



**KHAITAN
& CO** ADVOCATES
SINCE 1911



16 May, 2024

**SEBI Enables 100% NRI and OCI Participation in Indian
Capital Markets through IFSC, GIFT City based FPIs**

INTRODUCTION

Following its proposal in its Consultation Paper¹ on permitting increased participation of Non-Resident Indians (NRIs) and Overseas Citizens of India (OCIs) into Securities & Exchange Board of India (SEBI) registered Foreign Portfolio Investors (FPIs) based out of International Financial Services Centre (IFSC) in Gujarat International Finance Tec-City, India (GIFT City) dated 25 August 2023 (Consultation Paper), SEBI in its board meeting dated 30 April 2024 (Board Meeting) has approved the proposal to allow FPIs based in IFSC, GIFT City to accept up to 100% contributions from NRIs, OCIs and Resident Indians (RIs). This was followed by International Financial Services Centre Authority (IFSCA) Circular No. F. No. IFSCA-IF-10PR/2/2024-Capital Markets dated 02 May 2024 (IFSCA FPI Circular) laying down eligibility criteria and KYC parameters for FPIs accepting up to 100% commitment from NRIs and OCIs on similar lines as proposed by SEBI in its Board Meeting.

BACKGROUND

The foreign exchange regulations² stipulate a separate portfolio investment regime for NRIs and OCIs. Consequently, NRIs and OCIs are not permitted to register themselves as FPI under the SEBI (Foreign Portfolio Investors) Regulations 2019 (FPI Regulations) for making portfolio investments in Indian capital markets. Since the derecognition of Overseas Corporate Bodies (OCBs)³ as an investor class in the year 2003, the flexibility of NRIs and OCIs to make portfolio investment through body corporates in Indian capital markets was taken away. The said decision was taken in the backdrop of concerns raised by the Joint Parliamentary Committee (JPC) set up to examine the stock market scam and matters relating thereto in the year 2001. As per the JPC, OCBs due to their close proximity with

Indian entities/ promoters of Indian entities were misused for money laundering and making illegitimate use of the routes available in tax havens. The JPC also noted the difficulties faced by SEBI in gathering information about the actual beneficiaries of suspected OCBs.

Although the then in force SEBI (Foreign Institutional Investors) Regulations, 1995 and the succeeding SEBI (Foreign Portfolio Investors) Regulations, 2014 allowed NRIs and OCIs to remain constituents of pooled investment funds investing under the portfolio investment regime, the regulatory position was revisited by SEBI in its Circular CIR/IMD/FPIC/CIR/P/2018/64 dated 10 April 2018, which stated that NRIs/ OCIs and RIs could not be beneficial owners of FPIs. The said circular led to the formation of the working group under the Chairmanship of H.R. Khan, Deputy Governor (Retired), Reserve Bank of India. Based on the recommendation of the working group, the extant FPI Regulations were notified, which permitted NRI/ OCI and RI participation in the FPI⁴ up to the following limits:

1. contribution of a single NRI or OCI or RI⁵ should be below 25% of the total contribution in the corpus of the FPI.
2. the aggregate contribution of NRIs, OCIs and RIs should be below 50% of the total contribution in the corpus of the FPI.
3. FPIs not meeting the above requirements are required to comply within a period of 2 (two) years from the date of registration. FPIs who remains non-compliant even after the 2 (two) year period are prohibited from making any fresh purchase of securities and such FPIs are required to liquidate its existing position in the Indian securities market within a period of 180 days.

¹ Please see our previous Ergo on the Consultation Paper ([here](#))

² Currently, Foreign Exchange Management (Non-Debt Instrument) Rules, 2019

³ Overseas entity held 60% or more by NRIs

⁴ FPIs registering under non-investing FPI category, for example, investment advisors or asset management

companies or FPIs proposing to invest only in units of schemes floated by mutual funds in India were exempt from the aforesaid conditions.

⁵ Participation by RIs in FPIs, provided their contribution is made under the Liberalised Remittance Scheme (LRS) notified by RBI in global funds whose Indian exposure is less than 50%.

4. In case of a temporary breach of the above investment limits, the FPI is required to comply with the eligibility conditions within 90 days of its breach. In case the FPI remains non-compliant with the said requirement even after 90 days, then no fresh purchases are permitted and such FPI is required to liquidate its existing position in Indian securities market within a period of the next 180 days.

THE NEED TO REVISIT THE POLICY

Although India continues to remain the leading recipient of foreign remittance, participation by NRIs and OCIs in Indian capital markets has remained significantly less owing to the aforementioned investment restrictions. Also, the burden of monitoring NRI/ OCI/ RI participation and the risk associated with forced paring down NRI/ OCI/ RI holding in the FPI, especially on account of passive increase in their holdings due to redemption request from other investors discouraged FPIs from accepting commitments from NRI/ OCI/ RIs, resulting in lesser flow of funds from NRI and OCIs in Indian capital markets.

THE STRATEGIC ADVANTAGE OFFERED BY IFSC, GIFT CITY

The key impediment in allowing 100% NRI/ OCI participation through FPIs was the perceived risk of such FPI vehicles being potentially misused by promoter of Indian listed entities for circumventing the minimum public shareholding requirements by using FPIs owned and controlled by NRIs and OCIs as a cover.

