

EY Regulatory Alert

SEBI Circular introducing additional measures to address regulatory arbitrage for Offshore Derivative Instruments (ODIs) and Foreign Portfolio Investors (FPIs) with segregated portfolios vis-à-vis FPIs

EY Alerts cover significant tax news, developments and changes in legislation that affect Indian businesses. They act as technical summaries to keep you on top of the latest tax issues. For more information, please contact your EY advisor.

Executive summary

This alert summarizes a recent Circular released by the Securities and Exchange Board of India (SEBI), dated 17 December 2024 (Circular)¹ which introduces measures to address regulatory arbitrage for Offshore Derivative Instruments (ODIs) and Foreign Portfolio Investors (FPIs) with segregated portfolios vis-à-vis FPIs. The Circular is in furtherance to the consultation paper² (CP) released by SEBI for public comments on 6 August 2024. The Circular makes changes to the existing conditions for issuance of ODIs and mandates applicability of granular disclosure framework [released by SEBI vide Circular³ dated 24 August 2023 and subsequent amendments thereto (August Circular)] to ODIs and FPIs with segregated portfolios.

¹ Circular 'SEBI/HO/AFD/AFD-POD-3/P/CIR/2024/176'

² Consultation Paper on investment by Foreign Investors through Segregated Portfolios/ P-notes/ Offshore Derivative Instruments

³ SEBI/HO/AFD/AFD-POD-2/P/CIR/2024/104



The better the question.
The better the answer.
The better the world works.



Shape the future
with confidence

Background

- ▶ ODIs are instruments issued overseas by FPIs against securities held by it in India, as its underlying.
- ▶ As per the SEBI (FPI) Regulations, 2019, ODIs can be issued by Category I FPIs to persons eligible for registration as Category I FPIs after compliance with KYC norms and other conditions as may be specified by SEBI. In this regard, the Master Circular⁴ dated 30 May 2024, provides for additional conditions for issuance of ODIs, KYC norms for ODI subscribers, investment limits, reporting requirements, etc.
- ▶ Further, owing to concerns relating to use of derivatives by ODI issuing FPIs, SEBI had prohibited issuance of ODIs with derivatives as underlying, except in certain specific instances.
- ▶ Further, to ensure that FPIs do not (a) concentrate a substantial portion of their equity portfolio in a single investee company/ company group thereby circumventing regulatory requirements under Substantial Acquisition of Shares and Takeovers Regulations, 2011 (SAST Regulations) or circumventing the requirement of maintaining Minimum Public Shareholding (MPS)⁵; or (b) circumvent the restrictions imposed by Press Note 3⁶, the August Circular was issued by SEBI.
- ▶ The August Circular requires FPIs that fulfil certain prescribed criteria to provide granular details of all entities holding any ownership, economic interest, or exercising control in the FPI, on a full look through basis, up to the level of all natural persons, without any threshold.
- ▶ Hitherto, the August Circular is not applicable to ODI subscribers and to each segregated portfolio of FPIs (where FPIs invest through segregated portfolios).
- ▶ In this regard, (a) to rationalize the conditions relating to issuance of ODIs and (b) to reduce the potential regulatory arbitrage that exists between investments made through ODIs/ FPIs with segregated portfolios with sub-fund structures vis-à-vis the regular FPI route, SEBI released a CP on 6 August 2024 for public comments. The above proposals in the CP were approved by the SEBI Board

⁴ SEBI/HO/AFD/AFD-PoD-2/P/CIR/2024/70

⁵ The Securities Contracts (Regulation) Rules, 1957 read with Regulation 38 of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 make it mandatory for entities who have listed their equity shares on a stock exchange to maintain MPS of 25%. This ensures balance of promoter and public shareholding and reduces volatility in the market.

at its meeting held on 30 September 2024.

- ▶ SEBI has now released the Circular on 17 December 2024 introducing the changes proposed in CP. This alert summarises the amendments made by the Circular.

