

Consultation Paper on permitting increased participation of Non – Resident Indians (NRIs) and Overseas Citizens of India (OCIs) into SEBI registered Foreign Portfolio Investors (FPIs) based out of International Financial Services Centres (IFSCs) in India and regulated by the International Financial Services Centres Authority (IFSCA)

1. Objective:

To enhance investments by FPIs in India by facilitating increased participation from NRIs and OCIs as constituents of FPIs that are based out of IFSCs in India and regulated by IFSCA, while putting in place adequate measures to mitigate the risks emanating from such investments.

2. Background:

- 2.1. During the Foreign Institutional Investors (FIIs) regime, NRIs were not allowed to register as FIIs or sub – accounts (SAs). Further, companies that were majority owned by one or more NRIs were also not allowed to make investments as an FII.
- 2.2. However, funds having NRIs as constituents (investors) were not prohibited from obtaining registration as FIIs or SAs. In addition, companies promoted by NRIs were allowed to be registered as non - investing FIIs for managing funds of other FIIs/ SAs.
- 2.3. With the introduction of the FPI regime in 2014, the aforementioned position was carried forward in the context of FPIs. NRIs/ OCIs were not eligible for registration as FPIs; however, they could be investors in FPIs. Companies majority owned by one or more NRIs that were appropriately regulated were eligible for registration as FPIs under the SEBI (FPI) Regulations, 2014, for acting as investment manager for other FPIs.
- 2.4. In order to review the Know Your Client (KYC) compliances for FPIs, a thematic study was conducted in 2017 by SEBI with Custodians and Designated Depository Participants (DDPs), for further strengthening the KYC process for FPIs. Thereafter, SEBI, vide circular dated April 10, 2018, *inter – alia*, clarified that Resident Indian (RIs)/ Non – Resident Indians (NRIs) / Overseas Citizens of India (OCIs) cannot be Beneficial Owners (BOs) of FPIs. However, it was also clarified that if an FPI is an Investment manager of other FPIs and is a non- investing entity, it may be promoted by NRIs/ OCIs.
- 2.5. The circular generated widespread discussions and debate. Representations were received by SEBI from various stakeholders, pursuant to which the working group under the Chairmanship of Shri Harun R. Khan, Deputy Governor (Retired), Reserve Bank of India (RBI), was entrusted with the responsibility of looking into the issues emerging from the circular dated April 10, 2018.

- 2.6. The report in this regard submitted by the working group was put up for public consultation and thereafter put up for consideration of the SEBI Board in the meeting held on September 18, 2018. Post receipt of approval from the Board, the guidelines for NRIs/ OCIs being constituents of the FPI were spelt out vide SEBI circular dated September 21, 2018 which are specified in Para 3.1 as under. The same have now been incorporated in the Master Circular for FPIs and DDPs issued on December 22, 2022 (“MC”) under the SEBI (FPI) Regulations, 2019 (“FPI Regulations”).

3. Current Regulatory provisions with respect to NRIs and OCIs as participants of FPIs

- 3.1. Regulation 4(b) of the FPI Regulations states that the FPI applicant cannot be an NRI or OCI. Further, Regulation 4(c) states that NRIs or OCIs or Resident Indian individuals (RIIs) may be constituents of the applicant provided they meet the conditions specified by the Board from time to time. These conditions are mentioned in Para 1 (ii) of Part A of the MC and are reproduced below:

3.1.1. Where NRIs or OCI or RIs are constituents of the applicant –

- a. the contribution of a single NRI or OCI or RI shall be below twenty-five percent of the total contribution in the corpus of the applicant;
- b. the aggregate contribution of NRIs, OCIs and RIs shall be below fifty percent of the total contribution in the corpus of the applicant.

Explanation: The contribution of resident Indian individuals shall be made through the Liberalised Remittance Scheme (LRS) notified by Reserve Bank of India (RBI) and shall be in global funds whose Indian exposure is less than 50%.

- c. the NRIs, OCIs and RIs shall not be in control of the applicant. This is not applicable if the applicant is an ‘offshore fund’ for which ‘No Objection Certificate’ has been issued by the Board in terms of the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996, or is controlled by an Investment Manager which is controlled and/or owned by NRI or OCI or RI if the following conditions are satisfied:
 - i. such Investment Manager is appropriately regulated in its home jurisdiction and registered with the Board as a non-investing FPI, or
 - ii. such Investment Manager is incorporated or setup under the Indian laws and appropriately registered with the Board.
- d. The provisions mentioned at a to c above shall not apply to non-investing FPI or if the applicant proposes to invest or invests only in units of schemes floated by mutual funds in India.

