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### SEBI'S ENHANCED UBO DISCLOSURE FRAMEWORK FOR SELECT FPIS AND THE PROPOSAL TO EXPAND MARKET ACCESS FOR NRIS AND OCIS THROUGH IFSC, GIFT CITY

20 September 2023 **Introduction**

On 10 August 2023, the Securities and Exchange Board of India (SEBI) introduced an amendment (Amendment) to the SEBI (Foreign Portfolio Investors) Regulations 2019 (FPI Regulations), allowing SEBI the additional right to demand granular disclosure of Ultimate Beneficial Owners (UBOs) based on ownership, economic interests and control for those Foreign Portfolio Investors (FPIs) which meet the criteria specified by SEBI from time to time. Subsequently, SEBI by way of its Circular No. SEBI/HO/AFD/AFD-PoD-2/CIR/P/2023/148 dated 24 August 2023 (Circular) has outlined an objective criteria for imposing additional disclosure requirements on FPIs for identifying and disclosing its UBOs. The criteria prescribed under the Circular is as follows:

*Criteria A: FPI holds over 50% of its Indian equity Assets Under Management (AUM) within a single Indian corporate group.*

*Criteria B: FPI together with its investor group has INR 25,000 crore (USD 3 billion approx.) or more of equity AUM in the Indian markets.*

This Circular is envisaged to be the yardstick of disclosure norms in respect of SEBI's proposal in its consultation paper dated 24 August 2023 (IFSC FPI Consultation Paper) to allow increased participation of Non-Resident Indians (NRIs) and Overseas Citizens of India (OCI) in the Indian capital markets through the FPIs set up in International Financial Services Centre (IFSC) in Gujarat International Finance Tec-City (GIFT City).

#### **Existing Rules for UBO Disclosure by FPIs**

The SEBI FPI Regulations mandate FPIs to identify and disclose their UBOs, both based on economic ownership and control. Currently, the threshold for identification and disclosure of UBOs is aligned with the thresholds specified by the Government of India in the Prevention of Money Laundering (Maintenance of Records) Rules, 2005 (PML Rules).

The principles for identifying UBOs, whether participating directly or indirectly through intermediate investment entities, are as follows:

1. Economic Ownership: Identification of UBOs is linked to economic participation using materiality thresholds corresponding to the legal structure of the entity:

- Corporates: 10%<sup>1</sup>
  - Trusts: 10%
  - Partnerships and unincorporated associations or bodies of individuals: 15%
2. Control: UBOs are identified through a subjective test of control, pertaining to the capacity to influence decision-making for the FPI.
  3. Senior Management Official (SMO): If no UBO is identified based on economic ownership thresholds or control, disclosure of the name of the SMO responsible for key decision-making is necessary.

### ***Hindenburg Report, SEBI's Directive to FPIs for UBO Resubmission by 30 September 2023 and Enhanced Disclosure Consultation Paper***

Earlier this year in January, Hindenburg, a US-based research firm, in its report alleged that FPIs were exploiting the UBO identification materiality thresholds for Adani Group shares by using multiple FPIs, each with holdings below the economic participation materiality threshold. This approach was purportedly used to bypass minimum public shareholding requirements for listed companies<sup>2</sup>.

As a repercussion, in February 2023, SEBI issued an email directive to Designated Depository Participants (DDPs), requiring their client FPIs to resubmit UBO details in a newly prescribed format. During investigation into the allegations from the Hindenburg Report SEBI encountered challenges in identifying UBOs for FPIs, because FPIs did not maintain record of UBOs with economic participation below the materiality threshold. SEBI also sought help from its counterpart international securities regulators under the International Organization of Securities Commissions' Multilateral Memorandum of Understanding. However, due to a lack of registered cases of Indian penal law violation, SEBI was unable to obtain information from foreign counterparts.

### ***Enhanced Disclosure Consultation Paper***

On 31 March 2023, SEBI issued a consultation paper (Enhanced Disclosure Consultation Paper) suggesting granular disclosures on ownership, economic interest, and control for certain objectively identified FPIs. The stated objective behind introducing granular disclosure was to curb evasion of minimum public shareholding requirements and misuse of the FPI route to evade Government of India's Press Note 3 (PN3), which subjects foreign direct investment from countries sharing land border with India to Government approval. Though not citing specific instances, the Enhanced Disclosure Consultation Paper expressed concerns about promoters concentrating substantial parts of their equity portfolios in individual investee companies or groups through related or unrelated FPIs, potentially bypassing the regulatory requirements relating to minimum public shareholding.

