ELP SEBI update: New Regulations for Foreign Portfolio Investors

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The Securities and Exchange Board of India (**SEBI**) has issued the SEBI (Foreign Portfolio Investors) Regulations, 2019 (available here) (**New Regulations**), which have replaced the SEBI (Foreign Portfolio Investors) Regulations, 2014 (**Old Regulations**). Some of the key changes pertaining to Foreign Portfolio Investors (**FPI**) have been set out below, along with our analysis.

Topic	Summary of Changes
Categories of FPI	Under the Old Regulations, the FPIs were divided into 3 categories, whereas under the New Regulations, there are only 2 categories. Broadly, Category II has been subsumed into Category I, and the earlier Category III has been termed as Category II. The designated depository participants have been given a responsibility to recategorize existing FPIs as per the New Regulations. The following changes have also been made to the categorization
	(a) *Broad Based Funds*[1] The requirement for funds and insurance/ re-insurance companies to be broad based has been done away with. Now, these entities can register as Category I FPIs. Consequently, they are now permitted to issue, subscribe to or deal in offshore derivative instruments, directly or indirectly, which was not permitted in the Old Regulations. Under the Old Regulations, such entities could not be categorized as Category II Funds or deal in offshore derivative instruments.
	(b) *FATF*[2] *Member Countries* To be included in Category I, certain applicants must be from FATF member countries such as ▪ Appropriately regulated funds ▪ Unregulated funds whose investment manager is appropriately regulated ▪ University related endowments of such universities that have been in existence for more than 5 years
	(c) *Appropriately Regulated* Certain entities, to be registered as FPIs, are required to be "*appropriately regulated*", which was the position earlier as well. However, the definition of "*appropriate regulated*" has been modified. As per the revised definition, the entity may be regulated by the securities regulator, the banking regulator or "*otherwise*". The inclusion of the term "*or otherwise*" has broadened the scope of the term "*appropriately regulated*". It is interesting to note that, entities established in the International Financial Services Centre are also deemed to be appropriately regulated.
	(d) *New Inclusion* An entity can be a Category I FPI if it has ▪ An Investment Manager who is from a Financial Action Task Force (FATF) FATF Member Country and is registered as a Category 1 FPI; and

[1] Broad based funds are funds established or incorporated in India, which have at least 20 investors, with no investor holding more than 49% of the shares or units of the fund.
[2] Financial Action Task Force

	▪ Is at least 75% owned, directly or indirectly by, the specified appropriately regulated entities.
	(e) *Specific inclusions in Category II (previously, Category III)* The following entities have been specifically included in Category II ▪ Appropriately regulated funds not eligible as Category I FPIs ▪ Appropriately regulated entities investing on behalf of their client (subject to conditions specified by SEBI) ▪ Unregulated funds in the form of limited partnership and trusts.
Permitted Investments	*Debt Securities* References to specific debt securities have been removed. The Reserve Bank of India would specify the debt securities that an FPI may invest in. However, certain debt securities are already permitted investments for FPIs under the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India), 2017. *Contradiction with foreign exchange regulations* The New Regulations permit investment by FPIs only in Category III Alternate Investment Funds. However, as per the current provisions of the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India), 2017, FPIs may invest in units of *all categories* of Alternate Investment Funds. It remains to be seen if the foreign exchange regulations are amended to clarify both the above points.
	Carry Forward The restriction on carrying forward of transaction on stock exchanges has been removed.
	Transactions without brokers FPIs have been permitted to carry out certain additional transactions without dealing through a stockbroker, such as: ▪ Dealing in rights entitlements; ▪ Transactions involving a merger, demerger, or a resolution plan; ▪ Dealings in illiquid/ suspended or delisted securities; and ▪ Transactions between FPIs which are part of a multi investment manager structure of the same beneficial owner, and have a common Permanent Account Number.
Investment in Offshore Derivative Investments	Offshore derivative instruments[3], may be issued only by Category I FPIs. Offshore derivative instruments may be issued only to persons eligible to register as Category I FPIs.
Investment Limit	*Divestment* *If* an FPI, taken together with its investor group, exceeds the prescribed investment limit, then the FPI is required to divest the excess holding within 5 trading days from the date of settlement of the trades resulting in the breach. *Failure to Divest*

[3] "*offshore derivative instrument*" means any instrument, by whatever name called, which is issued overseas by a foreign portfolio investor against securities held by it in India, as its underlying.

	If the FPI fails to divest, then such investments would be categorised as Foreign Direct Investment under foreign exchange regulations, and further investment by the investor group in the company would not be allowed.
Non-resident Indians Applicants	The New Regulations state that SEBI would prescribe the conditions for FPI applicants, whose constituents include non-resident Indians or overseas citizens of India. The conditions prescribed in the Old Regulations have been removed.
Central Banks as Applicants	Now, Central Banks which are not a member of the Bank for International Settlements are also eligible FPI applicants. The Central Banks of only 60 countries (from a total of over 300 Central Banks around the world) are members of the Bank for International Settlements. Therefore, this liberalisation allows the other Central Banks to apply for FPI registration.
Registration of Offshore Funds	An offshore fund floated by an asset management company that has received a no-objection certificate under Regulation 24 of the SEBI (Mutual Fund) Regulations, 1996 is required to register as an FPI for investing in Indian securities. The timeline provided is 180 days from the date of the New Regulations.
Valid Registration Requirement	An FPI must have a valid registration to hold securities or derivatives in India, failing which, the holdings must be disposed of within a year from the date of the New Regulations. However, it is not clear what is the window for FPIs to dispose of holdings, if a registration is cancelled or becomes invalid after the aforementioned one year period.
Deemed Surrender of Registration	An FPI will be deemed to have applied for surrender of its registration if: ▪ It hasn't paid the registration continuance fees on time; and ▪ It does not have any cash, security or derivative position in India. The designated depository participant is required to process such surrender after obtaining approval from SEBI.
Know Your Customer	FPIs are required to undertake KYC of their shareholders/ investors as per the applicable laws of its jurisdiction.
Fees for Government or Government Related Entities	Now, government or government related entities also have to pay the fee for FPI registration.

ELP comment

The new regulations would incentivize new FPI registrations, as well as ease the regulatory requirements for FPIs. This underpins the efforts of the Indian Government to attract more foreign investment in a muted economic environment. Also, since the system of categorization of FPIs has been changed, existing FPIs may find that they have been recategorized.