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Sebi digging deeper into FPI composition

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By Sugata Ghosh Last Updated: Apr 20, 2020, 09.01 AM IST

A day after the government put up a barrier to scrutinise foreign direct investment (FDI) from China, Securities and Exchange Board of India (Sebi) has begun digging deeper into the composition of foreign portfolio investors (FPIs).

On Sunday morning, the capital market regulator told custodian banks to scan a mountain of information on offshore investors in various FPIs—with the probable intention to verify whether the control of these funds rests with the Chinese government or entities. "We are told Sebi has been asked by the government to collect the information," a person aware of the communication from the regulator told ET.

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In its email on Sunday, custodians were categorically told to specify the element of 'control' and how the ownerships were determined – through ownership interest or control or senior managing official.

The 'BO' in an FPI can be determined in three ways: first, whether the investor has put in 25% or more of the fund corpus; second, whether the investor 'controls' the board of directors of the asset management company of the fund; third, whether the investor has influence over the senior management persons of the FPI. An investor who stays below the radar by owning less than 25% and having no representation on the board, may still exercise control through senior managers. "Sebi rarely asks for such granular details," said the person.

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According to Richie Sancheti, head - investment funds at the law firm Nishith Desai Associates, “This could be a precursor to a closer scrutiny by Sebi on FPIs with BOs from China. Sebi may require beneficial ownership data segregated on the basis of ‘ownership’ and ‘control’ to identify those FPIs that are China owned or controlled. Scrutinising investments from those FPIs would be par for course under current environment. But vetting FPIs on the basis of a senior management officer being the identified beneficial owner, would be debatable.”

As per Sebi’s email on Sunday, besides Pakistan, Taiwan, North Korea, Iran and Myanmar, custodians will also have to examine the details of BOs from other Asian jurisdictions like Mongolia, Bhutan, Nepal, Afghanistan, Bangladesh and Yemen.

Amid a China backlash market circles are left wondering what could be Sebi’s next course of action. “Will there be more stringent KYC norms for FPIs with BOs from China, Hong Kong or countries that are politically close to China? Will such FPIs run into more hurdles when their licence comes up for renewal? Will they be asked to limit fresh (stock) purchases?” asked a senior broker.

As portfolio investment, a single FPI can own up to 9.9% equity of a listed stock. Beyond that, the entire holding is considered as FDI. With Chinese companies now required to take government approval for any FDI, no Chinese FPI can buy beyond 9.9% on the floor of the exchange without a prior permission from Indian authorities. The recent change in FDI rule assumes significance amid fears that many Indian companies may face takeover threats from Chinese investors due to falling stock prices.

On April 13, Sebi had sought details of ultimate ‘beneficial owners’— loosely defined as the last natural person — of FPIs based in China and Hong Kong.