



**Consultation Paper on framework for mandating additional disclosures from Foreign Portfolio Investors (FPIs) that fulfil certain objective criteria, to 1) guard against possible circumvention of Minimum Public Shareholding (“MPS”), and 2) to guard against possible misuse of the FPI route to circumvent the requirements of Press Note 3 (“PN3”)**

### **1. Objective:**

To enhance trust in the Indian securities markets by mandating additional granular disclosures around ownership of, economic interest in, and control of objectively identified high-risk Foreign Portfolio Investors (FPIs) that have either concentrated single group exposures and/ or significant overall holdings in their India equity investment portfolio.

### **2. Background and issues identified:**

- 2.1. For greater investor protection, and for fostering greater trust and transparency in the Indian securities market ecosystem, there is a felt need for additional disclosures from certain types of Foreign Portfolio Investors (FPIs). On the surface, any enhanced disclosure requirements may appear to detract from ease-of-doing investments. However, there can be no sustained capital formation without transparency and trust.
- 2.2. Overall, to minimize any inconvenience to the FPI ecosystem, only a limited number of objectively identified high-risk FPIs with either concentrated single group equity exposures or significant equity holdings will be mandated to provide additional granular disclosures around the ownership of, economic interest in, and control of such funds.

### **Issue 1 – Concentrated group investments by FPIs & the potential circumvention of SEBI regulatory requirements such as MPS:**

- 2.3. Some FPIs have been observed to concentrate a substantial portion of their equity portfolio in a single investee company/ company group. In some cases, these concentrated holdings have also been near static and maintained for a long time. Such concentrated investments raise the concern and possibility that promoters of such corporate groups, or other investors acting in concert, could be using the FPI route for circumventing regulatory requirements such as that of maintaining Minimum Public Shareholding (MPS). If this were the case, the apparent free float in a listed company may not be its true free float, increasing the risk of price manipulation in such scrips.
- 2.4. To confirm that there is no such circumvention of MPS or other related regulations, it is necessary to obtain granular information around the ownership of, economic

interest in, and control of FPIs with concentrated equity holdings in single companies or business groups.

**Issue 2 – Potential misuse of the FPI route for potential circumvention of Press Note 3 stipulations:**

- 2.5. The Government of India has recognized the inherent risks of opportunistic takeover/acquisition of Indian companies and therefore, vide Press Note 3 dated April 17, 2020, requires that an entity of a country that shares land border with India, or where the beneficial owner of an investment into India is situated in or is a citizen of any such country, can invest only under the Government route.
- 2.6. While Press Note 3 is not applicable to FPI investments, the FPI route could potentially be misused to circumvent the stipulations of Press Note 3. To this end, there is a need to identify investors in high-risk FPIs with large equity portfolios at a granular level, whose investors may be based out of land bordering countries. In certain instances, it has been observed that while the high-risk FPI itself may be situated out of a non-land bordering country, the investors in such high-risk FPIs may be based out of land – bordering countries.

**3. Extant regulations on disclosure of ownership of, economic interest in, and control over FPIs:**

- 3.1. In India, Prevention of Money Laundering Act, 2002 ('PMLA') and the Prevention of Money Laundering (Maintenance of Records Rules), 2005 (PML Rules) provide the framework for identifying the Beneficial Owners (BO) of legal entities, which is broadly in line with the recommendations of Financial Action Task Force (FATF).
- 3.2. **As per Prevention of Money Laundering Act, 2002 ('PML Act'), "Beneficial Owner (BO)" means an individual who ultimately owns or controls a client of a reporting entity or the person on whose behalf a transaction is being conducted and includes a person who exercises ultimate effective control over a juridical person.**
- 3.3. Rule 9(3) of the PML Rules specifies the thresholds based on ownership, or entitlement to capital or profits (i.e., economic interest), for identifying the BO of legal entities. The thresholds are 10% for companies and trusts, and 15% for partnerships etc. It also specifies that BO includes those natural persons who exercise ultimate effective control over a legal person or arrangement. "Control" includes the right to appoint a majority of the directors or to control the management or policy decisions including by virtue of their shareholding or management rights or shareholders' agreements or voting agreements.

- 3.4. In essence, BOs can emanate either from ownership criteria, or through economic interest, or through control. All such BOs need to be identified for each entity.
- 3.5. Further, where no natural person is identified on the basis of control through ownership, economic interest, or control through other means, the BO is the relevant natural person who holds the position of Senior Managing Official (SMO).
- 3.6. The SEBI (Foreign Portfolio Investors) Regulations, 2019 ('FPI regulations') and the circulars framed thereunder, require Designated Depository Participants ('DDP')/ Custodians to identify all BOs of FPIs on a look through basis, in accordance with Rule 9 of the PML Rules, and maintain a list of such BOs. Under these regulations, the materiality threshold to identify the BOs (either via ownership and/ or economic interest/ control criteria) is first applied at the level of the FPI. If any entity exceeds such materiality threshold at the level of the FPI, in turn, BOs of such intermediate entities are identified on a look through basis (after applying the threshold criteria) till all natural person BOs at the end of the chain are reached. Further, any change in the same also needs to be communicated by the FPIs to their DDPs within 7 working days of the change.
- 3.7. As per Rule 9(14)(i) of the PML Rules, regulators (such as SEBI) may prescribe enhanced measures to verify the client's identity as deemed necessary.

