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Dear Sir,

## RE: SEBI's recent FPI BO and SMO requirements

The undersigned asset and fund management associations, on behalf of our respective members, would like to share with SEBI the issues and challenges that we have with SEBI's recent directions for Foreign Portfolio Investors ("FPIs") in relation to disclosures of the details of their beneficial owner(s) ("BO") and senior managing official(s) ("SMO").

These directions follow the issuance of the [Prevention of Money Laundering \(Maintenance of Records\) Amendment Rules, 2023](#) ("PMLA Rules") on 7 March 2023, which, *inter alia*, lowered the threshold for identification of BO from 25% for company structures and 15% for trust structures to 10% for both companies and trusts, while retaining 15% for partnership firms and unincorporated associations or bodies of individuals.

### A. Publication of all FPI-related directives

While most of the recent FPI related changes have been brought about by SEBI through amendments to the SEBI (Foreign Portfolio Investors) Regulations, 2019 (the "**Regulations**") and issuances of circulars, such as SEBI's [15 March 2023 amendment to the Regulations](#) (the "**15 March Amendment Regulations**") and [27 March 2023 circular](#) amending the provisions of the Master Circular for FPIs, Designated Depository Participants ("**DDPs**") and Eligible Foreign Investors (the "**Master Circular**"), SEBI's directive sent to the DDPs vide an email in February 2023 on the legal entity declaration and SMO identification (the "**Direction**") was not published or otherwise shared with the FPIs, either before or after its release. This approach has resulted in some confusion for our members as different DDPs seem to have interpreted the Direction differently. We strongly suggest that in the future, SEBI publish all changes and requirements relating to FPIs so that both FPIs and DDPs are made aware of the requirements at the same time and in their original form directly from SEBI. This will create uniformity in the market, reduce the risks of different interpretations, and afford all market participants an equal opportunity to understand and evaluate SEBI's rules and requirements.

## B. BO and SMO in a fund context

The undersigned associations represent asset and fund managers, many of whom manage the investments of mutual funds, unit trusts, collective investment schemes, common trust funds and other pooled vehicles (including ETFs) that are either open for subscription to both retail and professional/sophisticated investors (collectively, “**Public retail funds**”) or to professional/sophisticated investors only (“**Private funds**”).

To invest in the Indian market, such managers may register the fund(s) (or each sub-fund) that they manage as the FPI. These funds may be set up in the form of a company, a trust or in a contractual or other form without legal personality. The Public retail funds are typically open-ended with numerous investors who are free to subscribe and redeem or trade units of these funds on a daily basis.

Public retail funds and appropriately regulated Private funds (such as EU’s Alternative Investment Funds (“**AIFs**”)) are highly unlikely to be used by an individual or a group of individuals to manipulate the Indian equity market. They are highly regulated investment products that offer diversification to investors by design and prohibited by law to invest in a single corporate group or entity. While appropriately regulated Private funds (such as AIFs) may offer more leeway to fund managers in making investment decisions than Public retail funds, they are typically distributed to highly regulated financial institutions (e.g., pension funds and insurance companies), which themselves have a diversified customer base.<sup>1</sup>

### Frequent subscriptions and redemptions

With the frequent changes of owners or unitholders of Public retail funds, it is challenging for the fund manager or fund management company to monitor and disclose daily changes of beneficial ownership of these funds. Nor is the disclosure of these granular changes particularly useful to SEBI.

### Barriers to BO disclosures outside the control of fund managers

Moreover, considering that Public retail funds are normally distributed or sold through intermediaries (e.g., banks, insurance companies, and/or trading platforms) under an omnibus/nominee structure, the fund manager typically does not have visibility into or access to the hundreds to hundreds of thousands of end investors of such funds. It also follows that the underlying investors of Public retail funds have no direct influence over the fund, which makes it impossible for them to have a controlling ownership interest or control over the activities of the fund.