IFSCA being a domestic regulator and under the supervision of the Ministry of Finance, allayed the concerns of SEBI in its ability to swiftly seek granular investors details of the FPIs should the need arise as compared to the administrative difficulty faced by Indian regulators and Government agencies in readily seeking investor details of FPIs from their counterparts by invoking provisions of the existing bilateral and multilateral

protocols. This comfort led to SEBI creating an exception in favour of FPIs from accepting up to 100% contribution from NRIs/ OCIs/ and RIs which are based at IFSC, GIFT City.

THE SEBI BOARD MEETING AND THE IFSCA FPI CIRCULAR

Though the final text of the framework for enabling the proposal is yet to be notified by SEBI, but a conjoint reading of the Board Minutes and the subsequently issued IFSCA FPI Circular suggest the following framework for allowing set up of FPI vehicles⁶ having 100% participation from NRIs/ OCIs/ RIs:

Alternative Route 1

NRI/OCI/RI investors may contribute up to 100% in the corpus of FPIs where such FPIs will be, *inter alia*, required to submit copies of PAN (or other suitable documents specified by SEBI), of all their NRI/OCI/RI individual constituents, along with their economic interests in the FPI, to the Designated Depository Participant. If a constituent does not have a PAN, the FPI will be required to submit a suitable declaration along with copies of prescribed Identity documents such as Indian passport, OCI Card, Aadhaar, etc.

Similar disclosure will also be required in case of indirect holding in the FPI through non-individual constituents that are majority contributed to, owned or controlled by NRI / OCI / RI individuals on a look through basis.

Alternative Route 2

FPIs desirous of having up to 100% aggregate contribution in their corpus from NRIs / OCIs / RI will not be required to submit the documents mentioned for Alternative Route 1, if they satisfy the following conditions:

- a) **Pooling:** Contribution of all investors of the fund are pooled into one investment vehicle that is registered as an FPI, with no side-vehicles.
- b) **Pari-passu and Pro-rata:** The corpus of the fund is a blind pool (i.e. common

⁶ FPI vehicle will be a scheme launched by a Fund management Entity registered with IFSCA under the IFSC (Fund Management Entity) Regulations, 2022

portfolio) with no segregated portfolios. All investors in the fund will have *pari-passu* and *pro-rata* rights in the fund.

- c) Diversification of investors: The fund has a minimum of 20 investors with each investor contributing not more than 25% to the corpus of the fund.
- d) Diversification of investments: A maximum of 20% of the corpus of the fund may be invested in the equity shares of an Indian listed entity.
- e) Independent Investment Manager: The investors in the fund do not have a say in the investment decisions of the fund. The Investment Manager is completely independent with respect to taking investment decisions for the fund. The Investment Manager of the fund is an Asset Management Company of a SEBI registered Mutual Fund which is sponsored by an RBI regulated Bank or its IFSC based subsidiary / branch.

In addition to the above, FPIs will be required to submit granular UBO details identified on the basis of ownership, economic interest or control without any materiality thresholds on a look through basis (in terms of SEBI Circular No. SEBI/HO/AFD/AFD-PoD-2/CIR/P/2023/148 dated 24 August 2023) if:

- a) such FPI holds more than 33% of their Indian equity Asset Under Management in a single Indian corporate group; or
- b) such FPI along with its investor group holds more than INR 25,000 crore (approx. USD 3 billion) of equity Asset Under Management in the Indian markets.

CONCLUSION

The measures taken by SEBI and IFSCA to facilitate increased participation of NRIs and OCIs in the Indian capital market represent a significant step towards broadening the investor base and fostering financial inclusivity. The amendments underscore the Government's recognition to the role NRI and OCIs can play in bringing foreign capital to Indian markets.

The new regime is likely to create opportunities for portfolio managers and asset management companies for offering bespoke solutions to their NRI and OCI clients. Previously, these clients either had to be admitted as minority participants in pools created for other foreign investors or had to be onboarded domestically as a client under portfolio management services. This subjected such NRI and OCI clients to cumbersome KYC and ongoing reporting obligations.

This regulatory reform also positions IFSC, GIFT City as the preferred choice of offshore jurisdiction for investment managers, particularly in view of the recent amendment to the Double Tax Avoidance Agreement between India and Mauritius (**DTAA**) pursuant to signing of the Protocol by incorporating a 'Principal Purpose Test'. The tax benefits under the DTAA may be denied if one of the 'principal purposes' of such arrangement is to obtain a tax benefit, and that providing such benefit is not in line with the objects and purposes of the DTAA⁷.

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

For any queries please contact:
editors@khaitanco.com

⁷ Our analysis of the Protocol can be accessed ([here](#))

AMBITION STATEMENT

"Our ambition is to be a respectable law firm providing efficient and courteous service, to act with fairness, integrity and diligence, to be socially responsible and to enjoy life. We should put greater emphasis on working in consonance with our aforesaid values than on maximizing earnings. Earn we should but with dignity and pleasure."

Khaitan & Co is a premier full-service Indian law firm with 25+ practice areas, over 1,000 lawyers, including 200+ partners. To know more about us, please visit www.khaitanco.com