

SEBI Initiates Consultation Process – ODI Holders & FPIs with Segregated Portfolio and Related Matters

To address regulatory arbitrage between Foreign Portfolio Investors (**FPIs**) and holders of offshore derivative instruments¹ (**ODI Holders**) and FPIs with segregated portfolios² (**Segregated Portfolios**) in relation to exposure to Indian securities market and to further tighten regulation of offshore derivative instruments (**ODI**), the Securities and Exchange Board of India (**SEBI**) seeks to amend the existing disclosure requirements and certain other FPI norms and has initiated a consultation process to obtain feedback from the market. The consultation paper dated August 06, 2024 setting out the proposed changes (**Consultation Paper**) can be accessed at - [link](#). The key aspects dealt with under the Consultation Paper are set out below:



Proposal to extend granular disclosures to ODI Holders/ Segregated Portfolios

Granular Disclosure Requirements – Developments thus far:

1. In 2023, SEBI enhanced the disclosure norms for FPIs in terms of which, FPIs that fulfilled the below prescribed criteria³, were obligated to provide granular disclosures of all entities holding any ownership, economic interest, or exercising control in the FPI, on a full look through basis, up to the level of all natural persons, without any threshold:

a. FPIs holding more than 50% of their Indian equity Assets Under Management (**AUM**) in a single Indian corporate group (**Concentration Criteria**);

or

b. FPIs that individually, or along with their investor group, hold more than INR 25,000 crore of equity AUM in the Indian markets (**Size Criteria**, and together with the Concentration Criteria, the **Prescribed Thresholds**).

2. For this purpose, a standard operating procedure (**SOP**) (*setting out the modalities of such compliance with disclosure obligations as well as detailed aspects on assessment of exempted categories*) was also issued by designated depository participants (**DDPs**) in consultation with SEBI. Since its notification, the SOP has been updated from time to time to *inter alia*, capture changes in respect of exempted categories.

3. If the Prescribed Thresholds are met, FPIs are required to re-align their investments within the specified timelines, failing which, they would trigger the granular

¹ 'ODI' has been defined to mean as "any instrument, by whatever name called, which is issued overseas by a foreign portfolio investor against securities held by it in India, as its underlying."

² FPIs that invest through sub-fund structures or separate class of shares or equivalent structure with segregated portfolio.

³ SEBI circular dated August 24, 2023 can be accessed here: [link](#) ("**August Circular**").

disclosure requirements. The timelines for re-alignment vary depending upon the settlement date of investment and the category of the Prescribed Threshold that the FPI triggers. Failure to comply with the disclosure requirements will render the FPI registration invalid, and the FPI will be precluded from making any further purchases. Such FPI will have to liquidate its securities and exit the Indian securities market by surrendering its FPI registration, as specified.

4. While stakeholders were assessing the applicability of the Prescribed Thresholds, exempt categories and evaluating next steps for re-alignment and/ or relevant disclosure obligations, in early 2024, SEBI, through a communication to the DDPs, clarified that “ODI subscribers of the FPI are considered the economic interest holders of the FPI and need to be disclosed in the additional disclosures” on the basis that returns on the various investments made by FPIs are passed on to respective ODI Holders by the ODI issuing FPI (**ODI Issuers**). That said, the disclosure obligations are on the FPIs, and these requirements were not directly applicable to ODI Holders.

Disclosure and Monitoring Mechanism to apply directly at ODI Holder Level and each Segregated Portfolio Level:

5. SEBI’s proposal envisages applicability of granular disclosures where:
 - a. Concentration Criteria or Size Criteria is met at ODI Holder Level; or
 - b. where Concentration Criteria is met at each Segregated Portfolio level.
6. In the context of Segregated Portfolios, SEBI has proposed that the relevant registered FPI is to compute the Concentration Criteria based on Indian equity AUM of each of the Segregated Portfolios independently and provide investment details of such portfolio to DDP on an ongoing basis. In case of a breach, extant disclosure obligations apply at portfolio/ sub-fund level.
7. In so far as the ODI Holders are concerned, it is envisaged that (i) ODI positions as well as clubbing of investment across ODI Holder and its group entities⁴ will be monitored by the ODI Issuer and its respective DDPs;

(ii) such data is expected to be obtained by ODI Issuer upfront and on continuous basis and required to be reported to the DDPs on a daily basis; (iii) for monitoring of Size Criteria, DDPs are required to onward submit this information to the depositories to enable them to monitor the Size Criteria across FPIs and ODI Holders. Further, in case Prescribed Threshold is met, the ODI Issuers are required to obtain the granular disclosures from the ODI Holders for onward submission to SEBI.

Important Considerations:

8. This approach is significantly different from extant requirements of monthly ODI reporting done by ODI Issuers to SEBI directly. Since ODI data is reported directly to SEBI and custodians track India investments of registered FPIs, any form of combined reporting may pose challenges from confidentiality standpoint as well as from the standpoint of DDPs not having accounts for ODI Holders. Any non-compliance with disclosure obligations would render such subscriber’s ineligible to subscribe or hold any ODI positions and redeem their existing positions within prescribed timelines of 180 days.

Other Proposals Relevant for ODI Issuers

9. **No ODIs with Derivatives as Underlying:** The ODI regime, as an alternate route available for foreign investors to gain exposure to Indian markets, has always been subject to scrutiny by SEBI and the regulations have evolved for better monitoring and transparency. That said, on account of excessive leverage related concerns, the regulator has always been rather circumspect about issuance of ODIs with derivatives. The Consultation Paper indicates that SEBI is keen to do away with limited exception that enabled ODI Issuers to have derivatives as underlying. The proposal is to enable hedging of ODIs with same securities on a one-to-one basis, throughout the life of the ODI. A transition period of 1 year is envisaged for this purpose.
10. **Separate ODI and non-ODI Registration:** If the proposal were to be implemented, it would be mandatory to issue ODIs only through a separate dedicated FPI

⁴ Group entities include ODI subscribers and registered FPIs with common ownership of more than 50% or common control.

registration to avoid any co-mingling of investments. Currently, this is required only if FPIs hold proprietary derivative positions. However, as a matter of market practice that has evolved, the approach of segregating proprietary investments and ODI investments in separate license is largely being followed.

Concluding remarks

11. The proposals mark a substantial overhaul of the ODI framework and will require a closer look by relevant stakeholders. Preliminarily, some of the challenges and key issues that will require assessment includes, *inter alia*,

- i. the feasibility of:
 - a. the monitoring mechanism through ODI Issuers and custodians; and
 - b. daily reporting of positions of ODI Holders and group entities.
- ii. accountability for determination of:
 - a. exempted category of ODI Holders/ group entities, as relevant; and

b. Size Criteria or Concentration Criteria.

- iii. Recourse to ODI Holders in case of ambiguity in determination of exempted category;
- iv. Interplay with clarification issued by SEBI earlier this year (as discussed above);
- v. Separate requirements in respect of ODI Holders who are registered as category I FPIs;
- vi. Challenges in case ODI positions are held through multiple ODI Issuers; and
- vii. Requirement of transition period to align with the new regime and formats for collation and reporting of information.

12. Per the data published by SEBI, it seems that investments through ODIs has been on a decline for a while now and in the event these proposals are implemented, there may be a further decline. The practical nuances will have to be ironed out before such changes are introduced their implementation will require considerable efforts from all stakeholders involved. This being a consultation process, SEBI has invited public comments on the proposals by August 26, 2024.

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