Consultation Paper on framework for providing flexibility to FPIs in dealing with their securities post expiry of their registration

1. OBJECTIVE

1.1. The objective of this consultation paper is to seek comments/views/suggestions from the public on the following proposals:

1.1.1. Provide for facilitating disposal of securities, post expiry of registration of FPIs.

1.1.2. Framework for dealing with securities blocked in the accounts of FPIs, after expiry of prescribed timelines for liquidation.

1.1.3. Framework for dealing with securities written-off by the FPIs.

2. BACKGROUND AND EXTANT FRAMEWORK

2.1. In terms of Regulation 7(5) of SEBI (Foreign Portfolio Investors) Regulations, 2019 ('FPI Regulations, 2019'), FPIs are required to have a valid registration as long as they hold securities in India. In order to keep their registration valid, *inter alia*, FPIs are required to pay registration fee for every block of three years. Non-payment of fee, on time, renders the FPI's registration expired. The FPI Regulations, 2019, do not provide for liquidation of securities by FPI post expiry of their registration and the securities held by such FPI remain frozen in their demat accounts.

2.2. Further, FPI Regulations, 2019 and circulars issued thereunder, *inter alia*, provide for restrictions on purchase and/or sale of securities in various cases, including:

2.2.1. when there is a change in compliance status of home jurisdiction of the FPI w.r.t. signatory to IOSCO MMOU/bilateral MoU with SEBI/membership of BIS/FATF;

2.2.2. when the FPI fails to provide additional KYC documents in case of reclassification from Category I to Category II, within the prescribed timelines;

2.2.3. when the FPI fails to make requisite disclosures in terms of SEBI circular dated August 24, 2023.

2.3. The aforementioned FPIs are required to liquidate their holdings within the timelines prescribed for respective non-compliances. In case the FPIs fail to do so, it may lead to instances where securities remain in the demat accounts of the FPIs, even after the prescribed timelines for liquidation. In the past, there have been several instances of securities remaining frozen in the accounts of FPIs, whose registration has expired. As on June 30, 2023, there were 55 such entities holding securities valued at approximately INR 3,300 crores in their demat accounts.

2.4. In terms of Regulation 43B of the FPI Regulations, 2019, an FPI is permitted to make an application to SEBI for relaxation from strict enforcement of any provision of the said regulations. In the past, SEBI has received several applications from FPIs under aforementioned Regulation 43B, requesting permission for sale of securities after the expiry of prescribed timelines for liquidation of holdings and/or reinstatement of registration. In such cases, if the FPI is not able to demonstrate that the non-compliance was caused due to 'factors beyond its control' or the compliance requirement is 'procedural or technical in nature', there is limited scope for any relaxation. Even if such applications can be considered on a case to case basis, it is preferable to have a consistent policy spelt out in the regulatory framework, to deal with such instances.

2.5. An FPI, whose registration has expired or who intends to surrender its registration, is permitted to authorize its custodian to write-off the securities held in its account. After write-off, the rights and interest, associated with such securities, do not flow to the FPI. Such securities are extinguished by the custodian from the safekeeping account (held in banks internal books/ system) of the FPI, but remain frozen in the demat account of the FPI. Monetary corporate benefits associated with such securities, if received by the custodians, are credited to the Investor Protection and Education Fund of SEBI (IPEF). Non-monetary corporate benefits, if received, keep getting accumulated in the FPI's demat account. As on June 30, 2023, there were 20 such entities that had written off securities notionally valued at approximately INR 94 crores.

2.6. As the securities, blocked in the accounts of FPIs or written-off by the FPIs, continue to remain frozen for perpetuity, the share capital of such companies is also being blocked for trading. The demat accounts of the FPIs also remain open (in frozen state) even after the FPIs have surrendered their registration, which is not desirable as it renders such accounts vulnerable to misuse.

3. ISSUES IDENTIFIED

3.1. FPI Regulations, 2019, do not provide for regularization of FPI registration or disposal of securities, post expiry of registration.

3.2. Further, there are no regulatory prescriptions for dealing with

3.2.1. securities that remain in the demat accounts of FPIs, post expiry of registration and expiry of prescribed timelines for liquidation.

