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News Alert
9 January 2014

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SEBI (Foreign Portfolio Investors) Regulations, 2014

Background

In its bid to encourage and simplify foreign portfolio investments, the Ministry of Finance set up a Working Group on Foreign Investment (WGFI) in 2010. Based on guidance received from the WGFI, the Securities and Exchange Board of India (SEBI) constituted a Committee in December 2012 under the Chairmanship of K.M. Chandrashekhar.

The Committee, in line with certain policy announcements made by the Finance Minister in his Budget 2013 speech, proposed a Foreign Portfolio Investor (FPI) regime. Based on recommendations of the Committee, draft SEBI (Foreign Portfolio Investors) Regulations, 2013 were released in October 2013. These draft regulations have now been finalised and notified[1] in the form of SEBI (Foreign Portfolio Investors) Regulations, 2014 (FPI Regulations).

The FPI Regulations replace the existing SEBI (Foreign Institutional Investor) Regulations, 1995 (FII Regulations) and the Qualified Foreign Investors (QFI) framework, and are effective from 7 January 2014.

This News Alert summarises the key points of the notified FPI Regulations.

[1] Notification No. LAD-NRO/GN/2013-14/36/12 dated January 7, 2014

Key points

Who is an FPI?

An FPI has been defined to mean a person who satisfies the prescribed eligibility criteria and has been registered under the FPI Regulations. All existing Foreign Institutional Investors (FIIs) and QFIs are to be merged into one category called FPI.

Eligibility Criteria for FPI

An applicant desirous of FPI registration should, *inter alia*, satisfy the following conditions:

- It should not be resident in India or a Non-Resident Indian.
- It should be a resident of a country:
  - whose securities market regulator is a signatory to IOSCO's Multilateral MOU or a signatory to a bilateral MOU with SEBI;
  - whose central bank is a member of the Bank for International Settlements;
  - against whom the Financial Action Task Force (FATF) has not issued any warnings
- It should legally be permitted to invest in securities outside the country of its incorporation or establishment or place of business.
- It should be authorised by its Memorandum of Association and Articles of Association or equivalent document(s) or the agreement to invest on its own behalf or on behalf of its clients.
- It must be a fit and proper person as prescribed.

Categories of FPI

- Category I FPIs include Government and Government-related investors such as central banks, Governmental agencies, sovereign wealth funds and international or multilateral organisations or agencies.
- Category II FPIs include:
  - appropriately regulated broad based funds such as mutual funds, investment trusts, insurance/reinsurance companies;
  - appropriately regulated persons such as banks, asset management companies, investment managers/advisors, portfolio managers;
  - broad based funds that are not appropriately regulated but whose investment manager is appropriately regulated. However, the investment manager of such broad based fund should be registered as a Category II FPI and should undertake that it shall be responsible and liable for all acts of commission and omission of all its underlying broad based funds and other deeds and things done by such broad based funds under these regulations.
  - university funds and pension funds; and
  - university-related endowments already registered with SEBI as FIIs or sub-accounts.
- Category III FPIs include all others not eligible under Category I and II FPIs such as endowments, charitable societies, charitable trusts, foundations, corporate bodies, trusts, individuals and family offices.

Broad based fund

- A broad based fund means a fund established or incorporated outside India, which has at least twenty investors with no investor holding more than forty-nine percent of the shares or units of the fund.

- If the broad based fund has an institutional investor who holds more than forty nine per cent of the shares or units in the fund, then such institutional investor must itself be a broad based fund.
- Underlying investors will also be counted to ascertain broad based criteria in the case of entities which have been set up for the sole purpose of pooling funds and making investments.

Note: Earlier, a Fund was exempted from the twenty investor requirement if one of its investor was an institutional investor. The FPI regulations do not provide that relaxation.

Registration of a FPI

- FPI registration is to be undertaken and granted by Designated Depository Participants (DDPs) on behalf of SEBI.
- Registration is to be granted within 30 days of application, subject to requisite information being provided.
- Registration will be permanent unless suspended or cancelled.

