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Introduction and Key Considerations

Indian Foreign Portfolio Investment regime for Russian Institutional Investors and Corporates

March 2023

Introductory FPI Primer

Attorney Client Privileged Communication

Presentation Outline

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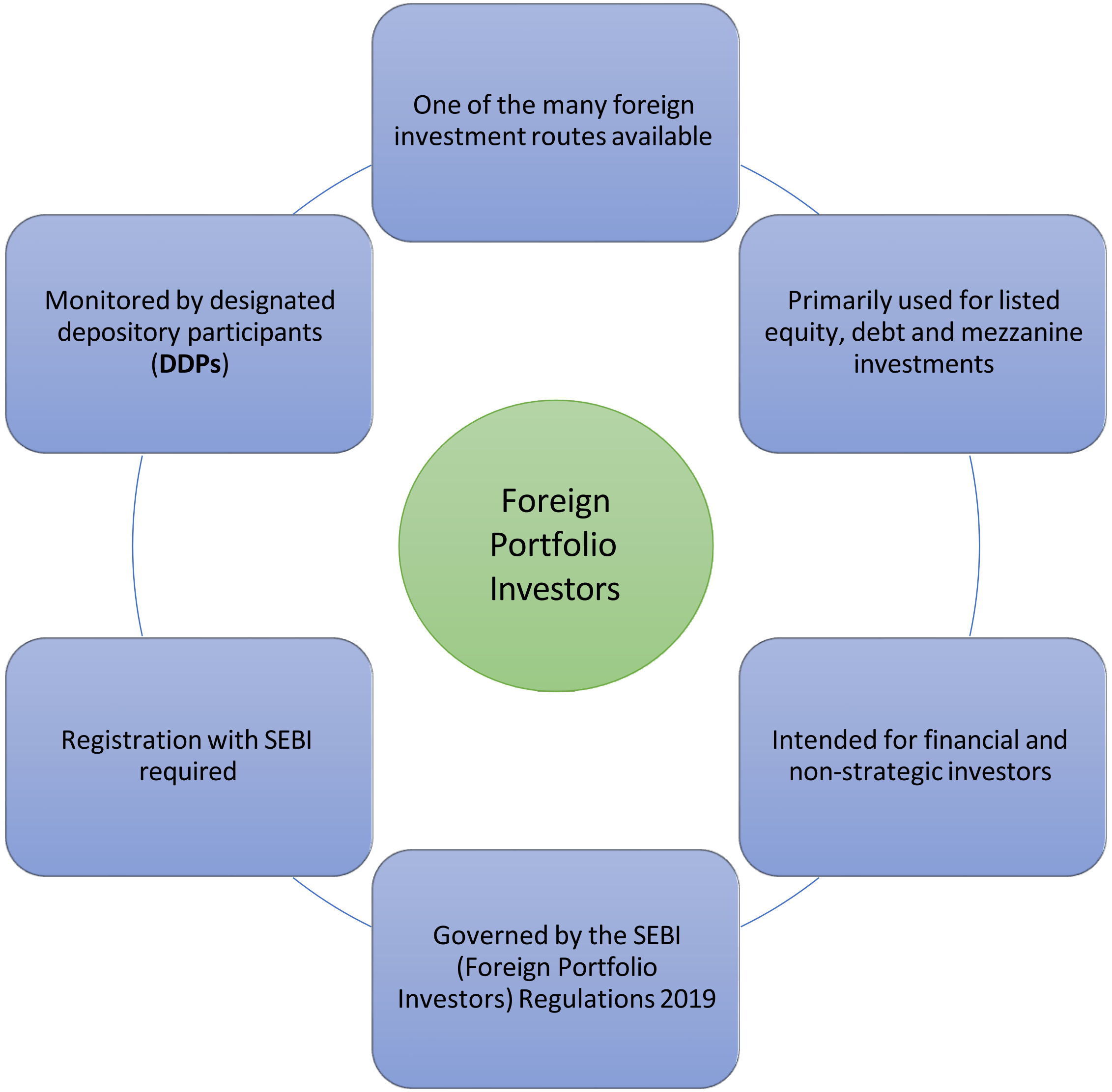
- **Foreign Direct Investment and Foreign Portfolio Investment**
  - Key Considerations