3.2.2. securities written-off by the FPIs.

4. RECOMMENDATIONS OF SEBI FPI ADVISORY COMMITTEE

4.1. The proposed framework was discussed in the FPI Advisory Committee (“the Committee”), in its meeting held on December 13, 2023. The Committee deliberated on the proposals and recommended certain changes in the proposals placed before it. The changes recommended by the Committee have been incorporated in the frameworks proposed in subsequent paragraphs.

5. PROPOSALS:

Proposal 1: Regularization of FPI registration and disposal of securities, post expiry of registration

5.1. Various intermediaries registered with SEBI (e.g. stock broker, merchant banker, mutual funds, etc.) in terms of respective applicable regulations, are required to pay a registration fee. Such intermediaries are also required to pay fees to be able to continue their registration and offer services to the investors. The respective regulations also provide for delayed payment of such fee by the intermediaries to keep their registration valid. The period allowed for such delayed payment ranges from two months in case of mutual funds, to six months in case of share transfer agents and debenture trustees.

5.2. FPIs are also SEBI registered intermediaries, albeit they are in the nature of investors. However, currently there is no provision for an FPI to regularise its registration after expiry. Therefore, similar to intermediaries who are permitted to make a delayed payment of fee, a flexibility may be extended to FPIs as well. Accordingly, with an objective to facilitate ease of doing business for FPIs, it is proposed to permit FPIs to regularize their account or dispose of securities lying in their demat accounts, post expiry of their registration. Such opportunity to regularize the registration is proposed to be time bound (within 30 days) and subject to imposition of certain financial disincentives (additional late fee @ 2% of registration fee per day). The registration fee for FPIs is currently USD 2,500 for Category I and USD 250 for Category II. Therefore, late fee on a per day basis in this context will work out to USD 50 for Category I and USD 5 for Category-II FPIs. As the FPI's registration application and renewal is handled by DDPs, the DDPs shall be required to send suitable reminders for renewal of registration to their respective clients, well in advance of expiry of registration.

5.3. Further, FPIs with expired registration are currently not permitted to liquidate their holdings. It is also proposed to permit such FPIs to liquidate their holdings within 180 days after the expiry of the above mentioned 30-day timeline. However, the remittance of sale proceeds to the FPI shall be subject to KYC, AML/CFT/Tax requirements. The proposed timeline of 180 days for such liquidation, is in alignment with the prescribed timelines for liquidation in other cases of non-compliances as per extant framework.

5.4. Accordingly, the proposals are summarized as under:

Details	Until validity of registration	Upto 30 days from date of expiry of registration due to non-payment of fee	Beyond 30 days from date of expiry of registration due to non-payment of fee
Permissible actions	All trading activity as long as certificate of registration is valid	• Re-activate the registration with payment of additional late fee as mentioned above • Sell existing holdings (purchases frozen)	• Cannot re-activate the registration, since timeline for late payment of fee has elapsed. • Sell existing holdings within a period of 180 days (purchases frozen)

Questions for public comments

1. Do you agree with the proposal to permit regularization of registration after expiry?
2. Do you agree with the proposed time-period for such regularization?
3. Do you agree with the proposed late fee @ 2% of registration fee per day?
4. Do you agree with the proposal to permit liquidation of holdings by FPI, whose registration has expired?
5. Do you agree with the proposed time-period of 180 days for such liquidation?

Proposal 2: Facilitation of liquidation of securities by FPIs, post expiry of registration

5.5. As mentioned above, the extant framework provides a timeline of 180 days for liquidation of securities by FPIs under various scenarios, viz., non-disclosure of granular disclosures upon breach of specified criteria, breach of thresholds specified for NRI/OCI/RI holding limit in the FPI, etc. However, in some scenarios, it is seen that the timelines given for liquidation is open ended, i.e. without any end date or are tagged to the end of the registration block. It is proposed that a liquidation period of 180 days may be given for the said scenarios as well. The proposed timelines for regularization and liquidation shall be applicable only for non-compliances that occur in future. FPIs, which are non-compliant as on the date of issuance of this proposed framework, may use the one-time opportunity under Proposal 4 below. For future cases of non-compliance, the following is proposed:

