Foreign Investment by Registered Foreign Portfolio Investor and Comparative Analysis.

C.A. Paresh Shah & C.A. Mitali Gandhi

1. Introduction

The previous articles of Foreign Direct Investment (FDI) dealt with the overall regulations governing Foreign Investment in India and various schedules for foreign investment under Notification No. FEMA 20(R)/ 2017-RB (hereinafter referred to as "Fema 20(R)").
In the current article we will cover:

i. Investment by Registered Foreign Portfolio Investor (RFPI)
ii. Comparative Analysis of Foreign Investment through various routes

2. Key definitions used in the article

i. Foreign Portfolio Investment(FPI) : Any investment made by a person resident outside India (PROI) through capital instruments where such investment is less than 10 percent of the post issue paid-up share capital on a fully diluted basis of a listed Indian company or less than 10 percent of the paid up value of each series of capital instruments of a listed Indian company.

ii. Registered Foreign Portfolio Investor (RFPI) means a person registered in accordance with the provisions of Securities Exchange Board of India (Foreign Portfolio Investors) Regulations, 2014. Under the SEBI FPI Regulations, 2014, Foreign Institutional Investors (FIIs), Sub Accounts (SA) and Qualified Foreign Investors (QFIs) were merged into a single category, referred to as FPIs.

iii. Broad Based Fund: A broad-based fund means a fund, established or incorporated outside India which has at least 20 investors with no individual investor holding more than 49% of the shares or units of the fund.

3. Investment by RFPI under Schedule 2 and Schedule 5 of Fema 20(R)

3.1. <u>Inclusions under RFPI</u>

i. An RFPI includes investment groups of Foreign Institutional Investors (FII), Qualified Foreign Investors (QFI), Asset Management Companies, Banks, Pension Funds, Mutual Funds, Investment Trusts as Nominee Companies, Incorporated / Institutional Portfolio Managers or their Power of Attorney holders, University Funds, Endowment Foundations, Charitable Trusts and Charitable Societies etc.

ii. As per SEBI circular no CIR/IMD/FPIC/CIR/P/2018/132 dated 21st September 2018 NRIs/ OCIs/ Resident Indians (RIs) shall be allowed to be constituents of FPIs subject to the following conditions: -

a) Contributions by NRI/ OCI/ RI** including those of NRI/ OCI/ RI** controlled Investment Manager should be below 25% from a single NRI/ OCI/ RI and in aggregate should be below 50% of the corpus of FPI.
***Resident Indian's contribution permitted is that made through Liberalised Remittance Scheme (LRS) approved by Reserve Bank of India in global funds whose Indian exposure is less than 50%.*

b) NRI/ OCI/ RI should not be in control of FPI.

c) However, an Investment Manager (IM) which is controlled and/or owned by NRI / OCI may control the FPI provided:
   1. The IM is appropriately regulated in its home country and is registered with SEBI as a non-investing FPI, or
   2. The IM is incorporated or set-up under Indian laws and appropriately registered with the SEBI

d) The above restrictions mentioned in (ii) do not apply to FPIs investing only in Mutual Funds in India.

e) In case of temporary breach, a time period of 90 days will be given to ensure compliance with above conditions.

f) The restriction that NRI/ OCI/ RI should not be in control of FPI shall also not apply to FPIs which are 'offshore funds' for which no-objection certificate has been provided by the Board.

3.2. <u>Categories of FPI</u>

i. Category l: Government and Government related investors such as central banks, Governmental agencies, sovereign wealth funds or international and multilateral organizations or agencies. Category l FPIs are subjected to the easiest set of compliance norms.

ii. Category ll: Regulated broad-based funds such as mutual funds, investment trusts, insurance/reinsurance companies.
-Regulated persons such as banks, asset management companies, investment managers/advisors, portfolio managers.
-Broad-based funds not 'appropriately regulated'** but whose investment manager (including investment advisor or trustee) is appropriately regulated and registered as Category II FPI Global Currency Futures & Options.
-University Funds, Pension Funds and University related Endowments already registered with SEBI.