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<sup>1</sup> For instance, the [ESMA 2022 AIF Statistical Report](#) indicates that “The ownership of [EU’s Alternative Investment Funds (AIFs)] continues to be highly concentrated: the top five investors account for more than 75% of the NAV across AIF types. More than 50% of all AIFs are entirely held by their top five investors, as indicated by the median of 100% for all AIF types [...]. The high ownership concentration is explained by the dominant role played by institutional investors. In some cases, AIFs can be set up for a single institutional investor that prefers to hold all of the AIF shares, as the fund can be set up to fulfil its specific investment objective.” (p. 12).

Further, it is important to note that many of these funds are not only sold locally but also distributed globally (e.g., EU's Undertaking for Collective Investment in Transferable Securities ("UCITS"))<sup>2</sup>. Therefore, the impact of SEBI's new BO requirements on these funds would have global ramifications.

In some cases, the distribution chain can be particularly long with three or four intermediaries between the fund and the BO. Consequently, obtaining information from these intermediaries may take weeks as they will have to reach out to their network of global distributors and sub-distributors, across a number of different time zones, to obtain the required BO information. As mentioned later in this letter, the new requirement to disclose the BO information within a seven-business day period would be challenging to say the least in view of the foregoing.

Even assuming fund distributors or intermediaries are operationally able to provide fund managers with the required BO information, they may not be willing to do so for their own commercial or proprietary reasons (e.g., preferring to keep the identity of their customers or clients to themselves). In addition, the numerous data privacy and protection regulations that have been introduced in many jurisdictions globally (e.g., the EU's General Data Protection Regulation and Hong Kong's Personal Data (Privacy) Ordinance) may limit intermediaries' ability to share their clients' personal information.

#### Exemption or Relaxation for Public retail funds

For these reasons, we request SEBI to consider exempting Public retail funds from the new BO disclosure requirements or not applying the reduced threshold of 10% to Public retail funds and retain the original 25%/15% threshold, as the case may be, for such funds. We are concerned that if FPI funds are unable to comply with the ongoing disclosure requirements as set out in the Direction, it may lead to their forced de-registration as an FPI which would not only be detrimental to the fund, the fund's investors and the fund manager but also to the Indian market.

It is important to note that typically Public retail funds are registered and regulated in their home jurisdiction which mean that they are subject to numerous regulations and protocols. For example, under the rules applying to UCITS, no single asset can represent more than 10% of the UCITS' assets, and holdings of more than 5% cannot in aggregate exceed 40% of the UCITS' assets (the "5/10/40" rule)<sup>3</sup>. More importantly, UCITS are not allowed to exercise control over the companies in which they invest<sup>4</sup> and many other Public retail funds have policies to limit their investments in companies to non-controlling (e.g., less than 10%) interests.

Another example is that to qualify as a regulated investment company (RIC) under the U.S. tax laws, all U.S. mutual funds, closed-end funds, and ETFs must meet a tax diversification test every quarter.

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<sup>2</sup> As indicated in the [EFAMA 2023 Factbook](#), EU funds are an important vehicle for international portfolio investment. By the end of 2022, non-EU investors held in EU Funds EUR 4.4 trillion in Assets under Management (AuM). The unintended consequences described in this letter would therefore concern a wide range of global investors.

<sup>3</sup> Article 52(1) of [Directive 2009/65 EC of the European Parliament and the Council of 13 July 2009](#) (hereafter "UCITS Directive").

<sup>4</sup> Article 56(1) UCITS Directive.

The effect of this test is that a fund with a modest cash position and no government securities would need to hold securities from at least 12 different issuers.<sup>5</sup>

Therefore, it is highly unlikely that a single investor could indirectly hold a significant interest in an Indian security through a Public retail fund registered as an FPI. Accordingly, we strongly urge SEBI to exempt or relax the FPI BO requirements for Public retail funds under the PMLA Rules, the Regulations and the Direction.