The Foreign Portfolio Investors Regime

Background, Eligibility Criteria, Categorisation, Registration and Compliance Requirements

Background



- The Foreign Portfolio Investment (**FPI**) route is a unified access route for all portfolio / public markets investments into India
- Governed primarily by:
  - SEBI (Foreign Portfolio Investors) Regulations (**FPI Regulations**) 2019;
  - SEBI's Master Circular for Foreign Portfolio Investors, Designated Depository Participants and Eligible Foreign Investors
  - Foreign Exchange Management (Non-Debt Instruments) Rules 2019 (**NDI Rules**)
  - SEBI circulars
  - RBI notifications on investment limits
- The FPI Regulations have replaced the SEBI (Foreign Portfolio Investors) Regulations 2014, removing broad basing requirements, placing emphasis on AML / KYC requirements and rationalising categorisation.
- Members of the Firm were part of the SEBI committee which reviewed the erstwhile FPI regulations and proposed the changes, culminating into the current FPI Regulations

Eligibility Criteria

- Resident of a country whose securities market regulator is a **signatory to International Organization of Securities Commission's Multilateral Memorandum of Understanding** or a signatory to bilateral memorandum of understanding with SEBI;
- If the applicant is a bank, is resident of a country whose central bank is a member of **Bank for International Settlements** provided that a central bank applicant need not be a member;
- The applicant and its underlying investors, contributing 25% or more in the corpus of the applicant, or identified on the basis of control, shall **not be persons mentioned in the 'Sanctions List' notified by the United Nations Security Council** and shall **not be from a jurisdiction which is identified in the public statement of the FATF** as having (a) deficient anti-money laundering laws; or (b) taken insufficient measures to remedy such deficiencies;
- The applicant, its principal officer, directors, promoters and the key management persons is a **'fit and proper person'** based on the criteria specified by SEBI

None of the restrictions on RI / NRI / OCI ownership and control are applicable to non-investing FPIs and / or FPIs investing only in units of schemes floated by mutual funds in India

Applicants have a period of 2 years from the date of registration to comply with these conditions

Restrictions on resident Indian (RI), non-resident Indian (NRI) and overseas citizen of India (OCI)

Cannot be a RI / NRI / OCI individuals

- There are no exceptions to this

Applicants shall comply with RI / NRI / OCI ownership thresholds

- Single NRI / OCI / RI contribution should be <25%
- Aggregate RI / NRI / OCI contribution should <50%

RIs / NRIs / OCIs should not be in control of the applicant

- Not applicable to offshore funds that have obtained a NOC under the mutual fund regulations from SEBI
- Not applicable to applicants with RI / NRI / OCI owned and controlled managers that: (i) are appropriately regulated and registered as a non-investing FPI, or (ii) incorporated under Indian laws and appropriately registered with SEBI

Categories of FPIs

- **CATEGORY I**
  - **Government and government related investors**
    (central banks, SWFs, governmental / international / multilateral organisations and entities where $\geq$75% ownership or control is held by such government related investors)
  - **University Funds and Pension Funds**
  - **Appropriately regulated entities**
  - **Specified entities from FATF member countries / notified countries****
    - Appropriately regulated funds
    - Unregulated funds with regulated managers and Category I FPI registration
    - University related endowments of universities that have been in existence for more than 5 years
  - **Specified entities from non-FATF member countries / otherwise not eligible**
    - Investment Manager is from FATF member country and registered as a Category I FPI
    - $\geq$75% shareholder is from an FATF member country and eligible for Category I FPI registration

- **CATEGORY II**
  - **All other entities not eligible under Category I FPIs**
    (endowments, charitable organisations, foundations, corporate bodies, appropriately regulated entities investing on behalf of their client as per SEBI specified conditions, individuals, family offices)