#### **4. The need for additional disclosures to address the potential issues flagged above:**

- 4.1. As flagged earlier, guarding against the two potential issues enumerated above requires granular details around the ownership of, economic interest in, and control of certain high-risk FPIs. Such disclosures must be unconstrained by any materiality thresholds set by the PMLA Rules and FPI regulations.
- 4.2. In addition, within FPI regulations, while BO details based on control or fund ownership have generally been made available, it is often observed that no natural person is identified as the BO of FPIs based on economic interest, since each investor entity in the FPI is generally found to be below the threshold prescribed under PML Rules. However, there is a possibility that the same natural person holds a significant aggregate economic interest in the FPI via different investment entities, each of which are individually below the threshold for identification as a BO.
- 4.3. Since granular details of all underlying investors with ownership, economic, or control interest in entities below the threshold is currently not required to be made available with the DDP/Custodian, it is not possible to determine whether the above scenario may be playing out. It has further been observed in some cases that entities having economic interest in an FPI are in jurisdictions where the equivalent PMLA

regulations require BO identification only on the basis of control or ownership, leaving ambiguity regarding entities that have economic interest but no ostensible control.

- 4.4. In such cases, it is often observed that control is provided to another entity (such as the investment manager/ trustee etc.) through arrangements such as voting shares/ management shares, and the person in control of such entity or the SMO is then identified as the BO of the FPI. Consequently, while in compliance with the letter of regulations, the actual investing constituents with economic interest may not be identified as BOs of the FPI. This issue can be further accentuated if holdings of such investors are spread through multiple FPIs.
- 4.5. Finally, note that the above issues relating to identification of economic interest BOs are common to both the erstwhile SEBI (FPI) Regulations, 2014 as well as under the current SEBI (FPI) Regulations, 2019. This is not an issue of recent origin or creation, and has sustained many policy debates over the years.

## 5. Proposal:

- 5.1. To mitigate the risk of circumvention of regulations such as MPS, and to prevent potential misuse of the FPI route to circumvent Press Note 3 stipulations, it is proposed that enhanced transparency measures for fully identifying all holders of ownership, economic, and control rights may be mandated for certain objectively identified high-risk FPIs that fulfil certain criteria. Specifically, such identification should be done on a look-through basis down to the level of natural persons, public retail funds, or large listed corporates, without applying any materiality thresholds, and notwithstanding any equivalent PMLA rules or secrecy laws that may be applicable in other jurisdictions of their domicile (including tax havens, if any).
- 5.2. At the first level, within the existing Category I and II FPI registrations, FPIs may be further categorized as High, Moderate and Low Risk based on the below mentioned criteria:
  - a. **Low Risk FPIs:** Government and Government related entities such as central banks, sovereign wealth funds, etc. since the ownership, economic and control interest in such entities is known due to predominant ownership by the Government of the respective country.
  - b. **Moderate Risk FPIs:** Pension Funds or Public Retail Funds as defined under Regulation 22(4) with widespread and dispersed investors in such funds. Categorization of such FPIs as moderate risk shall be subject to the ability of

DDPs to independently validate and confirm the status of such FPIs as Pension Funds and Public Retail Funds with a wide and diverse investor base.

c. **High Risk FPIs:** All other FPIs that are not low or medium risk.

5.3. For requiring additional disclosures, as discussed earlier, the above risk categorization is proposed to be coupled with either the quantum of concentrated investments by FPIs in a single corporate group (to prevent circumvention of MPS etc.), or the size of the overall equity AUM (to prevent misuse of the FPI route to circumvent the requirements of Press Note 3).

**Prevention of circumvention of MPS etc.:**

5.4. For now, it is proposed that high-risk FPIs (as defined above), holding more than 50% of their equity Asset Under Management ('AUM') in a single corporate group would be required to comply with the requirements for additional disclosures. Such FPIs shall be required to provide granular data of all entities with any ownership, economic interest, or control rights on a full look – through basis, up to the level of all natural persons and/ or Public Retail Funds or large public listed entities. Further, any material change in the same also needs to be communicated by the FPIs to their DDPs within 7 working days of such change.