**Appropriately Regulated means an applicant falling in Category II regulated or supervised by the securities market regulator or the banking regulator of the concerned foreign jurisdiction, in the same capacity in which it proposes to make investments in India.

iii. Category lll: All others FPIs not eligible under Category I and II such as endowments, charitable societies, charitable trusts, foundations, corporate bodies, trusts, individuals and family offices. Category lll FPIs are subjected to the strictest set of compliance norms

On the recommendation of the H R Khan committee SEBI has removed the concept of Category-III FPIs. There will now be only two categories of FPIs. However, there is no clarity how the two categories of FPIs will be decided.

3.3. FPI Investment Limits

i. The total holding by each registered foreign portfolio investor (RFPI) or an investor group as referred in SEBI (FPI) Regulations, 2014, shall be less than 10 percent of the total paid-up equity capital on a fully diluted basis or less than 10 percent of the paid-up value of each series of debentures or preference shares or share warrants issued by an Indian company.

ii. The total holdings of all RFPIs put together shall not exceed 24 percent of paid-up equity capital on a fully diluted basis or paid up value of each series of debentures or preference shares or share warrants. The aggregate limit of 24 percent may be increased by the Indian company concerned up to the sectoral cap/ statutory ceiling, as applicable, with the approval of its Board of Directors and its General Body through a resolution and a special resolution, respectively.

iii. One may note that there is no regulation to increase the individual limit of 10 percent and only the aggregate limit of 24% can be increased.

iv. In case the total holding of an FPI increases to 10 percent or more of the total paid-up equity capital on a fully diluted basis or 10 percent or more of the paid-up value of each series of debentures or preference shares or share warrants issued by an Indian company, the total investment made by the FPI shall be re-classified as FDI subject to the conditions as specified by Securities and Exchange Board of India and the Reserve Bank in this regard.

3.4. Mode of Payment

The amount of consideration shall be paid as inward remittance from abroad through banking channels or out of funds held in a foreign currency account and/ or a Special Non-Resident Rupee (SNRR) account. The foreign currency account and SNRR account shall be used only and exclusively for transactions under this Schedule

3.5. Pricing Guidelines

i. In case of Public Offer, the price of the shares to be issued is not less than the price at which shares are issued to residents.

ii. In case of issue by private placement, the price is not less than
   a. The price arrived in terms of guidelines issued by the Securities and Exchange Board of India, or
   b. The fair price worked out as per any internationally accepted pricing methodology for valuation of shares on arm’s length basis, duly certified by a SEBI registered Merchant Banker or Chartered Accountant or a practicing Cost Accountant.

3.6. Eligible Investments for RFPI as per Fema 20(R)

The following investments are subject to certain conditions and caps on exposure and size.

i. Capital instruments of Listed Indian companies and with the cap as per paragraph 3.5 above.

ii. Dated Government securities/ treasury bills;

iii. Non-convertible debentures/ bonds issued by an Indian company;
iv. Commercial papers issued by an Indian company;
v. Units of domestic mutual funds;
vi. Security Receipts (SRs) issued by Asset Reconstruction Companies up to 100 percent of each tranche, subject to directions/ guidelines of the Reserve Bank;
vii. Perpetual Debt instruments eligible for inclusion as Tier I capital and Debt capital instruments as upper Tier II capital issued by banks in India to augment their capital (Tier I capital and Tier II capital as defined by Reserve Bank) provided that the investment by all eligible investors in Perpetual Debt instruments (Tier I) shall not exceed an aggregate ceiling of 49 percent of each issue and investment by a single FPI shall not exceed the limit of 10 percent of each issue;
viii. Non-convertible debentures/ bonds issued by Non-Banking Financial Companies categorized as 'Infrastructure Finance Companies'(IFCs) by the Reserve Bank;
ix. Rupee denominated bonds/ units issued by Infrastructure Debt Funds;
x. Listed non-convertible/ redeemable preference shares or debentures issued in terms of Merger or demerger or amalgamation of Indian companies as given in Regulation 9 of Fema 20(R).
xi. Security receipts issued by securitization companies subject to conditions as specified by the Reserve Bank and/ or Securities and Exchange Board of India.
xii. Securitised debt instruments, including (i) any certificate or instrument issued by a special purpose vehicle (SPV) set up for securitisation of asset/s with banks, Financial Institutions or NBFCs as originators; and/ or (ii) any certificate or instrument issued and listed in terms of the Securities and Exchange Board of India (Regulations on Public Offer and Listing of Securitised Debt Instruments), 2008.
xiii. Currency Derivatives segment of stock exchange (subject to various position limits and other conditions)
xiv. Stock Derivatives
xv. Units of REITs, InvITs and Category III AIFs
xvi. Municipal Bonds

