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FPIs breaching exposure levels to reveal ODI holder details

By Sugata Ghosh, ET Bureau   Last Updated: Jan 19, 2024, 05:39:00 AM IST

Synopsis
ODIs, often loosely called participatory notes, are issued by FPIs (against underlying securities in India) to offshore investors who bet on Indian stocks without registering themselves with the Securities & Exchange Board of India (SEBI).

An FPI which issues ODI against a particular stock may choose to keep the position unhedged by not investing the amount received from the ODI subscriber in the particular stock.

Mumbai: Foreign portfolio investors (**FPIs**) have to reveal the ultimate identities of every holder of overseas **derivative** instruments (ODIs) once such funds breach the exposure levels specified by the **regulator**.

The Indian **capital market** regulator has spelt this out in a communique this week to the custodians of FPIs, a person aware of the matter told ET.

ODIs, often loosely called participatory notes, are issued by FPIs (against underlying securities in India) to offshore investors who bet on Indian stocks without registering themselves with the Securities & Exchange Board of India (SEBI).

ODIs are issued by 'Category 1 FPIs' to overseas investors who either prefer anonymity or are unwilling to trade on Indian stocks directly. Such investors subscribing to ODIs must have the eligibility to receive Category I FPI licence from SEBI.

At present, FPIs have to disclose names of ODI holders on a monthly basis to SEBI. The details of such information are based on the know-your-customer (KYC) rules under the anti-money laundering regulations.

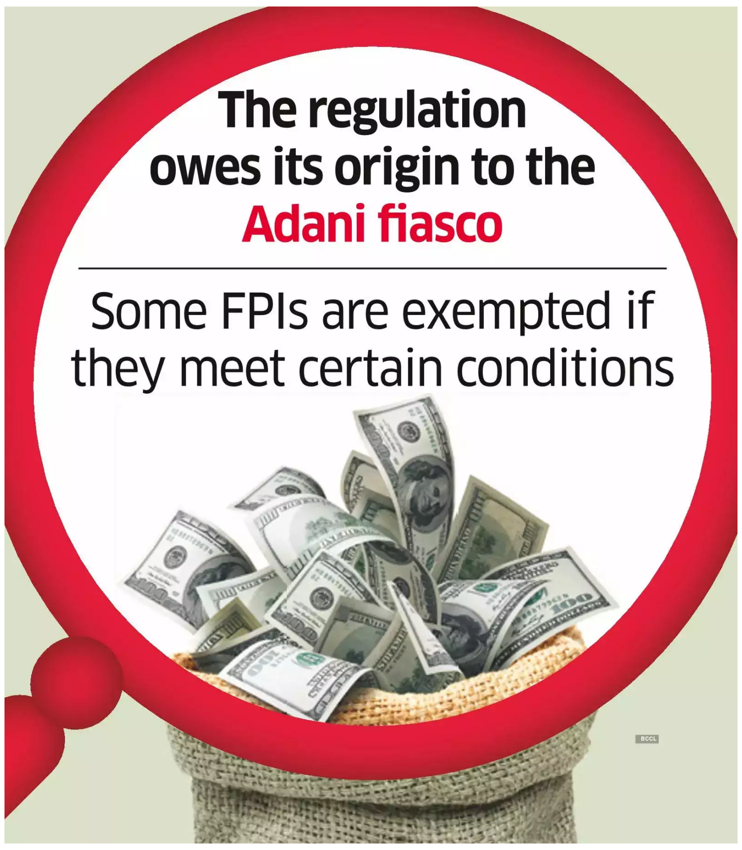
However, under the new granular disclosure requirements introduced by SEBI last year in the wake of the allegations made by the US short-seller Hindenburg against Adani group companies, FPIs must reveal the identities of the last natural persons behind every investor in funds with outsized India exposure to equities.

The rigorous disclosure rules are triggered on an FPI whose exposure to equities in India crosses ₹25,000 crore, or which has invested 50% of its India assets under management in stocks of companies belonging to a single corporate group. (Some FPIs like sovereign funds, pension funds etc. are however exempted from the detailed disclosure requirement).

A holder of an ODI having an underlying Indian stock receives dividend declared by the company concerned and is exposed to other corporate actions like rights, bonus, and buyback.

According to the SEBI email to custodians, "It is understood that in case of ODI issuing FPIs, the returns (whole or part thereof) on various investments made by the FPI are passed on to the respective ODI subscriber holding the ODI on that particular investment." Thus, the ODI subscribers of an FPI are considered the "economic interest holders of the FPI" and "need to be disclosed in the additional disclosures" required as per August 24, 2023 SEBI circular and the standard operating procedure for implementing it.

Responding to SEBI's clarification on ODI disclosure, Prakhar Dua, who leads the financial services and regulatory practice at the law firm Nishith Desai Associates, said, "This may upset the ODI market. Though SEBI has cleared the air now, since the issuance of the circular in August last year, it was evident that the ODI subscribers would have to be disclosed given the scope of the terms "economic interest" and "ownership interest". While disclosure of the ODI subscribers and their BOs has always been a requirement under the Operational Guidelines 2019 and then the Master Circular, 2022, the full look-through disclosure requirement would now push such indirect investors to be more selective while choosing the ODI issuing FPIs."



Ownership interest, as defined by the regulator, means ownership of shares or capital of the entity or entitlement to derive profits from the activity of the entity.

An FPI which issues ODI against a particular stock may choose to keep the position unhedged by not investing the amount received from the ODI subscriber in the particular stock.

In such a situation where an FPI, which has issued ODI against a particular stock, chooses to keep its position unhedged, and ends up breaching any of the two limits, such FPI may also be required to, arguably, disclose the ultimate beneficial owners of its **ODI holder** since the latter would be 'entitled' to derive profits from the FPI.

Thus an FPI having, say just 5% of its corpus as ODI, will have to share the details of all the ODI subscribers if the fund's exposure to India exceeds the regulatory thresholds. In its email, Sebi has reminded that FPIs that are in breach on October 31, 2023 will have to rebalance their portfolio by January 29, 2024, failing which they will need to share granular investor details or sell-off their positions and exit the market.