### ***The Amendment and the Circular***

Considering the challenges SEBI has faced under existing disclosure norms, the Amendment read with the Circular outlines the circumstances in which certain FPIs will be required to disclose details of all their UBOs, identified based on economic interest, control, and ownership. This involves adopting a 'full look-through' approach for all natural persons, without any thresholds.

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<sup>1</sup> Prior to 07 March 2023, this threshold was placed at 25%

<sup>2</sup> Listed Indian companies are required to maintain a minimum public float of 25% of the share capital.

It is important to highlight that the Circular's seeks to prevent the potential exploitation of the minimum public shareholding requirement for listed companies and to discourage any efforts to circumvent PN3 rules. The Circular, accordingly, requires FPIs to only reckon their equity holdings in Indian companies when calculating the AUM thresholds. Holdings in instruments other than equity shares are not included in the AUM calculation.

### Exemptions

The Circular provides exemptions for FPIs that don't pose systemic risks or face genuine constraints in adhering to the specified limits. The following FPIs have been granted exemptions:

- i. Government and Government related investors such as central banks, sovereign wealth funds, international or multilateral organizations or agencies including entities controlled or at least 75% directly or indirectly owned by such Government and Government related investor(s).
- ii. Public Retail Funds as defined under Regulation 22(4) of the FPI Regulations<sup>3</sup>, subject to independent confirmation by DDPs.
- iii. Exchange Traded Funds (with less than 50% exposure to India and India-related equity securities) and entities listed on specified exchanges in permissible jurisdictions as notified by SEBI<sup>4</sup>.
- iv. Pooled investment vehicles registered with or regulated by a Government or regulatory authority in their home jurisdiction or country of incorporation, where, subject to independent validation of disclosure by DDPs:
  - Their holding in an Indian corporate group is below 25% of their overall global AUM at a scheme level (Criteria A).
  - Their equity AUM in Indian markets is below 50% of their overall global AUM at a scheme level (Criteria B).

FPI investor groups with a collective equity AUM exceeding INR 25,000 crore (USD 3 billion approx.) in Indian markets are exempt from additional disclosures if the group includes exempted FPIs. If, after deducting the AUM of exempted FPIs, the net equity AUM of the group falls below INR 25,000 crore (USD 3 billion approx.), no further disclosures are required. However, if the equity AUM of the remaining non-exempt FPIs in the group still surpasses INR 25,000 crore (USD 3 billion approx.), a disclosure would be warranted.

### Other Exempt Circumstances

- i. FPIs unable to divest excess investments due to statutory restrictions (e.g., lock-in restrictions, moratoriums, regulatory orders, etc.) until such limitations cease.
- ii. Newly registered FPIs, for the initial 90 calendar days after the settlement of their first equity trade in India.

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<sup>3</sup> Public retail funds means -

(i) mutual funds or unit trusts which are open for subscription to retail investors and which do not have specific investor type requirements like accredited investors;

(ii) insurance companies where segregated portfolio with one to one correlation with a single investor is not maintained; and  
(iii) pension funds.

<sup>4</sup> Currently, the list of permissible jurisdictions is as mentioned in Annexure A to SEBI Circular on Framework for Issue of Depository Receipts, dated 28 November 2019, includes United States of America - NASDAQ, NYSE, Japan - Tokyo Stock Exchange, South Korea - Korea Exchange Inc., United Kingdom excluding British Overseas Territories- London Stock Exchange, France - Euronext Paris, Germany - Frankfurt Stock Exchange, Canada - Toronto Stock Exchange, International Financial Services Centre in India - India International Exchange, NSE International Exchange as the exchanges in the permissible jurisdictions.

- iii. FPIs in the process of winding down investments and notifying their DDP of intention to surrender FPI registration. Such FPIs must reduce holdings to 'NIL' within 180 calendar days from the surrender intimation date; otherwise, their accounts will be blocked, and regulatory actions will follow as per SEBI regulations.

#### **Compliance Window to Avoid Disclosure Requirements**

The Circular further carves out an exemption from disclosure for those FPIs who bring down their holdings below the disclosure thresholds, within the prescribed timelines and adhere to the exemption conditions mentioned below.