In addition, in its recent [Consultation Paper on framework for mandating additional disclosures from FPIs that fulfil certain objective criteria](#) issued on 31 May 2023, SEBI proposes to characterize pension funds and public retail funds with widespread and dispersed investors in such funds as “Moderate Risk FPIs”, which are not subject to enhanced transparency measures for fully identifying all holders of ownership, economic and control rights that are placed on High Risk FPIs. We strongly believe this proportionate approach to the application of enhanced KYC requirements should be applied in the recent Direction regarding disclosures of BO and SMO.

We also urge SEBI to ensure that the determination of whether an FPI is a Public retail fund should not be based solely on the number of shareholders in the register. There may be cases, particularly if sub-funds hold the FPI registration, where the shareholder base is not wide and diverse by virtue of number of shareholders. For example, this may be because a fund was just launched and has been seeded by only one investor, or due to market fluctuations, investors have divested, leaving a smaller shareholder base. The fact that there is a smaller shareholder base at a certain point in time does not detract from the fact that the fund is a Public retail fund and has the potential to have a wide and diverse investor base. Furthermore, an assessment that only focuses on the number of shareholders in the register could lead to unintended consequences for master funds in a master-feeder structure that may be automatically deemed as a High Risk FPI by virtue of only having the feeder fund(s) as shareholders when potentially these feeder funds have a wide and diverse investor base.

#### Exemption or Relaxation for certain Private funds

As suggested earlier, appropriately regulated Private funds, such as AIFs, are highly unlikely to be used by an individual or a group of individuals to manipulate the Indian equity market. We note that SEBI, at its board meeting held on 28 June 2023<sup>6</sup> where it approved the Consultation Paper on framework for mandating additional disclosures from FPIs that fulfill certain objective criteria, included “verified pooled investment vehicles meeting certain conditions” among the list of FPI entities that are exempt from making additional disclosures. The foregoing suggests that Private funds may also be exempted if they meet certain conditions.

Among the conditions for a Public retail fund or Private fund to be exempted from additional disclosures that SEBI may wish to consider, as appropriate, can be (a) whether the fund is authorised or registered in its home jurisdiction; (b) whether the fund is subject to regulation in that and/or other

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<sup>5</sup> See “Appendix A, How US-Registered Investment Companies Operate and the Core Principles Underlying Their Regulation” in the [ICI 2023 Factbook](#).

<sup>6</sup> See item 6 in the [minutes of SEBI Board Meeting](#) on 28 June 2023

jurisdictions; and/or (c) whether there is a limit (e.g., no more than 10%) on the fund's investment in a single company to comply with the relevant regulations and/or the fund's investment policy or objective.

### BO of funds

While our preference is for SEBI to exempt Public retail funds and appropriately regulated Private funds from the new BO requirements, we also request that SEBI clarify what BO means in the context of a fund.

We understand that for BO identification of an FPI, the individual investors holding the prescribed threshold in the FPI are disclosed. If there is no such individual, then the individual exercising control (whether through the appointment of a majority of the directors on the board of the FPI, the management or policy decisions for the FPI, through voting agreement, shareholding or otherwise) over the FPI is identified as the BO. If no one can still be identified, then the SMO of the legal entity at the end of the chain of legal arrangement should be identified and disclosed as the FPI's SMO.

However, we observe that, for purposes of identifying the BO of funds, some DDPs consider the BO of FPI funds at the fund level (e.g., the board of directors or trustee of the fund) while other DDPs consider the BO at the fund manager level. In the case of the latter, the DDPs would look all the way up the chain of ownership of the fund manager.

The PMLA Rules specify that for purposes of Client Due Diligence under Rule 9 thereof, BO means "the natural person who ultimately owns or controls a client and/or the person on whose behalf a transaction is being conducted and includes a person who exercises ultimate effective control over a juridical person".

