SEBI’s Disruptive Norms

Why in news?

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The Securities and Exchange Board of India’s revised know-your-customer norms for foreign portfolio investors (FPIs).

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What is foreign portfolio investment?

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- Foreign portfolio investment (FPI) consists of securities and other financial assets passively held by foreign investors.
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- It does not provide the investor with direct ownership of financial assets and is relatively liquid depending on the volatility of the market.
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- Foreign portfolio investment differs from foreign direct investment (FDI), in which a domestic company runs a foreign firm.
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- This is because although FDI allows a company to maintain better control over the firm held abroad, it may face more difficulty selling the firm at a premium price in the future.
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What is SEBI’s recent decision on FPI’s?

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- In is recent decision SEBI has mandated that non-resident Indians, overseas citizen of India and persons of Indian origin cannot be beneficial owners (BOs) of FPIs.
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- The threshold for identifying beneficial owners of FPIs on controlling ownership interest is 25 per cent in case of companies and 15 per cent for

partnership firms.
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- The threshold has been set lower, at 10 per cent, for "high-risk" nations with a history of money-laundering and terrorism.
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- FPI investments are capped at a limit of 10 per cent for the equity of a single company.
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- If the limit is breached, the BOs must either be treated as a foreign direct investor or sell in order to bring shareholding below the 10 per cent limit within five trading sessions of the breach.
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What are the concerns with the recent decision?

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- The definition of a BO in the Prevention of Money Laundering Act is “a natural person or persons who, whether acting alone or acting together, have controlling ownership interest in the FPI or control over the FPI.”
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- If a BO cannot be identified in this manner, a senior managing official of the FPI is construed to be its BO.
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- Moreover, the word “control” is also defined vaguely in the Prevention of Money Laundering Act.
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- It includes the right to appoint a majority of directors, or control management or policy decisions, by virtue of shareholding, management rights, shareholders' agreements and/or voting agreements.
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- Taking these definitions together and given the organisational structure of most FPIs, many of them would end up with a single officer defined as the BO for Sebi's purposes.
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- The KYC form demands disclosure of intimate information such as address, date of birth, tax residency number, social security number and passport number, among others.
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- Global privacy norms make FPIs uncomfortable with regard to sharing this level of information.
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What measures needs to be taken?

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- It would be advisable for SEBI to review its order on FPI, as It is unusual for any regime anywhere to demand this level of differentiated information for KYC.
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- There will also be practical difficulties in imposing the limit unless the definition of a BO is redefined pragmatically, or the limit removed.
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- The intent of the circular avoiding money laundering or round-tripping of hawala funds is clear enough, but there must be less disruptive ways to do that without forcing legitimate investors to exit.
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Source: Business Standardeco

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