<b>Category</b>	<b>Timeline for dilution</b>	<b>Additional condition</b>
FPIs holding over 50% of their Indian equity AUM in a single Indian corporate group	Within 10 trading days after exceeding the threshold.	During the next 30 calendar days after surpassing the threshold, such FPIs cannot make fresh equity share purchases in any company within the Indian corporate group.
FPIs, including investor groups, possessing over INR 25,000 crore of equity AUM (USD 3 billion approx.) in Indian markets	Within 90 calendar days after surpassing the threshold.	Accounts of all FPIs, individually or as part of the investor group, will be blocked for further equity purchases until their holdings decrease below INR 25,000 crore of equity AUM in Indian markets.
FPIs required to make the specified disclosures as of the Circular's applicability date	Within 90 calendar days after the circular's applicability date of August 24, 2023.	N/A

#### **DDPs to prepare a Standard Operating Procedure**

The Circular also mandates DDPs to jointly develop a Standard Operating Procedure (SOP) which will outline the detailed process for independently verifying FPIs' compliance with the provisions of the Circular. This SOP will be publicly accessible and regularly updated by the DDPs in consultation with SEBI. According to SEBI, this jointly developed SOP will promote industry-wide consistency and help prevent regulatory arbitrage.

#### **SEBI's Proposal to Ease Participation Threshold for NRIs and OCIs in FPIs setup in IFSC, GIFT City**

Currently, FPI Regulations does not allow NRIs and OCIs to register as FPIs, as the extant foreign exchange regulations establish a separate investment route for NRIs, distinct from the FPI route. However, acknowledging that participants in pooled investment funds may include NRIs and recognising the administrative challenges associated with completely prohibiting individual participation from this category of investors, who are otherwise restricted from participating in pooled investment vehicles, SEBI permits FPIs to include NRIs / OCIs and resident Indians as constituents. However, individual holdings by NRIs/OCIs and resident Indians in the FPI should not exceed 25% of the FPI's corpus, and their combined holdings should be under 50%.

In an effort to strike a balance between facilitating increased participation of NRIs/OCIs in the Indian economy and mitigating the risk of potential misuse of the investment route, SEBI, through its IFSC FPI Consultation Paper, has proposed raising the permissible contribution limit

for FPIs established in IFSC, GIFT City, India's inaugural designated special economic zone and a deemed foreign territory. The IFSC FPI Consultation Paper proposes the following:

1. For a single NRI / OCI, the permissible investment limit is set at less than 25% of the total contribution in the FPI applicant's corpus. However, FPIs established in IFSC, GIFT City, may accept contributions from NRIs/OCIs that constitute 50% or more of their corpus on an aggregate basis.
2. FPIs set up in IFSC, GIFT City and having an aggregate contributions from NRIs/OCIs representing 50% or more of its corpus will be required to furnish granular disclosures of all its UBOs, determined both on the basis of ownership and economic interests in accordance with the Circular, if the following two criteria are met:
  - i. if the FPI holds more than 33% of its Indian equity AUM within a single Indian corporate group; or
  - ii. if the FPI, either individually or as part of their investor group, holds more than INR 25,000 crore (USD 3 billion approx.) of equity AUM in the Indian markets.

### Analysis

In line with the principles articulated in the Enhanced Disclosure Consultation Paper, emphasising the importance of transparency and trust for sustainable capital formation, SEBI has established a clearly defined set of objective criteria for comprehensive disclosures. However, the sudden policy change raises concerns about consistency in the legal framework, impacting the legitimate expectations of FPIs in a mature market like India.

At the same time, SEBI's regulatory stance provides valuable insights into its approach to future FPI regime liberalization, potentially setting a precedent for further reforms aimed at increasing accessibility for foreign investors within a robust regulatory framework that enables vigilant oversight of capital sources. Credit must be given to SEBI for demonstrating its commitment to enhancing overseas capital participation in the Indian capital market and for providing IFSC, GIFT City with the impetus to become an attractive international financial services centre.

In conclusion, while the Circular may cause short-term friction leading FPIs to re-evaluate their UBO details, in the long term, a well-defined objective criteria is likely to establish India as a preferred destination for capital market investment, balancing accessibility with a robust disclosure-based regulatory framework.

- Siddharth Shah (Senior Partner), Shikhar Kacker (Counsel) and Foram Pathak (Associate)

For any queries please contact: [editors@khaitanco.com](mailto:editors@khaitanco.com)