Conditions for issuance of ODIs by FPIs

- ▶ Presently, the conditions for issuance of ODIs by FPIs (as prescribed in Part D of the Master Circular⁴ dated 30 May 2024) are as follows:
 - ▶ FPIs are neither allowed to issue ODIs with derivatives as underlying nor hedge the ODIs with derivative positions on the stock exchanges, except in the following cases:
 - Derivative positions taken on stock exchanges by the FPI for 'hedging of equity shares' held by it in India, on a one-to-one basis.
- 'Hedging of equity shares' means taking a one-to-one position in only those derivatives, which have the same underlying as the equity share held by the FPI in India.
- An ODI issuing FPI may hedge the ODIs referencing equity shares with derivative positions, subject to a position limit of 5% of market wide position limits for single stock derivatives.
- ▶ The above is permissible only through a separate FPI registration with ODI as a suffix.
 - ▶ FPIs shall be required to segregate ODI derivative investments from propriety derivative investments.
 - ▶ The Circular has replaced the above conditions with the following amendments:
 - ▶ FPI registration for ODI investments shall have "ODI" as suffix under the same PAN.

⁶ Press Note 3 dated 17 April 2020 provides that investment by an entity from a country which shares land border with India or where the beneficial owner of an investment into India is situated in/ citizen of any such country, shall only be under the Government route. Press Note 3 currently does not apply to FPI investments.

However, the same shall not be required where ODIs are issued with Government securities as underlying.

- ▶ FPIs shall not issue ODIs with derivatives as reference/ underlying.
- ▶ FPIs shall not hedge ODIs with derivative positions on stock exchanges in India. Further, ODIs shall be fully hedged with the same securities on a one-to-one basis, throughout the tenure of the ODI.

Applicability of Additional Granular Disclosures

For ODI subscribers

- ▶ As per the Circular, it will be mandatory for ODI subscribers to provide granular details of all entities holding any ownership⁷, economic interest⁸, or exercising control⁹ in the ODI subscriber, on a full look through basis, up to the level of all natural persons, without any threshold, if they fulfill the following criteria:
 - ▶ Criteria (a) - ODI subscriber having more than 50% of its equity ODI positions through the ODI issuing FPI in ODIs referenced to securities of a single Indian corporate group; or
 - ▶ Criteria (b) - ODI subscriber having 'equity positions' of more than INR 250 billion in the Indian markets.
- ▶ Equity positions include:
 - ▶ Equity ODI positions taken by the ODI subscriber through one or more ODI issuing FPIs
 - ▶ Equity ODI positions taken by ODI subscribers (through one or more ODI issuing FPIs) having common ownership, directly or indirectly, of more than 50% or common control with the ODI subscriber
 - ▶ Equity holdings of such ODI subscriber as a registered FPI
 - ▶ Equity holdings of FPIs having common ownership, directly or indirectly, of more than 50% or common control with the ODI subscriber
- ▶ ODI positions of ODI subscribers and holdings of ODI

issuing FPIs corresponding to the same underlying/ reference shares shall be counted only once so as to avoid double counting.

- ▶ Exemption from providing additional disclosures as currently applicable to FPIs shall also apply to ODI subscribers. This inter-alia includes:
 - ▶ Government and Government related investors.
 - ▶ Public retail funds, exchange traded funds (with less than 50% exposure to India and India-related equity securities), entities listed on specified exchanges.
 - ▶ Pooled investment vehicles meeting prescribed conditions.
 - ▶ University funds and university related endowments meeting the following conditions:
 - Indian equity ODI positions being less than 25% of Global Assets Under Management (AUM)
 - Global AUM being more than INR 100 billion equivalent
 - Appropriate return/ filing to the respective tax authorities in their home jurisdiction to evidence the nature of a non-profit organisation exempt from tax.
- ▶ ODI subscribers/ entities identified on look through basis meeting specified conditions. These conditions are similar to the conditions applicable for exemptions given to FPIs vide the August Circular including exemption applicable with respect to Criteria 'a' i.e. additional disclosure shall not be required if the apex company of the corporate group has no identified promoter.
- ▶ ODI subscribers breaching Criteria (a) and Criteria (b) shall not be required to make additional disclosure requirements, if their positions are realigned as per the below timeline es:
 - ▶ For breach of Criteria (a) - within 10 trading days from the date of breach
 - ▶ For breach of Criteria (b) - within 90 trading

