

SEBI Tightens norms on ODIs

The market regulator, Securities and Exchange Board of India (“SEBI”), issued a circular dated November 24, 2014 aligning the conditions of eligibility and investment norms between Foreign Portfolio Investment regime and subscription through Offshore Derivate Instruments (“ODI”) route. The circular has been issued with the objective to curb money laundering practices.

1. **Eligibility Norms for issuance of ODIs:** A FPI shall issue ODIs only to those subscribers who are eligible to procure a registration as a FPI under Regulation 4 of SEBI (Foreign Portfolio Regulations), 2014 (“**FPI Regulations**”) and do not have an opaque structure. In other words, a FPI shall issue ODIs only to those subscribers which meet the following criteria inter-alia:
 - a) the subscriber is a resident of the country whose securities market regulator is a signatory to International Organization of Securities Commission’s (“IOSCO”) Multilateral Memorandum of Understanding (“MMOU”) or a signatory to bilateral Memorandum of Understanding with SEBI.
 - b) the subscriber being a bank, is a resident of a country whose central bank is a member of Bank for International Settlements (“BIS”).
 - c) the subscriber is not resident in a country identified by Financial Action Task Force (“FATF”) as:
 - i. the jurisdiction having a strategic Anti-Money Laundering or Combating the Financing of Terrorism deficiencies to which counter measures apply; or
 - ii. the jurisdiction that has not made sufficient progress in addressing the deficiencies or has not committed to an action plan developed with the Financial Action Task Force to address the deficiencies.
 - d) The subscriber should not have opaque structure.
2. **Investment Restrictions:** The SEBI circular has extended the investment restrictions contained in Regulation 21 of FPI Regulations to ODI subscribers also. Regulation 21 of the FPI Regulations provides that a single FPI or FPIs belonging to the same investor group cannot hold more than 10% of the share capital of an Indian company. The circular further clarified that:
 - a) Two or more ODI subscribers having common Beneficial Owner (BO) shall be considered together as a single ODI subscriber, in the same manner as is being done in the case of FPIs.
 - b) Where an investor has investments as FPI and also holds positions as an ODI subscriber, these investment restrictions shall apply on the aggregate of FPI investments and ODI positions held in the underlying Indian Company. In other words, the investment as FPI and positions held as ODI subscriber will be clubbed together with reference to the said investment restrictions.
3. **Grandfathering Provisions:** The circular clarifies that it shall have no affect on the contracts already issued and existing, but the same shall not be allowed to renew or rollover unless the conditions specified above have been complied with.
4. **Onus of Compliance:** The onus of compliance with the provisions of the circular has been put on the FPI which issue ODIs to foreign investors.

ARA LAW View

- SEBI wants a regulatory oversight over the entities that come from jurisdictions that does not conform to a global regulatory standards before they access the Indian market.
- The inclusion of investment restriction of 10% is a significant change from the industry practice and thus, may impact several investors who attempts to hold more than 10% in individual companies by acquiring holdings simultaneously through both FPI and ODI routes or by investing in ODIs through different entities.
- In absence of procedural guidelines from SEBI, the FPIs may face administrative difficulties while monitoring the investment restrictions contained in this circular.

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