Monitoring of foreign investment limits in listed Indian companies

April 10, 2018

In brief

- The Foreign Exchange Management Act, 1999, prescribes various foreign investment limits in listed companies.
- To facilitate compliance with various foreign investment limits in listed companies, the Securities and Exchange Board of India (SEBI), in consultation with the Reserve Bank of India (RBI) has notified[1] a new system for monitoring foreign investment limits.
- Necessary infrastructure and IT systems shall be put in place for operationalising the monitoring mechanism of Depositories i.e., National Securities Depository Limited (NSDL) and Central Depository Services (India) Limited (CDSL) and by Stock Exchanges i.e., Bombay Stock Exchange (BSE), National Stock Exchange (NSE) and Metropolitan Stock Exchange (MSEI) for disseminating information on the available investment headroom.
- The system for collecting data from companies shall go live from 5 April, 2018. The companies shall provide the necessary data to the Depositories by 30 April, 2018. The new system shall be made operational on 01 May, 2018.

In detail

- The Foreign Exchange Management Act, 1999, prescribes various foreign investment limits in listed companies.
- These limits are currently monitored by the RBI.

Architecture of the new system

Housing of the system

- The system shall be implemented and housed at NSDL and CDSL.
- A company shall appoint any one of the Depositories as its Designated Depository, which will monitor the foreign investment limits for that company.

Company master

- The Stock Exchanges i.e., BSE, NSE and MSEI shall provide data on the paid-up equity capital of an Indian company on a fully diluted basis to the Designated Depositories.
- The Depositories shall provide an interface to the company to provide the following information to its Designated Depository:
  i. Company Identification Number (CIN)
  ii. Name
  iii. Date of incorporation
  iv. PAN number
  v. Applicable Sector
  vi. Applicable Sectoral Cap
  vii. Permissible Aggregate Limit for investment by Foreign Portfolio Investor's (FPI)
  viii. Permissible Aggregate Limit for investment by NRI's
  ix. Details of shares held by FPI, NRIs and other foreign investors on repatriable basis, in demat as well as in physical form
  x. Details of indirect foreign investments that are held in both demat and physical form

[1] SEBI Circular no. IMD/FPIC/CIR/P/2018/61 dated 05 April 2018

xi. Details of demat accounts of Indian companies making indirect foreign investment in the capital of the company

xii. Whether an Indian company with total foreign investment is either not owned and not controlled by the resident Indian Citizens or is owned or controlled by persons resident outside India (Yes or No)

xiii. ISIN-wise details of downstream investment in other Indian companies

This information shall be stored in a Company Master database. The Designated Depository shall, if required, seek additional information from the company for monitoring the foreign investment limits.

- In the event of any change in any details pertaining to the company, such as increase/ decrease in the aggregate FPI/ NRI limits or the sectoral cap, or a change in the sector of the company etc., the company shall inform the Designated Depositories of such changes.

Reporting of trades

- The reporting of confirmed trades of FPI clients by the custodian to the Depositories on a T+1 basis shall continue.
- For NRI (repatriable) trades, Authorised Dealer (AD) Banks shall report the transactions of their NRI clients to the Depositories.

Activation of a red flag alert

- The system shall calculate the percentage of FPI/ NRI holdings/ total foreign investments in a company and the investment headroom available at the end of the day with respect to the aggregate FPI/ NRI investments/ sectoral cap of the company.
- If the available headroom is within 3% or less than 3% of the aggregate FPI/ NRI limits or the sectoral cap, a "red flag" shall be activated. Thereafter, the Depositories and the exchanges shall display the available investment headroom, in terms of available shares, for all companies against which the red flag has been activated, on their respective websites, on a daily basis.
- The data on the available headroom shall be updated daily, end-of-day basis, as long as the red flag remains activated.

Breach of foreign investment limits

- Once the aggregate FPI/ NRI investment limits or the sectoral cap for a given company has been breached, the Depositaries shall inform the exchange about the breach. The exchanges shall issue circulars/ public notifications on their website and shall halt all further purchases by
  - FPIs, if the aggregate FPI limit is breached;
  - NRIs, if the aggregate NRI limit is breached;
  - All foreign investors, if the sectoral cap is breached.
- In the event of a breach, the relevant foreign investors shall divest their excess holdings within five trading days from the date of settlement of the trades by selling shares to only domestic investors.

Method of disinvestment

- A proportionate disinvestment methodology shall be followed for the disinvestment of excess shares. In this method, the disinvestment of the breached quantity shall be uniformly spread across all foreign investors/ FPIs/ NRIs who are net buyers of the shares in the company on the day of the breach.

For example,

Total shares that can be purchased by foreign investors until sectoral cap is not breached				600
Total quantity purchased by foreign investors on T day				1000
Breach quantity				400
Time	**Foreign investor**	**Purchased quantity**	**Cumulative purchases by foreign investor**	**Quantity to be disinvested by the foreign investor**
10 00 hrs	ABC	100	100	40
10 15 hrs	XYZ	250	350	100

11 45 hrs	TYU	50	400	20
12 30 hrs	POI	180	580	72
13 00 hrs	QSX	120	700	48
14 00 hrs	REW	150	850	60
14 10 hrs	LOP	150	1000	60
Total		**1000**		**400**

- FPIs/ NRIs who are required to disinvest shall be identified and informed through the custodians/ AD banks respectively.
- The Depositories shall utilise the FPI trade data provided by the custodians, post custodial confirmation on the T+1 day, where T is the trade date. The breach of investment limits (if any) shall be detected at the end of the T+1 day, and therefore, the announcement pertaining to the breach shall be made at the end of the T+1 day.

A table summarising the breach–disinvestment scenario is as follows:

Parameter	Purchase on T Day	Purchase on T+1
Date of breach	T day	T day
Date of trade	T day	T+1 day
Date of detection of breach	T+1 day (End of day) T+2 day (End of day, if T+1 is a settlement holiday)	T+1 day (End of day) T+2 day (End of day, if T+1 is a settlement holiday)
Date of settlement of transaction	T+2 day T+3 day, if either T+1 day or T+2 day is a settlement holiday)	T+3 day T+4 day, if either T+2 day or T+3 day is a settlement holiday
Disinvestment time frame	Five trading days from the date of settlement of the transactions, which were executed on the day of the breach, i.e., five trading days from T+2 day If T+1 day or T+2 day is a settlement holiday, then five trading days from T+3 day	Five trading days from the date of settlement of the transactions, which were executed on T+1 day, i.e., five trading days from T+3 day If T+2 day or T+3 day is a settlement holiday, then five trading days from T+4 day

- If the foreign shareholding in a company falls within the permissible limit during the time period for disinvestment on account of sale by other FPI or other group of FPIs, the original FPIs, which have been advised to disinvest, would still have to do so within the disinvestment time period, irrespective of the fresh availability of investment headroom during the disinvestment time period.
- There shall be no annulment of trades that have been executed and are in breach of the sectoral caps/ aggregate FPI/ NRI limits.

Failure to disinvest within five trading days

If the breach has taken on account of FPIs that have failed to disinvest as above, necessary action shall be taken by SEBI against such FPI's.

The takeaways

The Circular codifies the process of monitoring foreign investment limits. The process prescribed is broadly similar to the current process, with certain modifications. More importantly, the circular provides a method for disinvestment in the event of breach of limits. With necessary infrastructure and new systems, monitoring of foreign investment limits in listed Indian companies is expected to be more efficient.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact your local PwC advisor

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