- e. An applicant not meeting above requirements shall comply within a period of two years from the date of registration. A foreign portfolio investor who remains non-compliant even after the period specified above shall be prohibited from making any fresh purchase of securities and such foreign portfolio investor shall liquidate its existing position in the Indian securities market within a period of one hundred and eighty days.
- f. In case of temporary breach of above investment limits, the foreign portfolio investor shall comply with the eligibility conditions within ninety days of its breach. In case the foreign portfolio investor remains non-compliant with the said requirement even after ninety days, then no fresh purchases shall be permitted and such FPI shall liquidate its existing position in Indian securities market within a period of the next one hundred and eighty days.

4. Demand to increase the quantum of contribution by NRIs/ OCIs in the corpus of FPIs:

- 4.1. Over the years, there has been a constant demand for channelling more NRI/ OCI investments in the Indian securities markets by facilitating greater participation of NRIs/ OCIs in the corpus of the FPIs. It is a stated policy decision of the Government to facilitate higher NRI investments into the country. The Hon'ble Finance Minister had also acknowledged in the budget speech in July 2019 that even though India is the world's top remittance recipient, NRI investment in Indian capital markets is comparatively less.
- 4.2. NRIs/ OCIs have an avenue of investing in the Indian securities markets through the Portfolio Investment Scheme (PIS) route under Schedule III of the Foreign Exchange Management (Non – Debt Instrument) Rules, 2019 (NDI Rules). However, various stakeholders have given the feedback that investing through the PIS route restricts NRIs from investing in India through overseas pooled structures managed by professional managers, thereby depriving them of the benefit of investment management by professionals.
- 4.3. SEBI has received feedback from various stakeholders that the restrictions on contribution by NRIs/ OCIs to the corpus of FPIs increases the compliance burden and cost on the FPI/ its investment manager, and makes it difficult for them to monitor the same on an ongoing basis and take remedial measures. For instance, a redemption request from non – NRI/ OCI investors in an FPI may automatically cause a hike in the percentage contribution by NRIs/ OCIs in the FPI's corpus, requiring the investment manager to either arrange for fresh non-NRI/ non-OCI investments or forcibly redeem investments of NRIs/ OCIs in order to meet the thresholds. Due to these practical challenges, many foreign funds either exclude India as an asset class



from their portfolio or do not accept any participation from NRIs/ OCIs, resulting in loss of investment opportunities into India.

- 4.4. Of late, SEBI has also received requests from IFSCA to permit greater participation of NRIs/ OCIs in IFSC based funds that invest in the Indian securities markets through the FPI route. IFSCA has stated that IFSC funds receive a lot of interest from the NRI community because of their familiarity with Indian processes and trust in the domestic institutions, compounded by their patriotic sense of responsibility towards the nation. However, because of these restrictions on NRI/ OCI contribution in FPIs, IFSC funds are facing difficulty in raising money from NRI investors.

5. Risks of allowing NRIs/ OCIs to contribute without any limits to corpus of FPIs:

- 5.1. As stated in the preceding sections, from the very beginning, NRIs/ OCIs and NRI/ OCI owned and controlled entities were not permitted to invest directly as FPIs in the Indian securities markets.
- 5.2. The perils of allowing access to the securities markets to such persons/entities have been brought out in the Report of the Joint Committee on Stock market Scam and matters relating thereto ('JPC Report') that was presented to Lok Sabha on December 19, 2002. The report had, *inter – alia*, focused on the role of Overseas Corporate Bodies (OCBs) (entities owned directly or indirectly at least 60% by Non-residents of Indian nationality/origin), in the stock market scam of 2001, due to their close proximity with Indian entities/ promoters of Indian entities.
- 5.3. The major observations in the JPC report regarding role of OCBs in the market scam of 2001 are as under:
- 5.3.1. Indian companies used the OCB route for money laundering making illegitimate use of the routes available in tax havens. Certain unscrupulous persons residing in India were operating behind the façade of these OCBs. Some Indian promoters were suspected to have been using these OCBs as their fronts.
- 5.3.2. The trading pattern of OCBs reveals that they were involved in market manipulations, building of concentrated positions, creating artificial market, circular trading, circumventing Takeover Regulations etc.
- 5.3.3. OCBs were involved in several instances of violations such as non – delivery of shares, booking purchase orders without sufficient balances in accounts etc.
- 5.3.4. SEBI had faced difficulties in gathering information about the actual beneficiaries of suspected OCBs.
- 5.3.5. Certain OCBs had exceeded the threshold of 5%/ 10% permitted under the Portfolio Investment Scheme.