Nature of non-compliance	Timelines for compliance		Timelines for liquidation	
	Existing	**Proposed**	**Existing**	**Proposed**
Change in compliance status of home jurisdiction of the FPI w.r.t. signatory to IOSCO MMOU/bilateral MoU with SEBI/ membership of BIS/FATF	Purchase disallowed until the jurisdiction is compliant (sale allowed)	No change	Till the end of existing registration block	180 days or till the end of existing registration block, whichever is later
Reclassification from Category I to Category II	Purchase disallowed and sale allowed.	30 days from the date of change that requires reclassification. Purchase disallowed, sale allowed.	180 days from date of notification of change to DDP or end of registration block whichever is earlier.	180 days from date of elapse of the 30 days period allowed for compliance or end of registration block whichever is later.

5.6. In case the FPI is unable to liquidate its holdings due to any regulatory/statutory/Court imposed restrictions or directions from any enforcement agency, the timeline for liquidation shall be as per the direction of the enforcement/regulatory agency/Court or in case no such timeline is provided by the enforcement/regulatory agency/Court, within 180 days of removal of such regulatory/statutory restrictions. During the liquidation period, the securities continue to be in the demat account of the FPI and they are eligible to receive corporate benefits and exercise voting rights etc. w.r.t. such securities.

Questions for public comments

6. Do you agree with the above proposal for revision of the compliance and liquidation timelines?
7. Do you agree that the voting rights/corporate benefits w.r.t. securities held by the FPIs should continue to accrue to them during the liquidation period?

Proposal 3: Framework for dealing with future cases of FPIs with blocked securities in their accounts

5.7. Currently, an FPI whose registration has expired due to various non-compliances, fails to regularise its registration and fails to liquidate its holdings within prescribed timelines, is not permitted to sell its securities and the securities remain blocked in its demat account. The concerns regarding presence of such accounts have been discussed in Para 2 above. Therefore, a need is felt to provide for a regulatory mechanism to deal with securities blocked in the demat account of the FPI, after the expiry of timelines for liquidation.

5.8. The issue of foreign portfolio investors (including those registered under the erstwhile FII regime) holding securities after expiry of their registration was also dealt with, in "*Report of the Working Group on FPI Regulations*" dated May 24, 2019. On recommendation of the Working Group, it was provided under Regulation 7(5) of the FPI Regulations, 2019 that foreign portfolio investors whose registration had expired and were holding securities or derivatives were allowed to sell such securities within one year from the date of publication of the FPI Regulations, 2019.

5.9. However, the said regulations did not prescribe a framework for dealing with securities that remain unsold even after such one-year period. Further, as mentioned earlier, the restrictions on sale of securities by the FPI, prescribed under the FPI Regulations, 2019 may lead to instances where securities remain in the demat account of the FPIs even after the prescribed timelines for liquidation are over. In fact, there have been several instances of FPIs with blocked securities in their demat accounts.

5.10. In view of the above, it is proposed to provide a regulatory framework for dealing with securities that may be held by the FPI after expiry of their registration.

5.11. In this regard, in line with the recommendation made in the "*Report of the Working Group on FPI Regulations*", on the basis of which a period of one year was provided for those FPIs whose registration has expired, it is now proposed that after the elapse of the extant timeline for liquidation (180 days) is over, <u>an additional period of 180 days may be provided for disposal of such securities.</u> Therefore, a period of 360 days (180+180) shall be available for disposal of securities after expiry of an FPI's registration.

5.12. It is also appreciated that several securities lying in the accounts of such FPIs, may be suspended or unlisted/delisted from stock exchanges and the FPIs may not be able to dispose such securities through secondary market trades on the stock exchanges. Currently, FPIs with valid registration are permitted to sell such unlisted, suspended, and delisted securities through off-market transactions, in accordance with the pricing guidelines for such sale as per FEMA Rules, as specified in Para 3 of Part C of SEBI Master Circular for FPIs and DDPs dated December 19, 2022. In view of the above, it is proposed to permit sale of unlisted, suspended, and delisted securities through off-market transfer by such FPIs with expired registrations. However, considering that off-market sales of securities are bilaterally negotiated deals between the FPI and the buyer, the off-market sale may be permitted only through the sale by the FPI itself (Approach 1, Ref: Para 5.16 as under) and not through an empaneled broker (Approach 2, Ref: Para 5.17 as under).

