



भारतीय प्रतिभूति और विनिमय बोर्ड Securities and Exchange Board of India

CONSULTATION PAPER

On streamlining the process of monitoring of Offshore Derivative Instruments (ODIs)/Participatory Notes (PNs)

A. Background

1. SEBI had set out Conditions for issuance of Offshore Derivative Instruments (ODIs) through Regulation 22 of SEBI (Foreign Portfolio Investors) Regulations, 2014.
2. SEBI has been taking steps for streamlining and tightening the conditions for issuance and reporting of ODIs by FPIs registered with SEBI. A list of the measures taken by SEBI in this regard during recent past is given as follows:-
 - (a) The Regulation 22 (2) of SEBI (Foreign Portfolio Investors) Regulations, 2014 (“FPI Regulations”) has been amended to ensure that transfer of ODIs are done to persons subject to fulfilment of Regulation 22 (1) of FPI Regulations and prior consent of the FPI is obtained for such transfer, except when the persons to whom the ODIs/PNs are to be transferred to are pre-approved by the FPI itself.
 - (b) Vide a circular dated June 10, 2016, SEBI has issued instructions on Know Your Client (KYC) norms for ODI subscribers, transferability of ODIs, reporting of suspicious transactions, periodic review of systems and modified ODI reporting format. The circular inter alia advises as follows:
 - Applicability of Indian KYC/AML norms for Client Due Diligence: ODI Issuers shall now be required to identify and verify the beneficial owners (BO) in the subscriber entities, who hold in excess of the threshold as defined under Rule 9 of the Prevention of Money-laundering (Maintenance of Records) Rules, 2005 i.e. 25 % in case of a company and 15 % in case of partnership firms/ trusts/ unincorporated bodies.
 - KYC Review: The KYC review shall be done on the basis of the risk criteria as determined by the ODI issuers.

- Suspicious Transactions Report: ODI Issuers shall be required to file suspicious transaction reports, if any, with the Indian Financial Intelligence Unit, in relation to the ODIs issued by it.
 - Reporting of complete transfer trail of ODIs: ODI issuers shall also be required to report all intermediate transfers during the month in the monthly reports on ODIs.
 - Reconfirmation of ODI positions: ODI Issuers shall be required to carry out reconfirmation of the ODI positions on a semi-annual basis. In case of any divergence from reported monthly data, the same should be informed to SEBI in format provided.
 - Periodic Operational Evaluation: ODI Issuers shall be required to put in place necessary systems and carry out a periodical review and evaluation of its controls, systems and procedures with respect to the ODIs. A certificate in this regard should be submitted on an annual basis to SEBI by the Chief Executive Officer or equivalent of the ODI Issuer.
- (c) Vide a circular dated June 29, 2016, it was further clarified that ODI subscribers who have subscribed to ODIs under SEBI (Foreign Institutional Investors) Regulations, 1995 can continue to subscribe to ODIs under the FPI regime, subject to the condition that they comply with Regulation 22 of FPI Regulations and meet the eligibility criteria as laid down in the SEBI circular dated November 24, 2014 along with other norms which may be notified by SEBI from time to time. Those ODI subscribers which do not meet the aforementioned norms, including unregulated funds whose investment manager is appropriately regulated, can continue to hold the position till the date of expiry of such positions or till December 31, 2020, whichever is earlier. Such subscribers cannot take fresh positions or renew the old positions.
- (d) Pursuant to a meeting on April 26, 2017, the SEBI Board gave approval to insert an express provision in Regulation 22 (1) of the SEBI (FPI) Regulations, 2014 to prevent Resident Indians/NRIs or to the entities which are beneficially owned by Resident Indians/NRIs from subscribing to Offshore Derivative Instruments.

B. Impact of steps taken by SEBI in recent past.

As a result of the aforementioned steps taken by SEBI there has been a significant reduction in the notional value of Outstanding ODIs. The data in this regard is given as follows:-