We believe that it is important for SEBI to understand the implications of the foregoing for funds in the way that they are set up and managed. A fund's investment is typically managed by a fund manager, regardless of the legal form that it takes (e.g., a company, trust or contractual). Moreover, the fund itself, if in the form of a company, may have a board of directors or, if in the form of a unit trust, may have a trustee that oversees the overall management and operation of the fund. In either case, if investment decisions of a fund (i.e., discretion) rest with the fund manager or if the overall management or oversight of a fund rests with the fund's board of directors or the trustee, as the case may be ("**fund officers**"), there should be no need or rationale to look beyond the SMO of the fund manager (e.g., for funds without legal personality) or of the fund officers (e.g., for funds with a legal personality) as their decisions are based on the investment objectives of the fund and not determined or controlled by their shareholder(s). Obtaining ultimate BO information beyond the SMO of the fund manager or the fund officers would not be useful as the ultimate owner of the fund manager or fund management company are not the ones responsible for overseeing the management, policies, operations and administration of the fund.

Hence, it would be helpful if SEBI could clarify who they think should be the BO (e.g., fund manager or fund officers) in the case of the above-mentioned funds.

### Identification of SMO of funds

According to the Direction, in the event no natural person is identified as BO of an FPI, details of the SMO of the legal entity at the end of the legal chain needs to be disclosed as the BO of the FPI. Some DDPs are interpreting this to mean that the legal entity at the end of the legal chain must be the ultimate parent entity of the investment manager while other DDPs have interpreted it to mean the master fund of the feeder fund if the FPI is a feeder fund. For the reasons mentioned above, it would not be helpful for SEBI's purposes to know the SMO of the shareholders of a fund manager at the end of its chain of ownership because the SMO does not control the investment decisions of the fund manager. Similarly, the same concept applies to other legal forms of FPI where the SMO at the end of the chain of legal arrangement may not make any key decisions relating to the FPI.

This is also consistent with the Master Circular which provides that "The term senior managing official (SMO), for identification as BO, means individual(s) as designated by the FPI who holds a senior management position and makes key decisions relating to the FPI."

Therefore, we request SEBI to clarify to the DDPs that SMO of the FPI should be the individual(s) who hold(s) a senior management position and **makes key decisions relating to the FPI fund**. Notably, the SMO identification and declaration may vary in different cases depending on the structure of the FPI fund and/or its investment manager.

Further, given the increasing personal privacy restrictions across multiple jurisdictions, we suggest that personal identification information (i.e., name, citizenship) of the SMO of a fund manager or fund officers be made available to DDPs but that the actual identification documents (e.g., passport copies) be presented to SEBI only upon request.

### Reporting within 7 business days

We understand that the Direction requires reporting of updates to BO information within 7 business days, which is a very tight timeline given that many FPI funds are distributed widely and globally through numerous intermediaries, distributors and sub-distributors, across a number of different time zones. For the required BO information to be obtained within a seven-business day period would be extremely challenging, if not impossible, especially with frequently changing information due to fund subscriptions and redemptions. We are concerned that this ambitious timeline could lead to an increase in non-compliance with the 15 March Amendment Regulations even with best efforts from all parties involved.

This timing issue would be substantially reduced if Public retail funds are exempted from SEBI's FPI KYC requirements or the BO and SMO information is limited to that of the fund manager or fund officers with whom the responsibility for the management and administration of the fund rest.

### **C. High and Moderate Risk FPIs**

In its recent [Consultation Paper on framework for mandating additional disclosures from FPIs that fulfil certain objective criteria](#) issued on 31 May 2023, SEBI proposes to enhance transparency

measures for fully identifying all holders of ownership, economic and control rights who invest in India through “High Risk FPIs”. The Consultation Paper proposes to characterize pension funds and public retail funds with widespread and dispersed investors in such funds as “Moderate Risk FPIs” and therefore not subject to these enhanced transparency measures.