5.13. Further, with a view to bring finality to the process of liquidation, it is proposed that after expiry of the additional 180 days period, any securities remaining unsold shall be considered to have been compulsorily written-off and the FPI shall lose any beneficial interest in the said securities including voting rights, benefits arising from corporate action. Such written-off securities shall be dealt in the manner described in Proposal 5.

5.14. It is also proposed to provide for appropriate reporting requirements for the custodians with respect to such securities which are disposed by the FPI/empaneled broker.

5.15. For disposal of securities during the additional time period of 180 days, one of the two alternative approaches described below may be adopted.

Approach 1 – sale of securities by FPI itself

5.16. In this approach, it is proposed to allow the FPI itself to sell the securities remaining in its account, after expiry of liquidation period. However, the sale of securities shall be subject to a financial disincentive of 5% of the sale proceeds, which shall be deducted by the Custodian and credited to the IPEF. The opportunity to sell the securities shall be subject to the FPI fulfilling the prescribed KYC, AML/CFT/tax requirements. After expiry of the additional 180 days' period, the securities that remain unsold shall be considered to have been compulsorily written-off.

Approach 2 – sale of securities through exchange empaneled broker

5.17. In this approach, it is proposed that the securities lying in the demat account of the FPI after expiry of prescribed timelines for liquidation, shall be transferred by the respective custodian to an escrow account, to be operated by an exchange empaneled broker. The broker shall make attempts to sell the securities at the available market price and transfer the sale proceeds to the respective custodian's account after deducting brokerage and other statutory charges.

5.18. The receipt of sale proceeds to the FPI shall be subject to a financial disincentive of 5% of the sale proceeds and compliance with applicable KYC, AML/CFT/tax requirements. The amount deducted by the custodian from the sale proceeds shall be credited by the Custodian to the IPEF.

5.19. The securities which remain unsold after 180 days of transfer to the escrow account, shall be considered to have been compulsorily written-off by the FPI.

Questions for public comments

8. Do you agree with the proposal to provide additional time period for liquidation?
9. Do you agree with the proposed additional time period of 180 days for liquidation?
10. Do you agree with the proposal to permit off-market sale of securities by the FPI in the referred circumstances?
11. Do you agree with the proposal to write-off unsold securities, after the additional time period for liquidation is over?
12. Do you agree that proposed Approach 1 is suitable compared to Approach 2 during the additional time period for liquidation?
13. Do you agree that proposed Approach 2 is suitable compared to Approach 1 during the additional time period for liquidation?
14. Do you agree with the proposed financial disincentive of 5% of sale proceeds during the additional time period for liquidation?

Proposal 4: Framework for dealing with existing cases of non-compliant FPIs with blocked securities in their accounts

5.20. With respect to securities held in the accounts of FPIs, where timelines for regularization and/or timeline for liquidation have already expired as on date of issuance of this framework, it is proposed to provide a one-time opportunity for disposal of securities blocked in the accounts of such FPIs. Accordingly, FPIs, whose registration has expired, prior to issuance of this framework, shall be provided an opportunity to sell the securities lying in their demat accounts, within 180 days from the date of issuance of this framework. This opportunity to dispose the securities shall be without any financial disincentive and shall be subject to the FPI complying with KYC and AML/ CFT norms, applicable as on date.

5.21. For securities that remain unsold within the above referred 180 days' period, shall be disposed using one of the Approaches as mentioned in Proposal 3 above. For securities sold during the additional time period for liquidation, the FPI shall be entitled to receive the sale proceeds subject to financial disincentive of 5% of the sale proceeds and compliance with KYC, AML/CFT/tax requirements.

5.22. Securities which still remain unsold after the additional time period of 180 days using one of the two Approaches mentioned above, shall be considered to have been compulsorily written-off by the FPI.