⁷ Ownership interest means ownership of shares or capital of the entity or entitlement to derive profits from the activity of the entity.

⁸ Economic interest means returns from the investments made by the entity.

⁹ Control includes the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of shareholding or management rights or shareholders agreements or voting agreements or in any other manner.

days from the date of breach

Obligations of ODI issuing FPIs

- ▶ Where additional disclosure requirements are applicable, the ODI issuing FPIs shall collect the details from the ODI subscribers within 30 trading days from expiry of the above timelines and submit the same to the Depositories within 5 trading days.
- ▶ Non-disclosure by ODI subscribers shall render them ineligible to subscribe/hold any ODI positions through any ODI issuing FPI. ODI issuing FPIs shall redeem all ODI positions held by such ODI subscribers within 180 calendar days from the date of such ineligibility. A list of such ODI subscribers shall be made public by the Depositories and ODI issuing FPIs shall ensure that no ODIs are issued to these entities.
- ▶ Detailed mechanism for independently validating conformance of the ODI subscribers with the conditions, exemptions and format for disclosures

shall be spelt out in a Standard Operating Procedure (SOP) framed and adopted by Depositories, Custodians and ODI issuing FPIs in consultation with SEBI.

For FPIs with segregated portfolios

- ▶ With respect to FPIs with segregated portfolio(s), the criteria of the FPI holding more than 50% of their India equity AUM in a single corporate group shall apply individually to each segregated portfolio of the FPI and each segregated portfolio of such FPI shall be treated as separate FPI for the purpose of compliance with additional disclosure requirements.

Transitional measures for smooth operationalisation

<i>Timelines for certain ODIs to be redeemed</i>			
Sr. No.	ODIs issued and outstanding as on date of Circular i.e. 17 December 2024	Timelines to redeem the same	Remarks
1	ODIs with derivatives as underlying	1 year from date of Circular i.e. 17 December 2024	No renewal of such ODIs shall be permitted.
2	ODIs with securities (other than derivatives) as underlying and hedged with derivatives		Permitted to be redeemed or hedged with same securities as the underlying on a one-to-one basis
<i>Timelines for the Circular to come into force</i>			
Sr. No.	Provisions of this Circular	Effective Date	
1	Changes relating to conditions for issuance of ODIs	Immediate effect	
2	Changes relating to additional disclosures	5 months from the date of this Circular. SOP to be issued within 2 months from the date of this Circular.	

Comments

Issuance of ODIs or P-Notes by FPIs to foreign investors who seek exposure to Indian markets, without the complexities of direct registration with SEBI and tax obligations has been permitted by SEBI since more than 2 decades. Since then, SEBI has progressively tightened the rules relating to issuance of these instruments, hedging mechanisms and introduced greater disclosure requirements, with the objective to reducing opacity and systemic risks in the Indian capital markets.

SEBI's Circular dated 24 August 2023 mandating disclosure of granular details of 'high risk' FPIs (identified via concentration and size criteria) was a significant step in the direction to bring increased transparency of ownership of FPIs. Suitable exceptions and detailed SOPs were issued for implementation of the provisions of the said Circular. The current Circular now seeks to harmonize the disclosure requirements of the Circular dated 24 August 2023 and extend them to ODI subscribers as well as to FPIs with segregated portfolios. In this regard, detailed guidance is provided on aggregation of FPI's own positions in Indian markets and indirect positions through the issuance of ODIs for the purpose of calculating the concentration and size thresholds. These changes will come into effect from 17 May 2025.