Outstanding Notional Value of Offshore Derivative Instruments (ODIs) Vs Assets Under Custody (AUC) of FPIs/deemed FPIs								
[₹ Crore]								
Month	Notional value of ODIs on Equity, Debt & Derivatives *	Notional value of ODIs on Equity & Debt excluding Derivatives *	Notional value of ODIs on Equity *	Notional value of ODIs on Debt *	Notional value of ODIs on Derivatives *	AUC of FPIs/ deemed FPIs #	Notional value of ODIs on Equity, Debt & Derivatives as % of B	Notional value of ODIs on Equity & Debt excluding Derivatives as % of B
	A1	A2	A3	A4	A5	B	C1	C2
Jan-16	231,317	171,732	141,679	30,054	59,585	2,200,837	10.5	7.8
Feb-16	217,740	160,946	132,063	28,883	56,794	2,043,139	10.7	7.9
Mar-16	223,077	169,470	137,779	31,692	53,606	2,224,537	10.0	7.6
Apr-16	212,132	161,280	131,627	29,653	50,852	2,281,346	9.3	7.1
May-16	215,338	160,867	131,951	28,916	54,471	2,348,618	9.2	6.8
Jun-16	210,731	161,379	133,294	28,085	49,352	2,387,685	8.8	6.8
Jul-16	212,179	162,921	136,032	26,889	49,257	2,514,038	8.4	6.5
Aug-16	216,232	158,848	132,857	25,992	57,383	2,565,304	8.4	6.2
Sep-16	212,509	152,624	126,049	26,575	59,885	2,556,450	8.3	6.0
Oct-16	199,987	143,235	124,760	18,475	56,752	2,577,073	7.8	5.6
Nov-16	179,648	126,596	114,466	12,130	53,052	2,409,042	7.5	5.3
Dec-16	157,306	112,243	100,927	11,315	45,063	2,348,007	6.7	4.8
Jan-17	175,088	119,309	108,576	10,733	55,779	2,456,716	7.1	4.9
Feb-17	170,191	115,413	103,712	11,700	54,778	2,563,431	6.6	4.5
Mar-17	178,437	124,277	111,803	12,475	54,160	2,705,729	6.6	4.6
Apr-17	168,545	128,380	109,541	18,839	40,165	2,786,083	6.0	4.6

*Figures compiled based on reports submitted by FPIs/deemed FPIs issuing ODIs

#Figures compiled based on reports submitted by custodians & does not includes positions taken by FPIs/deemed FPIs in derivatives.

Column A2 is being provided which depicts the Total Value of ODI issued -with underlying as only Equity & Debt excluding derivatives

Column A3 is being provided which depicts the Total Value of ODI issued -with underlying as Equity

Column A4 is being provided which depicts the Total Value of ODI issued -with underlying as Debt

Column A5 is being provided which depicts the Total Value of ODI issued -with underlying as derivatives.

Column C2 is being provided which depicts the Total Value of ODI issued -with underlying as only Equity & Debt excluding derivatives- as percentage of Assets under custody

Note: The total value of ODIs excludes the ODIs issued on underlying such as portfolio hedging, unhedged , index etc., which FPIs/deemed FPIs are unable to segregate into equity, debt or derivatives.

C. Proposals for further tightening of ODI/PN Norms:-

In order to further enhance the transparency in the process of issuance and monitoring of ODIs being issued by the FPIs registered with SEBI, following steps are being proposed:-

1. Levy of Regulatory fees on FPIs issuing ODIs:-

As discussed above, in order to ensure that the ODI route is not misused, SEBI has been continuously making regulatory changes. These changes however, require investment in manpower and systems in order to make quick analysis of the voluminous data being submitted by the ODI issuing FPIs. SEBI incurs a significant expenditure in terms capital and manpower when it comes to monitoring of investments coming through the ODI route. SEBI has put in place dedicated IT systems for the ODI issuers to report the Beneficial Owners and other details of the ODI subscribers. We may therefore, levy regulatory fees on FPIs issuing ODIs and the group entities of such FPIs, which may be involved in taking underlying positions in Indian securities market. The proposal for implementation of fee on ODI issuing FPIs will require changes in SEBI (FPI) Regulations, 2014.

It is proposed that beginning April 01, 2017, for a period of every three years, regulatory fees of US\$ 1,000 be levied on each ODI issuing FPI for each and every ODI subscriber coming through such FPI. We understand from the monthly ODI data reported by the ODI issuers that quite a few ODI subscribers invest through multiple issuers. It will discourage the ODI subscribers from taking ODI route and encourage them to directly take registration as an FPI.

2. Prohibit ODIs from being issued against derivatives except for those used for hedging:-

Presently, ODIs are being issued against derivatives along with equity and debt. As of April 2017, the ODIs issued against derivatives had a notional value of INR 40,165 Cr which is 24% of the total notional value of outstanding ODIs. SEBI proposes to prohibit ODIs from being issued against derivatives for speculative purpose. Further, the ODI issuers shall be given time till December 31, 2020 to wind up the ODIs

issued against derivatives which are not for hedging purpose. It will be incumbent on ODI issuing FPI to ensure that ODI is issued against those derivatives which are purely for hedging purpose and not for naked speculation. The ODI issuing FPI shall put in place necessary system to ensure the same.

D. Public Comments:-

1. In light of the above, public comments are invited on the proposals given at 1 and 2 of C above. Comments/ suggestions may be provided as below:

S. No.	Pertains to C.(1) / C.(2)	Suggestions	Rationale

2. Comments may be forwarded by email to odi-feedback@sebi.gov.in latest by June12, 2017.

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