

Overview of the Khan Committee recommendations



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The Report of the HR Khan Committee has been commended as one of the best reports ever from a Working Group set up by SEBI. The objective of this piece is to review some of the game-changing suggestions from this Report.

Firstly, the background

Post the launch of the Foreign Portfolio Investor (FPI) regime in 2014, a number of clarifications,

guidelines and amendments have been issued in the form of circulars, FAQs, etc. Hence there was a need to re-visit the regulations afresh to action feedback received from various stakeholders from time to time.

In March 2018, SEBI constituted a Working Group under the chairmanship of Mr. Harun R. Khan (Working Group) to undertake review of the FPI regime to incorporate the circulars / FAQs / guidelines to the extent possible and simplify the language and complexities in the FPI regulations.

The Working Group has proposed recommendations with the primary objective of consolidation, simplification, rationalization and liberalization of FPI regime.

SEBI had invited comments from the public on the recommendations of the Working Group by 14 June 2019. The recommendations/suggestions are currently being reviewed by SEBI. Based on the feedback and suggestions received from market participant, SEBI will further deliberate before notifying the new amended FPI regulation.

The Securities Services business of Deutsche Bank was represented on this Working Group and contributed actively to the proceedings.

Objectives and Approach

To ensure a harmonized and hassle free investment experience for international investors and improve transparency, as economic regulations evolve, the Group's primary objectives were:

- Consolidation of FPI Regulations, Guidelines, Circulars and FAQs to present complete and comprehensive framework
- Simplification of the regulatory material by redrafting, reducing clutter and improving consistency in order to reduce complexity

- Rationalization of regulatory framework to present a streamlined set of rules based on feedback from industry participants and FPIs
- Liberalization with a view to improving ease of doing business for FPIs, largely aimed at institutional and well-regulated foreign entities
- Know Your Client (KYC) and Anti Money Laundering (AML) measures were reviewed and revised guidelines provided under the existing PMLA.

Key Recommendations:

A. FPI Registration Process:

1. Fast-track onboarding process for select Category II FPIs

The following investors should be eligible for fast track registration process and simplified documentation requirements (most likely just a simple 1-page form would be required):

- Public retail funds (including mutual funds and similar retail collective investment schemes / funds, insurance companies¹ and pension funds) and non-investing FPIs established in FATF2 member countries
- Applicants intending to invest only through the Voluntary Retention Route (VRR) or only in Government securities (including Central Government securities, State Development Loans or Municipal Bonds) or units of mutual funds.

This recommendation has been particularly welcomed by the investor community as truly game-changing.

2. Broad-based condition for appropriately regulated entities

Currently, appropriately regulated entities, such as banks, including private banks and merchant banks, asset management companies, investment managers/advisors, portfolio managers, insurance/reinsurance companies, broker dealers and swap dealers, etc., investing on behalf of clients, can seek Category II FPI registration, provided they fulfil the broad-based criteria and maintain a common portfolio across all clients/investors. The proposal is to allow such entities to obtain Category III FPI registration if they do not fulfil aforesaid conditions.

This addresses the previous requirement around common portfolio and enables segregated portfolios.

3. Deemed broad based status:

The following entities should be deemed to be broad based and therefore eligible for Category II FPI registration:

- Subject to certain conditions, insurance/reinsurance companies either, itself or as an investor in an FPI with majority stake jointly or separately, directly or indirectly with other institutional investors
- FPIs whose majority (i.e. more than 50%) of investors are, directly or indirectly, constituted by Category I eligible entities.

Another great recommendation as per most investors. This will help new funds gain broad-based status and ensure stability particularly in the initial stages.

4. Modification in broad-based fund criteria:

Following additions should be made to the current definition of broad based fund:

- All types of collective investment vehicles (and not only funds) should be eligible to be considered as broad based. Also, ownership interest could be held by investors in the form of shares or units or any other instruments.
- If the broad based status is achieved by an FPI on the basis of another fund making investments in the FPI, such other fund should own at least 25% stake in the FPI. Existing FPIs not meeting this condition should be grandfathered for a period of 3 years.

Persistent investor feedback has been around why broad-based criteria is required at all. Though not fully done away with, simplification is nevertheless welcomed.

5. Conditional registration as Category II FPI

- 180 days validity of conditional registration currently available to newly set-up funds to be extended to Category II FPI applicants who are well established in their home country;
- 90 days conditional registration to be granted to unregulated funds seeking Category II FPI registration, whose investment manager is registered as Category II FPI or for regulated Category III FPIs.