In addition, SEBI has also prohibited hedging of ODIs with derivatives as underlying with the stated intention to curb overleveraging and systemic risks posed by the use of derivative products. Existing exceptions related to the use of derivatives by ODI issuers have been done away with. This change is effective immediately for new ODI contracts whereas existing ODI contracts with derivatives as underlying have been given time until 16 December 2025 to unwind.

Issuance of a detailed SOP to be framed by DDPs in consultation with SEBI is awaited and should provide further clarity, where needed.

SEBI's measures relating to ODIs over the years has resulted in the total value of ODIs as a percentage of FPIs Assets under Custody declining from 44% in 2006-07 to 2.1% in 2023-24¹⁰. Despite this, given the attractiveness of the Indian capital markets, interest amongst foreign investors to avail of the ODI route continues to remain buoyant. It remains to be seen if the latest round of restrictions and disclosure requirements will impact the volume of ODI transactions. While SEBI's new changes should eventually increase transparency and assist in tracking foreign investments in the Indian capital markets more effectively, it will not be without its set of challenges. The new requirements may likely increase the operational burden on ODI participants as well as prime brokers (specifically relating to validating the disclosures reported by their clients) and DDPs who are required to monitor the various disclosure norms. Besides confidentiality concerns relating to ODI subscribers having to provide their ownership data to the level of last natural person could likely pose a challenge, at least in some cases.

From a tax standpoint, the revised norms relating to one-to-one hedging shall require further analysis and review of investment structures to assess the tax impact.

For additional information with respect to this Alert, please contact the following:

Keyur Shah

Financial Services - Tax and Regulatory services
Partner & Leader - India Region
Email: keyur.shah@in.ey.com

Tejas Desai

Partner & Leader, Wealth & Asset Management -
Tax, India Region
Email: tejas.desai@in.ey.com

Anahita Kodia

Financial Services - Tax & Regulatory services
Partner - India Region
Email: anahita.kodia@in.ey.com

¹⁰ Based on data provided in Consultation Paper dated 6 August 2024

Our offices

Ahmedabad

22nd Floor, B Wing, Privilon
Ambli BRT Road, Behind Iskcon Temple
Off SG Highway
Ahmedabad - 380 059
Tel: + 91 79 6608 3800

8th Floor, Building No. 14A
Block 14, Zone 1
Brigade International Financial Centre
GIFT City SEZ
Gandhinagar - 382355, Gujarat
Tel +91 79 6608 3800

Bengaluru

12th & 13th Floor
"UB City", Canberra Block
No.24 Vittal Mallya Road
Bengaluru - 560 001
Tel: + 91 80 6727 5000

Ground & 1st Floor
11, 'A' wing
Divyasree Chambers
Langford Town
Bengaluru - 560 025
Tel: + 91 80 6727 5000

3rd & 4th Floor
MARKSQUARE
#61, St. Mark's Road
Shantala Nagar
Bengaluru - 560 001
Tel: + 91 80 6727 5000

1st & 8th Floor, Tower A
Prestige Shantiniketan
Mahadevapura Post
Whitefield,
Bengaluru - 560 048
Tel: + 91 80 6727 5000

Bhubaneswar

8th Floor, O-Hub, Tower A
Chandaka SEZ, Bhubaneswar
Odisha - 751024
Tel: + 91 674 274 4490

Chandigarh

Elante offices, Unit No. B-613 & 614
6th Floor, Plot No- 178-178A
Industrial & Business Park, Phase-I
Chandigarh - 160 002
Tel: + 91 172 6717800

Chennai

6th & 7th Floor, A Block,
Tidel Park, No.4, Rajiv Gandhi Salai
Taramani, Chennai - 600 113
Tel: + 91 44 6654 8100