5.5. It is observed that some of the prima facie high-risk FPIs that crossed the 50% investment threshold in a single group, may have an India-oriented AUM that is relatively small vis-à-vis their global AUM across all their investments at a scheme level. Subject to the ability of DDPs to independently validate the same, such FPIs with a single India/ India-related corporate group exposure below 25% of their overall AUM at a scheme level may be reclassified as moderate risk rather than high-risk. They may therefore be exempt from any requirements of additional disclosures.

5.6. In addition, to aid portfolio formation, new FPIs that have just begun investments will be allowed to cross the 50% group concentration threshold up to a period of 6 months without the need for additional disclosures becoming effective. Beyond 6 months, however, any crossing of the 50% concentration threshold by such FPIs will trigger the requirement for additional disclosures.

5.7. Similarly, existing FPIs that are in the process of winding down their investments may temporarily breach the 50% investment threshold in a single corporate group, provided that the portfolio of such FPIs is wound down within 6 months, the need for additional disclosures will not apply in such cases.

5.8. Existing high-risk FPIs that have more than the 50% concentration threshold in a single corporate group will be provided a window of six months to bring down such

exposure below 50%, before the need for additional disclosure requirements become effective.

- 5.9. On an ongoing basis, high-risk FPIs that momentarily breach the 50% group concentration investment threshold will be provided a window of 10 days to bring down such concentration, before the additional disclosure requirements become effective.
- 5.10. Failure to provide such additional granular disclosures wherever required will render the FPI registration invalid. Such FPIs would be required to wind down within 6 months.

**Prevention of misuse of the FPI route for circumvention of Press Note 3:**

- 5.11. Separately, it is proposed that existing high-risk FPIs with an overall holding in Indian equity markets of over Rs. 25,000 Cr. shall also be required to comply with additional granular disclosure requirements within 6 months, failing which the FPI should bring down its AUM below the said threshold within that time frame. The additional disclosure would include granular data of all entities with any ownership, economic interest, or control rights on a full look – through basis, up to the level of all natural persons and/ or Public Retail Funds or large public listed entities. Further, any material change in the same also needs to be communicated by the FPIs to their DDPs within 7 working days of such change.
- 5.12. In line with Para 5.5 above, prima-facie high-risk FPI schemes with significant holdings where their India-oriented AUM is relatively small vis-à-vis their global AUM may be classified as moderate risk and therefore, not subject to the additional disclosure requirements. Few examples in this regard include large global index/ ETF and other funds tracking global indices of which India forms a part.
- 5.13. High-risk FPIs that cross the Rs 25,000 Cr. AUM threshold in the future will be required to comply with additional granular disclosure requirements (as above) within 3 months of the event, failing which the FPI should bring down its AUM below the said threshold within that time frame. Thereafter, any material change in the same also needs to be communicated by the FPIs to their DDPs within 7 working days of such change.

**Miscellaneous**

- 5.14. Based on the data as of March 31, 2023, and on certain assumptions, we estimate that FPI AUM of around Rs. 2.6 Lakh Cr. (or around 6% of total FPI equity AUM, and less than 1% of India total equity market capitalization) may potentially be identified as high-risk FPIs that meet either of the 50% group concentration or the Rs. 25,000 Cr. fund size thresholds.

- 5.15. To reiterate, the proposed additional disclosure requirements will not impact low-risk and moderate-risk FPIs in any manner.
- 5.16. At the time of registration, high-risk FPIs shall be asked to submit an undertaking confirming that they have suitable mechanisms/ agreements in place with their investors (on a full look through basis), which shall include waiving off their privacy rights in their respective home jurisdictions in favor of SEBI, to allow for submission of additional granular disclosures to SEBI/ DDP if any of the concentration or size threshold conditions were to be crossed. Existing high-risk FPIs shall submit such undertaking within 6 months of issuance of the guidelines.
- 5.17. While the primary responsibility of monitoring the status vis-à-vis concentration and size thresholds shall rest with the FPI, the responsibility of monitoring the same, informing the FPI regarding exceeding the threshold, if any, rectification of the same and taking further actions would rest with the DDP of the FPI.
- 5.18. Preliminary discussions on the above framework were also held with the SEBI FPI Advisory Committee.

## 6. Public Comments

- 6.1. 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



- 6.2. Kindly mention the subject of the communication as, “*Consultation Paper on framework for mandating additional disclosures from Foreign Portfolio Investors (FPIs)*”.
- 6.3. Comments as per aforesaid format may be sent to the following, latest by June 20, 2023, in any of the following manner:
- (i) Preferably by email to [afdconsultation@sebi.gov.in](mailto:afdconsultation@sebi.gov.in), with a copy to Mr. Arpit Anand, Assistant General Manager ([arpit\\_anand@sebi.gov.in](mailto:arpit_anand@sebi.gov.in)) and Ms. Chitra M, Manager ([chitram@sebi.gov.in](mailto:chitram@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

**Issued on: May 31, 2023.**