***Mauritius is the only country notified so far*

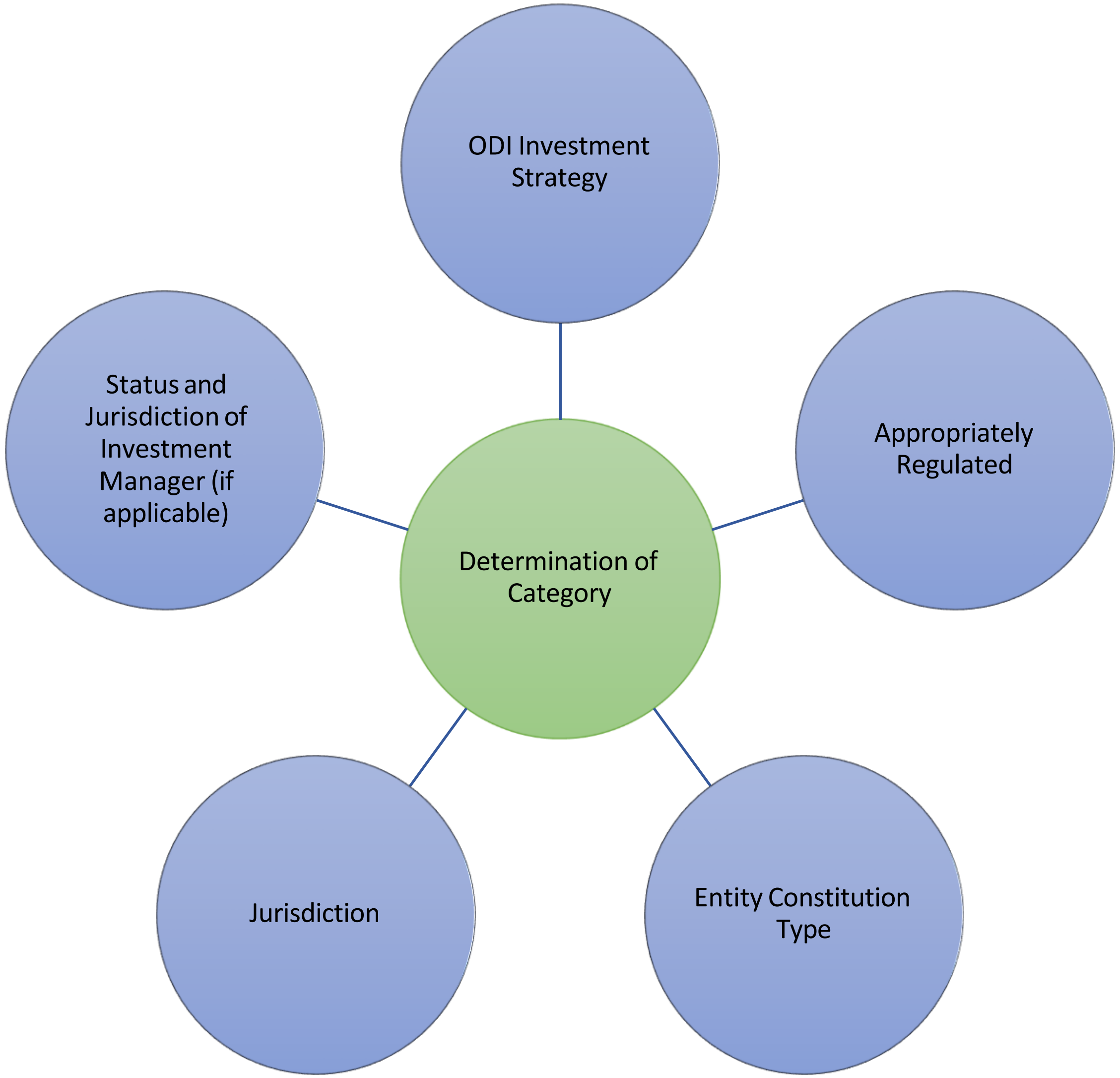
Key Considerations for Categorisation

WHY CATEGORY I?

