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EY Regulatory Alert

Additional disclosure framework for Foreign Portfolio Investors - SEBI Consultation Paper on proposal to increase the size criteria

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Executive summary

This alert summarizes a recent consultation paper (CP) released for public comments by the Securities and Exchange Board of India (SEBI) on 10 January 2025. The CP is in furtherance to the Circular issued by SEBI dated 24 August 2023[1] (August Circular), which outlines a framework for mandating additional granular disclosures by Foreign Portfolio Investors (FPIs) fulfilling prescribed concentration and size criteria and subsequent amendments made thereto including SEBI Circular dated 17 December 2024[2] to include subscribers of Offshore Derivative Instruments and FPIs with segregated portfolios.

The CP proposes to increase the threshold in respect of the size criteria with an objective to guard against the potential circumvention of Press Note 3[3] stipulation from INR 250 billion to INR 500 billion.

The last date to provide comments is 31 January 2025.

[1] Please refer to [EY Alert dated 29 August 2023]

[2] Please refer to [EY Alert dated 24 December 2024]

[3] 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.

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Background

- FPIs are regulated by the SEBI and are permitted to invest in, *inter-alia*, shares of listed Indian companies.

- 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)[4]; or (b) circumvent the restrictions imposed by Press Note 3[3], the August Circular was issued by SEBI.

- The August Circular, which became effective from 1 November 2023, mandated FPIs to disclose granular details of all entities holding any ownership, economic interest, or exercising control[5] in an FPI, on a full look through basis up to the level of natural persons, in the following cases:

  - <u>Concentration Criteria</u> - FPIs holding more than 50% of their Indian equity Assets Under Management (AUM) in a single Indian corporate group; or
  - <u>Size Criteria</u> - FPIs that individually, or, along with their investor group[6], hold more than INR 250 billion of equity AUM in the Indian markets.

  Additionally, the August Circular also provided that FPIs meeting certain prescribed conditions shall be exempted from the increased disclosure requirements.

- Further, a Standard Operating Procedure (SOP) was also framed by the Custodians and DDPs Standard Setting Forum (CDSSF), in consultation with SEBI to outline the detailed mechanism for independently validating conformance of FPIs with the conditions and exemptions as provided in the August Circular.

- Subsequently, with a view to address regulatory arbitrage with respect to Offshore Derivative Instruments (ODIs) and FPIs with segregated portfolios vis-à-vis FPIs, the additional granular disclosure framework was made applicable to ODI subscribers and FPIs with sub funds or separate class of shares or equivalent structures vide SEBI Circular dated 17 December 2024.

- Accordingly, for the purpose of computing breach of size criteria, combined equity holdings/ positions taken through FPI and ODI route is to be considered.

- During interactions with various industry participants, feedback has been received by SEBI and it was observed that due to their size and diversified investor base, very large non-exempt funds breaching the size criteria face challenges in providing granular details of every person holding any ownership, economic interest, or control in such funds.

- Given that the intention of obtaining granular information from FPIs who breach the size criteria is to ascertain whether the FPI is effectively domiciled in a Land Bordering Country (LBC), SEBI had released a consultation paper[7] on 30 July 2024, proposing a suitable risk-based threshold of disclosure of investors and stakeholders to categorize an FPI as LBC or non-LBC entity, rather than mandating disclosure of each and every interest owner in the FPI.

- While the above CP has not yet been formalized by SEBI, SEBI has issued the recent CP proposing to increase the threshold for the size criteria of INR 250 billion.

- This alert summarizes the key aspects of the CP dated 10 January 2025 issued by SEBI.

Proposal as per the Consultation Paper

- As indicated above, the size threshold has been introduced by SEBI with a view to guard against the

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[4] 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.

[5] Ownership interest means ownership of shares or capital of the entity or entitlement to derive profits from the activity of the entity.
Economic interest means returns from the investments made by the FPI.
Control has been defined to mean right to appoint majority of 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.

[6] Investor Group is defined in the SEBI (FPI) Regulations, 2019 to mean multiple FPIs, directly or indirectly, having common ownership of more than 50% or common control.
[7] Please refer to EY Alert dated 6 August 2024

potential circumvention of Press Note 3. The rationale for the same being that FPIs with large India equity portfolios may have the potential to disrupt the orderly functioning of the Indian securities markets.

- The CP states that 'potential to disrupt the functioning of the market' has to be evaluated relative to the size of the market. In this regard, a broad market parameter such as turnover can be considered to assess the size of the market.

- The data for average daily turnover in the capital market segment of the NSE for FY 2022-23 and FY 2024-25 (till December 2024) indicates an increase of 122%.

- Given the above increase in volume of transactions, the CP proposes to increase the threshold of the size criteria from INR 250 billion to INR 500 billion.

- The requirement for FPIs to make additional granular disclosures on breaching the 'concentration criteria' continues to apply and no changes are being proposed to the existing framework.

Comments

SEBI had released the August Circular with an intention to ensure that FPIs neither circumvent the restrictions imposed by Press Note 3 nor concentrate a substantial portion of their equity portfolio in a single investee company/ company group. Since its introduction in August 2023, based on suggestions and feedback from the industry, the August Circular and SOP have been amended from time to time.

Given that the volume of transactions has increased significantly from the time when the limit was introduced (i.e from INR 53,434 crores to INR 118,757 crores), this CP seeks to increase threshold of the size criteria from INR 250 billion to INR 500 billion.

This is a positive development and should help mitigate the compliance burden on large FPIs thereby facilitating ease of doing business in India.

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