5.4. Based on prima facie findings of involvement of some of the OCBs in aiding, assisting and abetting Ketan Parekh entities in market manipulations, SEBI had recommended to the Government that this facility of portfolio investments provided to OCBs, needs to be withdrawn. The Government accepted this suggestion of SEBI. RBI has, since then, prohibited OCBs from investing in secondary market through portfolio investment route. Thereafter, on September 16, 2003, the RBI had also derecognized OCBs in India as an eligible class of investors.

6. Current Situation and need for review:

- 6.1. The regulatory framework and surveillance/ monitoring mechanisms have strengthened over the years for keeping a check on malafide entities that may attempt to manipulate the market through dubious actions. As a result, instances of non - delivery of shares, booking purchase orders without sufficient balances in accounts, etc. have substantially reduced.
- 6.2. However, certain issues identified by JPC relating to OCBs (relaxed version of NRI owned entities) including their low capitalization, proximity / likely proximity to Indian promoters, difficulty in identification of actual beneficial owners etc. exist even today.
- 6.3. This raises the possibility of Indian entities/ promoters using the FPI route to circumvent the requirements specified under various SEBI regulations such as maintenance of Minimum Public Shareholding (MPS), disclosures required under Substantial Acquisition of Shares and Takeovers Regulations, 2011 (SAST), by using FPIs owned and controlled by NRIs as their fronts.
- 6.4. During the course of recent investigations as well, SEBI has faced difficulties in seeking details of BOs of FPIs/ investors of FPIs incorporated in jurisdictions which have stringent data privacy laws or where anti-money laundering rules and guidelines do not require BOs identification as per the thresholds prescribed by Prevention of Money Laundering Act, 2002 ("PMLA") and Prevention of Money Laundering (Maintenance of Records) Rules, 2005 ("PMLR").
- 6.5. It may be noted that the aforementioned issues also exist in respect of FPIs that may have investors other than NRIs/ OCIs. To address the same, vide SEBI circular dated August 24, 2023, FPIs fulfilling either criteria mentioned below have been mandated to provide granular details of all persons with any ownership, economic interest, or control rights in the FPI, on a full look through basis, up to the level of all natural persons, without any threshold:

- 6.5.1. FPIs holding more than 50% of their Indian equity Assets Under Management (AUM) in a single Indian corporate group;
- 6.5.2. FPIs that individually, or along with their investor group (in terms of Regulation 22(3) of the FPI Regulations), hold more than INR 25,000 crore of equity AUM in the Indian markets.

The above may be applied along with the exemptions provided in the said circular to certain entities that do not pose significant systemic risk due to their structures or ownership have been exempted from making such additional disclosures, which, inter-alia, include Government and Government related investors, Pension Funds and Public Retail Funds, certain listed ETFs, corporate entities and verified pooled investment vehicles meeting certain conditions etc.

- 6.6. IFSC has stated that the risks associated with NRI/ OCI owned entities trading in the Indian securities markets through the FPI route may be suitably addressed in case of funds based out of IFSC, as IFSCA, which is, in essence, an Indian regulator, shall regulate such funds. The KYC / due diligence / AML requirements applicable to such funds shall also be in line with those prescribed under PMLA and PMLR. IFSCA has, therefore, suggested that under the supervision of an Indian regulator, administered under the laws of the land, the investment vehicles in IFSC may be liberalized from the NRI participation limits and placed as a regulated and optimal avenue for channelling NRI/OCI investments into India.

7. Proposal and Rationale:

- 7.1. The concerns of market manipulation by NRI/ OCI owned entities stated in the JPC Report exist even today due to possible proximity of persons of Indian origin with Indian companies/ promoters. At the same time, it is also recognized that further investments in the Indian securities markets can be facilitated by channelling NRI/ OCI investments into the country through FPIs that are professionally run by investment managers and whose securities are kept in safe-keeping/custody by SEBI registered custodians.
- 7.2. In this respect, there is a need to balance the requirement of facilitating and increasing the avenues for investment from NRIs/ OCIs in the country with appropriate risk mitigation measures to address the concerns listed in the JPC report as mentioned above.
- 7.3. Accordingly, if the aggregate contribution of NRIs/ OCIs beyond 50% of the corpus of the FPI is to be permitted, it is proposed that this may be made applicable only to such FPIs that are based out of International Financial Services Centres (IFSCs) in India and regulated by the International Financial Services Centres Authority (IFSCA).

Considering that IFSCA is a domestic regulator, the KYC and due diligence undertaken by an IFSC Fund Management Entity in onboarding an investor for its fund and identifying and verifying its BOs shall broadly be the same as carried out by Indian intermediaries, as entities from both these jurisdictions are governed by the PMLA and PMLR. Similar to domestic financial institutions, the institutions in IFSC are also required to take registration with Financial Intelligence Unit (FIU) and file Suspicious Transaction Reports (STRs).