3.7. Investment conditions/ Restrictions on investment by RFPI

i. FPIs investments in corporate debt securities:
   a) FPIs are permitted to invest in corporate bonds with minimum residual maturity of above one year, subject to the condition that short-term investments (i.e. investment in securities with residual maturity up to 1 year) in corporate debt securities by an FPI shall not exceed 20% of the total investment of that FPI in corporate bonds. This requirement applies on an end of day basis.
   (short-term investments do not include any investment made after April 27, 2018)

   b) Investment by any FPI (including investments by investor group as determined on the basis of clubbing requirement on the basis of common beneficial owner in accordance with Regulation 23(3) of SEBI (FPI) Regulations, 2014), in corporate debt securities, shall be subject to the following concentration limits:
   (i) Long-term FPIs: 15% of prevailing investment limit.
   (ii) Other FPIs: 10% of prevailing investment limit.

(iii) In case an FPI has investments (INV0) in excess of the concentration limit on the effective date (date on which these concentration limits come into existence as prescribed by RBI), it will be allowed relaxations as given in SEBI operating guidelines for FPI, subject to availability of overall limits, as a one-time measure

c) FPI investment in corporate bond (including investment by investor groups) shall not exceed

d) 50% of any issue of a corporate bond. In case an FPI, including investments by investor groups, has invested in more than 50% of any single issue, it shall not make further investments in that issue until this stipulation is met.

e) FPIs are not permitted to invest in partly paid debt instruments.

f) FPI investments in any Central Government securities cannot exceed 30% of the outstanding stock of that security.

ii. Position limits available to FPIs for stock and stock index derivative contracts

a) Position limits available to Category I & II FPIs for stock derivate contracts shall be same as of Trading Member level limits as advised by SEBI from time to time.

b) Position limits available to Category III FPIs shall be same of client-level limits as advised by SEBI from time to time.

iii. FPI Position Limits in Exchange Traded Interest Rate Futures (IRF)

a) For category l and ll FPIs there is a limit of INR 5,000 crore on aggregate basis to FPIs for taking long position in IRFs.

b) For Category III FPIs, the gross open positions across all contracts within the respective maturity bucket shall not exceed 3% of the total open interest in the respective maturity bucket or INR 200 crore, whichever is higher.

c) For Category I,II & III FPIs, the total gross short (sold) position of an FPI in IRF shall not exceed its long position in the government securities and in Interest Rate Futures, at any point in time.

iv. An FPI shall not hold more than twenty five percent stake in a category III AIF.

3.8. <u>A RFPI is not eligible to invest in a Limited Liability Partnership or in capital instruments of unlisted Indian companies.</u>

3.9. <u>Recent Amendments in Investment by RFPI</u>

i. As per RBI A.P. (DIR Series) Circular No. 19 dated 15th February 2019, RBI has withdrawn the provision mentioned in paragraph 4(f) (ii) of the AP (DIR Series) Circular No. 31 dated June

15, 2018 that no FPI shall have an exposure of more than 20% of its corporate bond portfolio to a single corporate (including exposure to entities related to the corporate).

ii. SEBI eased the KYC norms and eligibility terms for FPIs through circular no CIR/IMD/FPIC/CIR/P/2018/131 dated 21st September 2018.

3.10. Recommendations by Working Group on FPI Regulations

SEBI had constituted a working group on March 26, 2018 under the Chairmanship of Shri H.R. Khan, Deputy Governor (Retired), Reserve Bank of India, which was entrusted with the task of reviewing the current Securities and Exchange Board of India (Foreign Portfolio Investors) Regulations, 2014 and recommending any amendments that may be required for rationalising and simplifying the SEBI FPI regulations.

