory oversight, SEBI has now said that FPIs must collect $1,000 from every subscriber of ODI and deposit with it, Singh said.

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