Category I FPIs have the following advantages over Category II FPIs:

- Exemption from indirect transfer tax in India
- Eligible to deal in offshore derivative instruments (**ODIs**)
- Relatively lesser KYC formalities relative to Category II FPIs
- Availability of qualified institutional buyer (**QIB**) status that is not available to individuals, corporates and family offices that are only eligible for Category II FPI registration

Category I FPIs are subject to a higher recurring registration fee, to be paid in advance for a block of 3 years, of USD 3000 vis-à-vis Category II FPIs who are required to pay USD 300 only



Registration Process and Compliance Requirements

1. Assessment of Eligibility Criteria and Categorisation
2. Appointment of DDP
3. Application for FPI Registration and PAN under the Common Application Form
4. KYC Requirements and Identification of Beneficial Owners
5. Opening of cash and custody accounts

The registration typically takes between 4-6 weeks, not taking into account the time taken internally to arrange KYC documentation and inordinate delays in negotiation of documentation with DDPs

Most of the compliance requirements in respect of investment reporting is carried out by the DDP / custodian. Set out below are certain ongoing requirements that the FPI will be required to comply with:

- **Ongoing Reporting Requirements**
  - Penalties and Litigation
  - Change in Information
  - Investment specific disclosures including disclosures under the Takeover Regulations
  - Beneficial Owners
  - Offshore Derivative Instruments Reporting
  - Information as may be requested by DDP / SEBI
- **Appointment of Compliance Officer and Auditor**
- **Auditing of the FPI and filing tax returns**
- **Maintenance of books and records**

Permissible Investments

Permissible Instruments, Key Investment Conditions and Recent Debt Investment Routes

Permissible Investments

- Shares, debentures and warrants issued by body corporates, listed or to be listed on a recognised stock exchange in India, through primary or secondary markets;
- Shares that are to be listed on a stock exchange pursuant to an initial public offer, follow-on public offer, rights issue, private placement or shares received through involuntary corporate actions in accordance with relevant pricing guidelines;
- Units of schemes floated by domestic mutual funds and collective investment schemes;
- Units of exchange traded funds which invest less than or equal to 50% in equity;
- Derivatives traded on a recognised stock exchange;
- Treasury bills and dated government securities;
- Units of real estate investment trusts, infrastructure investment trusts, Category III alternative investment fund (up to 25%) or units of an offshore fund for which no-objection is issued in accordance with the SEBI (Mutual Fund) Regulations 1996 which in turn invest more than 50% in equity instruments;
- Listed and unlisted non-convertible debentures / bonds / commercial papers issued by an Indian company, credit enhanced bonds and security receipts issued by asset reconstruction companies;
- Debt instruments issued by banks, eligible for inclusion in regulatory capital;
- Rupee denominated bonds or units issued by infrastructure debt funds;
- Indian depository receipts of companies resident outside India and issued in Indian capital markets;
- Non-convertible redeemable debentures / non-convertible redeemable preference shares issued by an Indian company pursuant to a scheme of arrangement subject to certain conditions;
- Securitised debt instruments, including any certificate or instrument issued by a special purpose vehicle set up for securitisation of asset(s) with banks, financial institutions or NBFCs as originators;
- Municipal bonds; and
- Such other instruments specified from SEBI from time to time

Key Investment Conditions

HEAD	EQUITY
General	SEBI and RBI prescribe investment limits for various types of specific securities as well, which are notified from time to time. The SEBI prescribed investment limits can be found in the Operating Guidelines
Investment Limits	▪ ***Single FPI / Investor Group Limit***: 10% ▪ ***Aggregate Limit***: Sectoral cap / company reduced cap / 24% (*for foreign direct investment* (***FDI)*** *prohibited sectors*) ▪ ***Basis for Calculation***: - <u>Equity Shares</u>: total paid-up equity capital on a fully diluted basis - <u>Preference Shares / Warrants / Debentures</u>: the paid-up value of each series of debentures or preference shares or warrants issued
Debt	The RBI prescribes limits for investments in central government securities, state development loans and corporate bonds every financial year. These limits are a combination of a percentage of outstanding stock as well as amount limits
Clubbing of Investment Limits	All FPIs that have <u>50% direct or indirect common ownership</u> or <u>common control</u> are treated as part of an investor group, and their investment (*direct or indirect, including by way of ODI*) are clubbed *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*