- 7.4. It is, therefore, felt that compared to other international regulators, IFSC shall have better information sharing mechanism with SEBI and shall be in a better position to oversee structures having predominant NRI/ OCI ownership, with more effective monitoring of the quality of capital flows, in line with the principles prescribed under PMLA/ PMLR and Foreign Exchange Management Act, 1999 (FEMA).
- 7.5. Further, as stated in the previous sections, vide SEBI circular dated August 24, 2023, framework for seeking additional granular details have been prescribed for FPIs fulfilling certain criteria to guard against possible misuse of FPI route for circumvention of requirements of MPS, SAST, etc. Considering that these concerns in the past were heightened in case of entities predominantly owned by NRIs/ OCIs due to possible proximity with Indian entities/ promoters, it is proposed that the criteria which makes an FPI liable for granular level disclosures of persons having ownership, economic interest or control in the FPI, may be made relatively stricter for such FPIs.
- 7.6. Also, to ensure proper identification and verification of BOs in such NRI owned and controlled entities, it is proposed that an identifier issued by the Government of India may be obtained from the BOs, in case the BO is a NRI/ OCI.
- 7.7. Accordingly, the following framework is proposed for channelizing NRI/ OCI investments in the Indian securities markets through the FPI route:
- 7.7.1. The contribution of a single NRI or OCI or RI shall be below twenty-five percent of the total contribution in the corpus of the applicant.
- 7.7.2. At an aggregate level, NRIs and OCIs may be allowed to contribute fifty percent or more to the corpus of an FPI subject to the following conditions:
- 7.7.2.1. Such entities are based out of International Financial Services Centres (IFSCs) in India and regulated by the International Financial Services Centres Authority (IFSCA).
- 7.7.2.2. Such entities shall provide to their DDPs, the granular details of all entities holding any ownership, economic interest, or exercising control

in the entity in terms of the guidelines and exemptions mentioned in SEBI circular dated August 24, 2023, in case such FPIs fulfil any of the criteria mentioned below:

- 7.7.2.2.1. FPIs holding more than 33% of their Indian equity Assets Under Management (AUM) in a single Indian corporate group;
- 7.7.2.2.2. FPIs that individually, or along with their investor group (in terms of Regulation 22(3) of the FPI Regulations), hold more than INR 25,000 crore of equity AUM in the Indian markets.
- 7.7.2.3. NRIs/ OCIs identified as BOs of the FPI shall be required to provide passport no. / OCI no. respectively to their DDPs. In case such FPIs fulfil any criteria mentioned in Para 7.7.2.2, they shall provide data in the manner and format specified vide SEBI circular dated August 24, 2023 read with the Standard Operating Procedure (SOP) mentioned therein.
- 7.7.2.4. FPIs/ FPI applicants based out of IFSCs in India and regulated by IFSCA, that are desirous of having more than 50% aggregate contribution from NRIs/ OCIs in their corpus, may opt to do so by submitting declaration in this regard to their DDPs. Such declaration may be submitted at the time of seeking registration or anytime during the validity of their registration. Once a FPI submits such declaration, it shall comply with the aforementioned conditions throughout the validity of its registration, irrespective of the actual aggregate NRI/ OCI contribution in the corpus of the FPI.

8. Public Comments

- 8.1. Public comments are invited for the proposals given above. The comments / suggestions may be provided in MS Excel file as per the format given below:

Name of the person/ entity proposing comments:	
Name of the organization (if applicable):	
Contact details:	
Category: whether market intermediary/ participant (mention type/ category such as FPI, law firm, consultant, etc.) or public (investor, investee company, academician etc.)	

Sr. No.	Para. no. of the consultation paper	Extract from the consultation paper	Comments / Suggestions	Rationale

8.2. Kindly mention the subject of the communication as, *“Consultation Paper on permitting increased participation of Non – Resident Indians (NRIs) and Overseas Citizens of India (OCIs) into SEBI registered Foreign Portfolio Investors (FPIs) based out of International Financial Services Centres (IFSCs) in India and regulated by the International Financial Services Centres Authority (IFSCA)”*.

8.3. Comments as per aforesaid format may be sent to the following, latest by September 10, 2023, in any of the following manner:

(i) Preferably, by email to afdconsultation@sebi.gov.in, with a copy to Shri Arpit Anand, Assistant General Manager (arpit_anand@sebi.gov.in) and Shri Naveen Kumar, Assistant General Manager (naveenkr@sebi.gov.in).

(ii) By post to:

Shri Vikash Narnoli,
Deputy General Manager,
Alternative Investment Fund and Foreign Portfolio Investors Department,
Securities and Exchange Board of India,
SEBI Bhavan, C4-A, G-Block, Bandra Kurla Complex,
Bandra (East), Mumbai -400051.

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