Delhi NCR

Aikyam
Ground Floor
67, Institutional Area
Sector 44, Gurugram - 122 003
Haryana
Tel: +91 124 443 4000

3rd & 6th Floor, Worldmark-1
IGI Airport Hospitality District
Aerocity, New Delhi - 110 037
Tel: + 91 11 4731 8000

4th & 5th Floor, Plot No 2B
Tower 2, Sector 126
Gautam Budh Nagar, U.P.
Noida - 201 304
Tel: + 91 120 671 7000

Hyderabad

THE SKYVIEW 10
18th Floor, "SOUTH LOBBY"
Survey No 83/1, Raidurgam
Hyderabad - 500 032
Tel: + 91 40 6736 2000

Jaipur

9th floor, Jewel of India
Horizon Tower, JLN Marg
Opp Jaipur Stock Exchange
Jaipur, Rajasthan - 302018

Kochi

9th Floor, ABAD Nucleus
NH-49, Maradu PO
Kochi - 682 304
Tel: + 91 484 433 4000

Kolkata

22 Camac Street
3rd Floor, Block 'C'
Kolkata - 700 016
Tel: + 91 33 6615 3400

Mumbai

14th Floor, The Ruby
29 Senapati Bapat Marg
Dadar (W), Mumbai - 400 028
Tel: + 91 22 6192 0000

5th Floor, Block B-2
Nirlon Knowledge Park
Off. Western Express Highway
Goregaon (E)
Mumbai - 400 063
Tel: + 91 22 6192 0000

3rd Floor, Unit No 301
Building No. 1
MindSpace Airoli West (Gigaplex)
Located at Plot No. IT-5
MIDC Knowledge Corridor
Airoli (West)
Navi Mumbai - 400708
Tel: + 91 22 6192 0003

Altimus, 18th Floor
Pandurang Budhkar Marg
Worli, Mumbai - 400 018
Tel: +91 22 6192 0503

Pune

C-401, 4th Floor
Panchshil Tech Park, Yerwada
(Near Don Bosco School)
Pune - 411 006
Tel: + 91 20 4912 6000

10th Floor, Smartworks
M-Agile, Pan Card Club Road
Baner, Taluka Haveli
Pune - 411 045
Tel: + 91 20 4912 6800

Ernst & Young LLP

EY | Building a better working world

EY is building a better working world by creating new value for clients, people, society and the planet, while building trust in capital markets.

Enabled by data, AI and advanced technology, EY teams help clients shape the future with confidence and develop answers for the most pressing issues of today and tomorrow.

EY teams work across a full spectrum of services in assurance, consulting, tax, strategy and transactions. Fueled by sector insights, a globally connected, multi-disciplinary network and diverse ecosystem partners, EY teams can provide services in more than 150 countries and territories.

All in to shape the future with confidence.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. Information about how EY collects and uses personal data and a description of the rights individuals have under data protection legislation are available via ey.com/privacy. EYG member firms do not practice law where prohibited by local laws. For more information about our organization, please visit ey.com.

Ernst & Young LLP is one of the Indian client serving member firms of EYGM Limited. For more information about our organization, please visit www.ey.com/en_in.

Ernst & Young LLP is a Limited Liability Partnership, registered under the Limited Liability Partnership Act, 2008 in India, having its registered office at Ground Floor, Plot No. 67, Institutional Area, Sector - 44, Gurugram - 122 003, Haryana, India.

© 2025 Ernst & Young LLP. Published in India.

All Rights Reserved.

ED None.

This publication contains information in summary form and is therefore intended for general guidance only. It is not intended to be a substitute for detailed research or the exercise of professional judgment. Neither EYGM Limited nor any other member of the global Ernst & Young organization can accept any responsibility for loss occasioned to any person acting or refraining from action as a result of any material in this publication. On any specific matter, reference should be made to the appropriate advisor.

ey.com/en_in

 @EY_India  EY  EY India  EY Careers India  @ey_indiacareers



Download the EY India Tax Insights App