We would like to take this opportunity to suggest expanding the scope of “Moderate Risk FPIs” beyond just pension funds and public retail funds. We believe that the following also should fall within the definition of “Moderate Risk FPIs” because they are appropriately regulated entities or are pooling vehicles that are (1) insurance/reinsurance entities, (2) banks and asset management companies, (3) investment/portfolio managers and investment advisors, (4) broker dealers and swap dealers, (5) proprietary trading firms, (6) private funds and investment trusts that are only available to institutional investors (e.g., insurance companies and pension funds), (7) collective investment trusts having pension plans of various organisations as clients, and (8) common trust funds (e.g., those regulated by the U.S. Office of the Comptroller of the Currency).

You can see that the issues mentioned above are quite common to global asset/fund managers. We hope that SEBI will consider and quickly act upon our suggestions to alleviate the problems created by the aforementioned requirements on funds that are registered as FPIs as it may impact their investments in India. At the minimum, we respectfully request SEBI to extend the deadline for compliance from 30 September 2023 to 31 December 2023.

We would appreciate an opportunity to meet with you virtually to explain further the challenges that our members face with these new requirements and to answer any questions that you may have. Due to time zone differences, it would be easier if you could contact Eugenie Shen, Head of Asset Management Group at ASIFMA to arrange such a meeting.

We look forward to hearing from you.

With kind regards on behalf of the undersigned associations,

Eugenie Shen  
Managing Director, Head of Asset Management Group  
Asia Securities Industry & Financial Markets  
Association’s Asset Management Group (AAMG)



Vincent Ingham  
Director, Regulatory Policy  
European Fund and Asset Management Association  
(EFAMA)



Matthew Mohlenkamp  
Managing Director, Asia and Global Analytics  
ICI Global



Kevin Ehrlich  
Managing Director, Asset Management Group  
Securities Industry and Financial Markets  
Association's Asset Management Group  
(SIFMA AMG)



### **About the signatory associations**

**AAMG:** The Asset Management Group (**AAMG**) of Asia Securities Industry & Financial Markets Association (**ASIFMA**) was set up a decade ago to represent and advocate for the interests of asset managers in Asia ex-Japan ex-Australia. AAMG currently has 42 members, most of which are the world's largest long only asset manager, and whose combined assets under management exceed US\$50 trillion. A list of the AAMG members can be found in <https://www.asifma.org/membership/members/>.

**EFAMA:** EFAMA is the voice of the European investment management industry, which manages EUR 28.5 trillion of assets on behalf of its clients in Europe and around the world. We advocate for a regulatory environment that supports our industry's crucial role in steering capital towards investments for a sustainable future and providing long-term value for investors. Besides fostering a Capital Markets Union, consumer empowerment and sustainable finance in Europe, we also support open and well-functioning global capital markets and engage with international standard setters and relevant third-country authorities. EFAMA is a primary source of industry statistical data and issues regular publications, including Market Insights and the EFAMA Fact Book. More information is available at [www.efama.org](http://www.efama.org)

**ICI Global:** [ICI Global](#) carries out the international work of the [Investment Company Institute](#), the leading association representing regulated investment funds. With total assets of \$38.9 trillion, ICI's membership includes mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and UCITS and similar funds offered to investors in Europe, Asia and other jurisdictions. ICI's mission is to strengthen the foundation of the asset management industry for the ultimate benefit of the long-term individual investor. ICI Global has offices in Brussels, London, Hong Kong, and Washington, DC.

**SIFMA AMG:** The Asset Management Group of the Securities Industry and Financial Markets Association ("**SIFMA AMG**") brings the asset management community together to provide views on U.S. and global policy and to create industry best practices. SIFMA AMG's members represent U.S. and global asset management firms whose combined assets under management exceed \$45 trillion. The clients of SIFMA AMG member firms include, among others, tens of millions of individual investors, registered investment companies, endowments, public and private pension funds, UCITS and private funds such as hedge funds and private equity funds. For more information, visit <https://www.sifma.org/committees/amg/>