Question for public comments

15. Do you agree with the proposal to provide one-time opportunity (180 days) to FPIs for disposal of securities, where the timelines for liquidation have already expired?
16. Do you agree with the proposal to provide additional time period of 180 days for liquidation using one of the Approaches mentioned in Proposal 3, for disposal of securities after the one-time opportunity of 180 days?
17. Do you agree with the proposal to write-off unsold securities, after the additional time period for liquidation is over?

Proposal 5: Framework for disposal of written-off securities

5.23. As mentioned earlier, the written-off securities are extinguished by the custodian from the safekeeping account (held in banks internal books/ system) of the FPI, but remain frozen in the demat account of the FPI. While the monetary corporate benefits are credited to IPEF, the securities along with any non-monetary corporate benefits accumulate in the demat account of the FPI itself. In this regard, it is proposed to provide a framework for dealing with securities written-off by the FPIs but held in their demat accounts.

5.24. The extant regulatory framework provides only for voluntary write-off of securities by the FPIs in case the registration has expired or the FPI intends to surrender the registration. However, as described in Proposals 3 and 4, securities which remain unsold after the prescribed timelines shall be considered to have been compulsorily written-off.

5.25. The securities written-off by the FPIs as on date of issuance of this framework or those written-off post issuance of this framework shall be transferred by the custodian to a separate escrow account, operated by exchange empaneled broker. The broker shall attempt to sell the securities at the available market price on a weekly basis until the securities are disposed off. The proceeds from the sale, net of brokerage and statutory charges, shall be transferred to the IPEF.

5.26. The FPI loses all beneficial interest in the securities written-off by it. Pursuant to write-off of securities, transfer to escrow account and eventual sale by the empaneled broker, there may be certain tax implications that may have to be considered.

Question for public comments

18. Do you agree with the proposal to liquidate written-off securities and transfer of proceeds to IPEF?

6. PUBLIC COMMENTS

6.1. Considering the implications of the aforementioned matters on the market participants, public comments are invited on the above-detailed proposals. The comments/ suggestions should be submitted by any of the following modes latest by February 28, 2024, through the following link:

https://www.sebi.gov.in/sebiweb/publiccommentv2/PublicCommentAction.do?doPublicComments=yes

6.2. The instructions to be followed for submitting comments on the consultation paper are as under:

INSTRUCTIONS FOR SUBMITTING COMMENTS

1. Before initiating the process, please read the instructions given on top left of the web form as "**Instructions**".
2. Select the consultation paper you want to comment upon from the dropdown under the tab – "**Consultation Paper**" after entering the requisite information in the form.
3. Email Id and phone number cannot be used more than once for providing comments on the same consultation paper.
4. If you represent any organization other than the types mentioned under dropdown in "**Organization Type**", please select "**Others**" and mention the type, which suits you best. Similarly, if you do not represent any organization, you may select "**Others**" and mention "**Not Applicable**" in the text box.
5. There will be a dropdown of **Proposals** in the form. Please select the proposals one-by-one and for each proposal please record your level of agreement with the selected proposal. Please note that submission of agreement level is mandatory.
6. If you do not want to react on any proposal, you may skip the same by selecting "**Skip this proposal**";
7. If you want to provide your comments for the selected proposal, please select "**Yes**" from the dropdown under "**Do you want to comment on the proposal**" and use the text boxes provided for the same.
8. After recording your response to the proposal, click on "**Submit**" button. System will save your response to the selected proposal and prompt you to record your response for the next proposal. Please follow this procedure for all the proposals given in the dropdown.

9. Please download the pdf file, link of which is given at the bottom of the form, just before finally submitting the comments to last and final proposal. This pdf will help in case technical issue is faced while final submission of comments.
10. The final comments shall be submitted only after recording your response on all of the proposals in the consultation paper.

6.3. In case of any technical issue in submitting your comment through web based public comments form, you may contact the following through email with a subject: *"Issue in submitting comments on Consultation Paper on framework for providing flexibility to FPIs in dealing with their securities post expiry of their registration"*

a) afdconsultation@sebi.gov.in
b) Manish Kumar Jha, DGM (manishkj@sebi.gov.in)
c) Naveen Kumar, AGM (naveenkr@sebi.gov.in)

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