The Khan Committee has submitted its report on May 24, 2019 to SEBI. The report contains the following:

i. **Ease of access** - fast track on-boarding process for select category II FPIs, review of broad based condition for appropriately regulated entities, pension fund to be considered for category I FPI registration, deemed broad based status for insurance/ re-insurance entities, simplified registration for multiple investment manager (MIM) structures, entities established in the international financial services centre(IFSC) be deemed to have met the jurisdiction criteria for FPIs, etc.

ii. **Simplification of documentation** - removal of 'opaque structure" definition, simplified KYC documentation for category III FPI, KYC reliance on same group regulated entity of custodian for non-PAN documents, etc.

iii. **Review of Investment restriction** - Liberalized investment cap, harmonization between investment restrictions in FPI regulations and FEMA 20(R), reclassification of investment from FPI to FDI, permitting FPIs for off-market transactions, review of restriction on sovereign wealth funds for investment in corporate debt securities etc.

iv. **Other aspects** - strengthening of clubbing restrictions, alignment between FPI and alternative investment fund (AIF) routes, strengthening of offshore derivative instrument (ODI) framework, etc.

Entire report can be found on https://www.sebi.gov.in/sebi_data/commondocs/may-2019/Annexure-A_p.pdf

4. Investment avenues in capital instruments of Indian companies by PROI through Foreign structure under Fema 20(R)

A PROI has various investment avenues to invest in India. Most of which has been discussed in the previous articles. Following are the various avenues available to an PROI for investment in India.

4.1. Investment in Capital Instruments of Indian Companies along with management control (Foreign Direct Investment)

i. Schedule I: A PROI can invest in the capital instruments of an Indian company (i.e. Listed and Unlisted) under schedule I, subject to entry routes, sectoral caps and pricing guidelines. Along with filing of form FCGPR within 30 days of issue and form FCTRS within 60 days of transfer of capital instrument.

ii. Schedule VII: A PROI can invest through an FVCI in equity and equity linked instruments or debt instruments of start-ups or the permitted ten sectors (ie Biotechnology, IT related to hardware and software development, Nanotechnology, Seed research and development, Research and development of new chemical entities in pharmaceutical sector, Dairy industry, Poultry industry, Production of bio-fuels, Hotel-cum-convention centres with seating capacity of more than three thousand and Infrastructure sector) whose shares are not listed on any recognized stock exchange at the time of issue of the said securities; Pricing guidelines do not apply to investment and disinvestment by an FVCI. An FVCI has to disclose all its investment strategies to the SEBI before it makes any investment in India.

4.2. Investment in capital instruments of a Listed Indian Companies with no Management control

i. Schedule II – A PROI(excluding NRI)can invest in capital instruments of Listed Indian companies by investment through RFPI under Schedule ll of Fema 20(R) subject to a cap of 10% of the total paid-up equity capital on a fully diluted basis per RFPI or an investor group (same set of beneficial owner) and the total holdings of all FPIs put together shall not exceed 24 percent of paid-up equity capital on a fully diluted basis. The aggregate limit of 24% can be increased by the Board of directors through a special resolution. An FVCI can also be registered as an FPI as per SEBI circular no CIR/IMD/FIIC/05/2015.

ii. Schedule ll & lll - An NRI can invest in capital instruments of a Listed Indian Company through the following ways:

  a) Schedule ll: Through an RFPI with a 25% cap on investment per NRI/OCI/RI and aggregate investment should be below 50% of the AUM along with other investment conditions as mentioned above.
  b) Schedule lll: Through direct purchase/sell on a recognized stock exchange in India. The total holding by any individual NRI or OCI shall not exceed 5 percent, and the total holdings of all NRIs and OCIs put together shall not exceed ten percent of the total paid-up equity capital on a fully diluted basis.

iii. Schedule VII – A PROI can invest in equity shares of a Listed Indian company by investment through a Foreign Venture Capital Investor, However an FVCI can only invest 33.33% of its investible funds by way of an IPO or through preferential allotment with one-year lock in.

4.3. Investment in Limited Liability Partnership (LLP)

Schedule VI: A PROI (other than citizen of Bangladesh and Pakistan) can invest in an LLP under schedule 6 of Fema 20(R) only in sectors where 100% foreign investment is permitted under automatic route with no FDI linked conditions, subject to pricing guidelines. An FVCI and FPI cannot invest in an LLP.

5. Investment avenues for PROI in capital instruments of Indian company through Domestic structure under Fema 20(R)

5.1. Investment through Alternate Investment Fund (AIF)

Schedule VIII: A PROI can invest through an AIF in capital structure of unlisted companies through category I, ll and lll AIF and in capital instruments of Listed companies through category lll AIF subject to other conditions of investment.