Recent Debt Investment Routes

- **VOLUNTARY RETENTION ROUTE**
  - Voluntary Retention Route (**VRR**) Introduced by the RBI for FPIs to make investments in the debt market exceeding the debt investment limits applicable to them otherwise
  - Allocation of investment amounts to FPIs under this route are made on tap or through auctions and the minimum retention period is 3 years, or as otherwise decided by the RBI, for each allotment by tap or auction
  - Income from investments through VRR may be reinvested at the discretion of the FPI and such investments will be permitted in excess of the committed portfolio size
  - The aggregate cap on investments under the VRR is INR 2500 billion, allocated across investments in government securities, corporate debt instruments and instruments eligible under both government securities and corporate debt instruments

- **FULLY ACCESSIBLE ROUTE**
  - Fully Accessible Route (**FAR**) is the latest route introduced by RBI, with effect from 1 April 2020
  - For investment in certain specified government securities as notified by the government from time to time
  - FAR offers unrestricted access to such notified government securities to all foreign investors (including FPIs), as opposed to the investment limits that FPIs are subject to for most debt securities and bonds in India

Foreign Portfolio Investment - clearing and settlement mechanism

The Intermediaries involved and their role

Intermediaries involved in clearing and settlement of trades

- **Independent intermediaries**: Functions relating to execution, settlement, clearing, delivery and payments are performed by independently regulated intermediaries, hence, the counterparty risk is minimal.
- **Rolling settlement of trades on a T+1 basis**
- **Intermediaries:**
  - **Stock Exchange**: The Indian securities are listed on a recognised stock exchanges having national wide trading terminal viz. the National Stock Exchange (NSE) and the Bombay Stock Exchange (BSE).
  - **Depositary**: Securities of Indian companies are created in dematerialised form. The FPI opens a DEMAT account in its own name with a Depository. ***Owing to the Russian federal law requirements, Russian FPIs can open the account in the name of its Special Depositary as nominee for the benefit of the FPI entity. The Special Depositary need not separately seek any registration as FPI***. Similar nominee relationship will be reflected in records of other intermediaries too.
  - **Clearing Corporation**: An independent entity associate with the stock exchange which handles the confirmation, settlement and delivery of securities.
  - **Stock Broker**: The stock broker provide trade execution services. Stock broker is also required to become a trading member of a stock exchange.
  - **Custodian / Depositary Participant/ Clearing Member**: The Custodians are also registered as depositary participant and become clearing member with stock exchanges. Custodian matches the trades in the contract note with the trade details provided by the stock exchange, checks the client’s bank/ Demat account balance before confirming the trade and thereafter, debits the funds/ securities for the pay-in to the stock exchange.
  - **Bank**: In-flow and out-flow of cash is made through a Special Non-Resident Rupee (SNRR) Account maintained by the FPI with an Indian Bank (or an Indian branch of a foreign bank for example, Sberbank India Branch)

Flow of clearing and settlement of trades on the stock exchange

- **Equity Trade Cycle Process**
  - Trades are executed by the stock broker using the unique CP (custodial participate) code of the client i.e. the FPI
  - The broker shares the contract note with the custodian and client separately. The client sends an email to the custodian attaching the contract note as a trade confirmation.
  - The custodian matches the trades in the contract note with the trade details provided by the stock exchange at the end of the trade day i.e. 'T'. Final obligations is generated by 8:30 am on T+1.
  - Custodian checks the client's bank/ Demat account balance before confirming the trade. Trades are confirmed to the stock exchange, if balances are sufficient.
  - The custodian debits the funds/ securities for the pay-in to the stock exchange.
  - Stock exchange transfers the securities/ funds on T+1, which is then transferred to the client's account on the same day.
- **Currency/ Derivative Trade Cycle Process**
  - In order to receive a trading limit from the exchange, the client is required to maintain cash collateral with the custodian/ clearing member. The custodian / clearing member also provides the collateral to be exchanged on the client's behalf.
  - The customer can move forward with trade execution after the stock exchange assigns the limit to the custodian/ clearing member and from the custodian/ clearing member to client.
  - Stock brokers mentions the unique CP code when executing trades. Once a trade is completed using a CP code, it is sent to the custodian/ clearing member for clearing and settlement.
  - The clearing member is responsible for confirming trades on the stock exchange based on available margin and settling daily mark-to-market (MTM) settlements on behalf of clients.
  - On the expiry of contracts, the open position is cash settled in the case of the currency derivative segment.

