

FPI-FDI transition to give overseas funds more elbow room

To pave way for higher exposure to startups, mid-sized firms

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Mumbai, 13 November

With the new operational framework for reclassifying foreign portfolio investors (FPI) as foreign direct investment (FDI) upon breaching the 10 per cent threshold, certain overseas funds are set to get more flexibility in their India investments, experts said.

There are around 17 companies listed on the National Stock Exchange (NSE) where a single FPI has holdings of up to 9 per cent, according to data provided by Primeinfobase. A majority of these are based out of popular jurisdiction destinations such as Mauritius and Singapore.

These investors, if they wish to take their holdings above 10 per cent in an investee company, will now also have the option to either divest stake or reclassify as FDI upon approval from the government.

"This relaxation meets one of the demands of certain funds which want to take a higher exposure in Indian companies especially mid-caps where the 10 per cent limit became restrictive. The enabling framework can now be implemented because the operational process has been specified," said Rajesh Gandhi, partner, Deloitte.

While the norms for reclassification were already present in the Foreign Exchange Management Act (Fema), in absence of operational guidelines, industry players have maintained status quo. Earlier this week, the Reserve Bank of India (RBI) and Securities and Exchange Board of India (Sebi) issued the broad contours for FPI-FDI transition.

Gandhi said that while the framework provides greater flexibility, it also increases the tax obligation upon reclassification on FDI.

"Any exposure beyond 10 per cent was meant for investors who were interested in providing value accretive guidance to the organisation and contributing to the larger growth of the company and the broader economy. The difference always existed in spirit and the guidelines issued now clearly document the same in letter as well," said Vivek Iyer, partner, Grant Thornton Bharat.

Once reclassified, the entire investment of an FPI will be deemed FDI and remain so, even if holdings fall below 10 per cent at a later date, according to the framework. FPIs must state their intent to reclassify the investment as FDI.

"More clarity may be required in certain nuanced cases where multiple managers are dealing with multiple custodians—as to who will keep the track of the shareholding," said another player managing FPI transactions.

"The market regulator had last year brought more stringent norms on granular disclosure on economic interest and ultimate beneficial ownership for FPIs which have over 50 per cent exposure in a single corporate group. Around 6-7 such FPIs had sought exemption from the disclosure requirements but were not granted. Had the

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WINDOW OF OPPORTUNITY

FPIs whose stakes are near the 10% threshold

FPI	Company	Stake (in %)
Aries Opportunities	Dolphin Offshore	9.99
Jupiter India	EIH Associated Hotels	9.98
Augusta Investments	Prime Focus	9.75
Nalanda	Cera Sanitaryware	9.57
Nalanda	NRB Bearings	9.49
Atyant Capital	Ponni Sugars	9.46
Nalanda	Matrimony.Com	9.45
Gamnat (Singapore GIC)	Le Travenues Technology	9.43
Polus	Mitcon Consultancy	9.36
Vikasa	Visa Steel	9.32

Source: primeinfobase.com

framework been operationalised before, many such FPIs would have opted to reclassify as FDI," said a bank-based custodian.

The custodian added that many such FPIs divested or exited their holdings to comply with the norms on granular disclosure.

Industry players also added that FPIs may now take more time to make investment as they will have to account for the time taken in the approval process from the government which may stretch to months.

However, some participants opine that many FPIs may stick with the 10 per cent threshold and may not be willing to be reclassified as FDI.

"Upon reclassification as FDI, any further divestment or investment by the entity will be done off the exchange. They will have to look for investors and do the deals on the OTC market. Many FPIs may not be willing to go off the exchanges," added another player from the FPI ecosystem.

The facility to reclassify from FPI investment to FDI is restricted in certain sectors.