Minimum ticket size for investment is Rupees one crore per investor. If the sponsor and the manager of the AIF are Indian owned and controlled then downstream investment in operating companies will not be treated as foreign Investment and will be deemed to be resident Investment. This would permit the foreign investors to invest in Indian companies without any sectoral restrictions.

5.2. Investment through a Private or Public company registered with Reserve Bank of India (RBI) as Non-Banking Finance Company (NBFC) under 100% Automatic route

6. Investment avenues in capital structure of an Indian company for RFPI

6.1. <u>Investment in capital instruments of Listed company</u>

i. Schedule III: An RFPI can purchase/sell capital instruments on a recognized stock exchange as per Schedule 2 subject to a cap of 10% of the total paid-up equity capital on a fully diluted basis per RFPI or an investor group (same set of beneficial owner) and the total holdings of all FPIs put together shall not exceed 24 percent of paid-up equity capital on a fully diluted basis. The aggregate limit of 24% can be increased by the Board of directors through a special resolution.

ii. Schedule VIII: An RFPI can invest through investment in category lll AIF subject to a maximum investment of 25% of the AUM of the Fund and other investment conditions.

6.2. <u>Investment in capital instruments of an unlisted company</u>

Schedule VIII: An RFPI can invest in an unlisted company through investment in category lll AIF subject to a maximum investment of 25% of the AUM of the Fund and other investment conditions.

7. Investment avenues in capital structure of an Indian company for FVCI

7.1. <u>Investment in capital instruments of Listed company</u>

Schedule VII: Maximum up to 33.33% of the corpus of FVCI can be invested by way of an IPO or preferential allotment with a one year lock in.

7.2. <u>Investment in capital instruments of Unlisted company</u>

i. Schedule VII: an FVCI can invest in equity and equity linked instruments or debt instruments of start-ups or the permitted ten sectors (i.e Biotechnology, IT related to hardware and software development, Nanotechnology, Seed research and development, Research and development of new chemical entities in pharmaceutical sector, Dairy industry, Poultry industry, Production of bio-fuels, Hotel-cum-convention centres with seating capacity of more than three thousand and Infrastructure sector) whose shares are not listed on any recognized stock exchange at the time of issue of the said securities; Pricing guidelines do not apply to investment and disinvestment by an FVCI. An FVCI has to disclose all its investment strategies to the SEBI before it makes any investment in India.

ii. Schedule VIII: An FVCI can invest in unlisted companies through investment in units of a Venture Capital Fund or of a category I AIF.

8. Conclusion/Summary

Below is the summary for various Investment avenues under Fema 20(R)

Investor Type	Investing Entity				
	Listed Company (FDI)	**Unlisted Company**	**Listed Company (Portfolio Investment)**	**LLP**	**AIF**

PROI (excl NRI)	Permitted under Sch I subject to FDI related conditions.	Permitted under Sch I of Fema subject to FDI related conditions.	Permitted under Sch II,VII and VIII, subject to respective investment conditions as discussed above	Permitted under Sch VI only in sectors where 100% FDI is permitted under Automatic route with no FDI linked conditions	Permitted in all 3 categories of AIF
NRI/OCI	Permitted under Sch I subject to FDI related conditions.	Permitted under Sch I of Fema subject to FDI related conditions.	Permitted under Sch II,III,VII and VIII, subject to respective investment conditions as discussed above	Permitted under Sch VI only in sectors where 100% FDI is permitted under Automatic route with no FDI linked conditions	Permitted in all 3 categories of AIF
RFPI	not permitted	Permitted through investment in Category III AIF under sch VIII. Maximum up to 25% of the AUM.	Permitted under Sch II subject to respective investment conditions as discussed above	not Permitted	Permitted only through category III AIF up to maximum 25% of AUM
FVCI	not permitted	Permitted under Sch VII in start-ups and ten sectors as mentioned above	Permitted under Sch VII up to 33.33% of corpus of FVCI only by way of IPO or by way of preferential allotment with one-year lock-	not Permitted	Permitted only through category I AIF
AIF	Permitted only through category III AIF	Permitted through category, I, II and III AIF	Permitted only through category III AIF	Permitted through category, I, II and III AIF	