FPIs not to be permitted to issue or subscribe Offshore Derivative Instruments during the period of conditional registration

6. FPI registration related

- Pension funds, superannuation funds or similar schemes, which provide retirement benefits to employees to be treated as Category I FPI subject to such entities furnishing specified Beneficial Ownership details
- University-related endowment funds from FATF

member countries where the university has been in existence for more than 5 years to be eligible for Category II FPI registration; existing university-related endowment funds registered as Category II FPI to be grandfathered

- Sub-funds of a fund with segregated portfolio to be registered separately as FPI; existing FPIs provided one year to comply with this provision
- Entities owned 75%, directly or indirectly or controlled by investors eligible for Category I FPI registration at all times to be eligible for Category I FPI registration
- Entities owned 100% by foreign banks, insurance/reinsurance entities or university funds to be eligible for Category II FPI registration
- Central banks that are not members of the Bank for International Settlements (BIS) to be eligible for FPI registration

7. Documentation related

- In case of Multiple Investment Manager (MIM) structure, the FPI only needs to provide the name of the new investment manager when requesting for new registration; FPI need not furnish registration details already provided
- Certain documentation requirements, such as memorandum and articles of association, information evidencing sufficient experience, good track record, etc., specified in the FPI regulations for applicants seeking Category III FPI registration to be done away with
- Furnishing declaration on “opaque structure” to be deleted, since FPIs are required to provide details of their Beneficial Owners
- Requirement of submitting declaration and undertaking for Protected Cell Company/ Multi-Class Vehicle when seeking FPI registration, to be done away with
- Requirement of furnishing “No Objection Certificate” from SEBI/ RBI for applicants that are banks/ subsidiaries of banks, which do not have local presence, to be done away with

Simplification of KYC requirements:

Some of the key KYC relaxations include:

- Relying upon KYC performed by global custodian
- Doing away with self-certification of KYC documents
- FPI registration certificate as proof of identity document for obtaining PAN Card
- Dispensing with the requirement of physical verification of PAN Card:
- Power of attorney as proof of address for Category III FPIs
- Lower KYC for regulated Category III FPIs:
- Similar KYC norms to apply for FPI and FDI accounts:
- The current requirement to obtain photographs of authorised signatories for Category III FPIs should

be done away with.

- If the mode of communication between the FPI / its authorised representative (should be based in FATF member country) and the local custodian is through SWIFT, there should be no need for the FPI to provide Board Resolution and Authorised Signatory List to the local custodian as a part of the KYC documentation.

Liberalisations and rationalisation of investment restrictions

1. Liberalisation of investment caps in listed Indian company

- FPIs may be allowed to invest in an Indian company up to the applicable sectoral cap on an aggregate basis
- Indian companies may be allowed to decrease the aggregate limit to pre-specified limits (24%, 49% or 74%) with the approval of their Board of Directors and its General Body through a resolution

2. Permit FPI investment in prohibited sectors

- FPIs to be allowed to invest (up to 49%, including investment through ADR/ GDR) even in sectors where investment is prohibited under the FDI route
- To promote and encourage FPI investments in distressed assets, a separate investment limit has been recommended for FPI investments in security receipts.

3. Harmonisation between FPI Regulations and FEMA Regulations

To address inconsistencies that have crept in various regulations/ guidelines, the recommendations, inter alia, are as follows:

- Clarify whether perpetual debt instruments will be regarded as a part of corporate debt investment
- Credit of unlisted shares through voluntary corporate actions should be allowed. However, such unlisted investment shall be treated as FDI

4. Investment by sovereign wealth funds in corporate debt

The residual maturity and 50% issue size restrictions, currently applicable for FPI investment in corporate bonds should not apply to investments made by Sovereign Wealth Funds.

5. Strengthening of clubbing restrictions

- "Investor group" should consist of all associate entities of FPIs that are investing in Indian securities and identified on the basis of common ownership of > 50% or common control.
- FPIs to ensure that holding of all of their group entities in shares of a company shall be <10%.
- In case the 10% limit is breached, either all entities or investor group are re-categorised, as FDI or divestment is made within the prescribed time limit.

Conclusion

As can be seen above, the recommendations by HR Khan Committee are wide-ranging and at the same time quite aimed at easing and streamlining the process of application, KYC and also alignment with the FDI route. As and when implemented, the clear regulatory intent of further simplifying the regime to boost foreign investment inflows would be much appreciated by all stakeholders.