Foreign Direct Investment and Foreign Portfolio Investment

Key Considerations

Key Considerations and Differentiators between FDI and FPI

- FDI and FPI routes are **<u>independent foreign investment routes</u>**, the key considerations (and differentiators) that should be kept in mind while assessing the correct route of investment are set out below

- Breach of the 10% FPI investment limits leads to conversion of the entire FPI investment into FDI investment on failure to divest within 5 trading days in accordance with the Operating Guidelines and NDI Rules

- Similarly, on breach of the aggregate investment limit, divestment is carried out through the disproportionate divestment methodology on breach of the aggregate limit

- FPI and FDI investments can be both made through the same entity

Prohibited Sectors and Sectoral Caps	On-market / off-market
Strategic or Financial Investment	Taxation Considerations
Listed / Unlisted	Debt / Equity

Credentials

#	CLIENT NAME	BRIEF DESCRIPTION OF TRANSACTION AND ROLE
1.	**AION Capital**	Advised the client in relation to its foreign portfolio investment in security receipts issued by various ARC trusts.
2.	**Amansa Capital**	Acted for the client for FPI registrations, advisory in relation to FPI regulations and related issues.
3.	**APG Group Netherlands**	Acted for the client for FPI registrations, advisory in relation to FPI regulations and related issues.
4.	**DSP Blackrock**	Acted as Indian legal counsel for setting up FPIs for investing in Indian listed securities domiciled in Mauritius.
5.	**Duro Capital**	Acted as Indian legal counsel for setting up FPIs for investing in Indian listed securities domiciled in Mauritius and Singapore.
6.	**Eastbridge Capital**	Acted for the client for FPI registrations, advisory in relation to FPI regulations and related issues.
7.	**Eight Capital**	Advised the client on structuring of investments and investments in various ARC trusts.
8.	**India Acorn Fund (White Oak Capital)**	Acted as Indian legal counsel for setting up FPIs for investing in Indian listed securities domiciled in Mauritius.
9.	**India Resurgence Fund**	Advised the client on ARC setup, structuring of investments and investments in various ARC trusts.
10.	**Makrana Capital**	Acted as Indian legal counsel for setting up FPIs for investing in Indian listed securities domiciled in Singapore.
11.	**MIT Investment Management Co.**	Provide Indian legal and tax advice to client for their investments in India under the FPI Route.

Credentials

#	CLIENT NAME	BRIEF DESCRIPTION OF TRANSACTION AND ROLE
12.	**Motilal Oswal ICAV**	Acted for the client for FPI registrations, advisory in relation to FPI regulations and related issues.
13.	**PIMCO**	Advised client from an Indian legal and regulatory perspective for their investments in India under the FPI Route.
14.	**Samena Capital**	Acted for the client for FPI registrations, advisory in relation to FPI regulations and related issues.
15.	**Scopia Capital Management**	Advised client from an Indian legal and regulatory perspective for their investments in India under the FPI Route.
16.	**Susquehanna International Group**	Advised client from an Indian legal and regulatory perspective for their investments in India under the FPI Route.
17.	**Wellington Asset Management**	Advised client from an Indian legal and regulatory perspective for their investments in India under the FPI Route.
18.	**West Virginia Investment Management Board.**	Advised client from an Indian legal and regulatory perspective for their investments in India under the FPI Route.

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