Registration Fees

- Category I FPIs are exempt from payment of registration fees.
- A registration fee of USD 3,000 and USD 300 is payable by Category II & III FPIs respectively for a block of three years.

Transitional provisions for existing FIIs/sub-accounts and QFIs

- All the FIIs/sub-accounts may continue to buy, sell or otherwise deal in securities under the FPI regime until the expiry of their existing registration or until they register as a FPI. QFIs may continue to buy, sell or otherwise deal in securities until a period of one year from the date of notification of these regulations. In the meantime, they may obtain FPI registration through DDPs.
- A one-time conversion fee of USD 1,000 is payable by existing FIIs/sub-accounts and QFIs to obtain registration as FPIs. Certain international/multilateral agencies are however exempt from payment of the conversion fee.
- Any pending FII/sub-account registration application with SEBI shall be dealt with in accordance with the FII Regulations.
- SEBI may grant registration certificates in such cases by 31 March 2014, which may be extended until 30 June 2014.

Investment Conditions and Restrictions

- The instruments available for investments to FPIs are broadly in line with the instruments offered under the FII regime.
- Total investment by each FPI is restricted to 10% of the issued equity capital of the company.
- In case the same set of ultimate/end beneficial owner(s) invest through multiple entities, such entities shall be treated as part of the same group and the investment limits of all such entities shall be clubbed as applicable to a single FPI.

Note: A threshold of 50% of direct or indirect common shareholding/ beneficial ownership/ beneficial interest will be considered for the purpose of clubbing investment limits across a common investor group.

Offshore Derivative Instruments (ODIs)

- FPIs can issue, subscribe to or otherwise deal in ODIs, directly or indirectly, only if such ODIs are issued to persons who are regulated by an appropriate foreign regulatory authority, and the ODIs are issued after compliance with 'Know Your Client' (KYC) norms.

- Unregulated broad based funds which are classified as Category II FPIs by virtue of their investment manager being appropriately regulated shall not deal in ODIs.
- Category III FPIs also cannot deal in ODIs.
- FPIs shall ensure that further issue or transfer of any ODIs issued by or on behalf of it is made only to persons who are regulated by an appropriate foreign regulatory authority.
- Outstanding ODIs shall be deemed to have been issued under the corresponding provision of the FPI Regulations.

DDPs and Custodian of securities

- Existing qualified depository participants and custodians of securities registered/ approved by SEBI before commencement of FPI Regulations shall be deemed to have been granted registration as DDPs under the FPI Regulations, subject to payment of the specified fees.
- FPIs shall mandatorily appoint a custodian of securities before making any investments.
- The custodian shall ensure that combined holdings of all FPIs in the same investor group remains below ten per cent of the issued capital of the investee company at any time.
- DDPs shall ensure that FPIs submit an undertaking along with a certificate from a chartered accountant to an authorised dealer certifying that all taxes have been paid or funds have been set aside to meet the tax liability before remittance of any sum out of India.

Operational Guidelines for DDPs

SEBI has also issued a Circular[2] that provides operational guidelines to DDPs. They, *inter alia*, state that:

- Conditional registration to an entity seeking to register itself as a broad based fund under Category II may be granted, subject to certain prescribed conditions;
- A validity period of 180 days is provided in the case of conditional registration;
- The procedure for surrender of registration, disinvestment, name change approval, change in DDP/custodian, etc. have been prescribed.

Clarification still awaited

Under the Income-tax Act, 1961 (the IT Act), FIIs/sub-accounts are governed by a special tax regime. No corresponding amendment has yet been made under the IT Act to extend this special regime to FPIs. The Government should consider amending the provisions of the IT Act to bring FPIs within the ambit of Section 115AD of the IT Act.

Conclusion

The FPI Regulations are a step in the right direction towards rationalising and simplifying the portfolio investments in India for foreign investors, with a view to encourage foreign investment in the Indian securities markets.

[2] SEBI circular no. CIR/IMD/FIIC/02/2014 dated January 8, 2014

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