9. Issues in various sectors under FDI policy

9.1. FDI in print Media and Broadcasting

i. FDI Policy on Broadcasting Sector applies to Broadcasting Carriage Services (such as Cable Networks, DTH, Mobile TV, etc.) FDI is permitted up to 100% under Automatic route. Broadcasting Content Services being FM Radio, Up-linking of 'News & Current Affairs'(FDI is permitted up to 49% under govt route) and 'Non-News & Current Affairs' TV Channels / Downlinking of TV Channels. (FDI is permitted up to 100% under Automatic route)

ii. FDI Policy on Print Media Sector applies to Publishing of newspaper and periodicals dealing with news and current affairs, Publication of Indian editions of foreign magazines dealing with news and current affairs, Publishing/printing of scientific and technical magazines/specialty journals, etc. and Publication of facsimile edition of foreign newspapers. FDI is permitted up to 29% under Government Route

iii. Detailed conditions are specified for these sectors. Operational conditions seek to regulate the activities of the journalists through sector-specific laws & guidelines.

iv. It can be observed that both sectors deal with different methods of dissemination of information which may be News & Current Affairs or non-News & Current Affairs.

v. However, Internet-based journalism and online dissemination of information through portals which is rapidly proliferating is not specifically covered under the FDI Policy under the above Sectors

Key Issue: Can an Indian company proposing to engage in collection of news & current affairs, analysis & reporting / publishing of same through internet online portals invite FDI under automatic route? Is this a oversight in the law as the intention of the FDI Policy is to regulate foreign investment in sensitive sectors which deal with matters of national interest?

9.2. <u>FDI in Real Estate Sector</u>

Various conditions are specified for undertaking 100% investment in the Construction Sector under the automatic route. Earlier, such conditionalities did not apply to investment by NRIs/OCIs. Now, all the conditionalities except the lock-in conditions will apply to NRI/OCI investment. The issue that arises is whether this requirement restricts NRIs who have historically been offered beneficial conditions for FDI.

9.3. <u>FDI in Defence Sector</u>

i. As per Consolidated FDI Policy, in Defence Industry is subject to Industrial license under the Industries (Development & Regulation) Act, 1951 and Manufacturing of small arms and ammunition under the Arms Act, 1959, FDI is permitted up to 49% in automatic route and up to 100% through Govt. route if it is likely to result in access to modern technology or for other reasons to be recorded.

ii. Licence applications will be considered and licences given by the Department of Industrial Policy & Promotion, Ministry of Commerce & Industry, in consultation with Ministry of Defence and Ministry of External Affairs.

iii. Foreign investment in the sector is subject to security clearance and guidelines of the M/o Defence.

The issue that arise,

a) In case of items related to Defense sector but not falling under Industrial Licensing or Arms Act such as electronic components used in Defense products as well as in other industries will attract licensing as per se there is no manufacturing of Defense products.
b) In such cases, will security clearance from Ministry of Defense still be required?

9.4. <u>FDI Policy relating to Other Financial Services</u>

i. FEMA Notification no.FEMA.375/2016-RB dated September 9, 2016 amended the sectoral cap for ‘other financial services’ thereby doing away with the minimum capitalization norms. Instead of specifying various activities, the provision has been simplified to mean Financial services activities regulated by financial sector regulators, viz., RBI, SEBI, IRDA, PFRDA, NHB or any other financial sector regulator as may be notified by the Government of India. Financial service activities governed by aforesaid regulators will be permitted to bring 100% FDI under automatic route.

ii. FDI in unregulated/ partly regulated financial sector activities or where there is doubt regarding the regulatory oversight, FDI will be permitted under approval route subject to conditions including minimum capitalization requirement, as may be decided by the Government.

The issue that arises is:
The issue that arises is that a number of financial services (e.g. non-fund based services) are now inadvertently brought under Govt. approval route as such services do not have any Regulator / Govt. agency monitoring the activities. Is this the intent of the legislation?

10.Conclusion: A careful analysis of the FDI policy will reveal that schedular rules are aimed at providing a set of rules for the type of the Foreign Investor. As far as possible a type of investor will not be able to enter or make investment of a particular type or with similar conditions through more than one schedule. Investment type could be Capital or Debt, direct or portfolio leading to either on repatriation or on a nonrepatriation basis