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# **OVERVIEW OF THE LEGAL LANDSCAPE FOR DEBT INVESTMENTS BY FOREIGN PORTFOLIO INVESTORS**

AUTHORED BY - SUPRAJA SRI LASYA KUCHI<sup>1</sup>

*FPI is a strategic pathway for foreign entities to engage with Indian financial markets through equity and debt instruments. Governed collaboratively by SEBI and RBI, FPIs are subject to specific regulatory limits and frameworks, including categorization, registration, and investment routes (such as VRR, MTF, and FAR). These mechanisms ensure balanced market participation and foster a transparent investment environment. This paper seeks to provide a comprehensive understanding of the routes available to FPIs to enter Indian debt markets.*

## **Introduction**

Foreign Portfolio Investment (FPI) is a key route for foreign investors to access Indian financial markets. It involves investments by individuals or institutions in financial assets such as stocks, bonds, and mutual funds located outside their home country. Unlike Foreign Direct Investment (FDI), which entails acquiring significant ownership or operational control in a foreign entity, FPI is characterized by passive investment without direct control over the assets.

Foreign Portfolio Investment has been defined as “any investment made by a person resident outside India in equity instruments where such investment is (a) less than 10 percent of the post issue paid-up equity capital on a fully diluted basis of a listed Indian company or (b) less than 10 percent of the paid-up value of each series of equity instruments of a listed Indian company.”<sup>2</sup>

Initially, the term "capital instruments" was used instead of "equity instruments". The regulatory shift to "equity instruments" has clarified that the 10% threshold applies only to equity investments, while debt investments are not subject to this limit. Consequently, when an entity seeks to invest beyond the 10% threshold, they would fall within the category of Foreign Direct Investment and would attract a different set of regulatory framework. The 10% threshold for an investor including its investor group is further backed by regulation 20(7) of

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<sup>2</sup> Foreign Exchange Management (Non-Debt Instruments) Rules 2019 (notified on 17 October 2019) Notification No. FEMA. 395/2019-RB.

the FPI regulations.<sup>3</sup>

On the debt side, an alternative route for investment is *External Commercial Borrowings (ECBs)*, which are subject to their own regulatory provisions<sup>4</sup>. Thus, international debt investments in India are regulated either under the FPI framework or ECB regulations, depending on the investment structure.<sup>5</sup>

## Regulatory Landscape

The regulatory framework governing Foreign Portfolio Investments (FPIs) in India is a collaborative effort between two primary authorities: the *Securities and Exchange Board of India (SEBI)* and the *Reserve Bank of India (RBI)*.

**SEBI** oversees market participation aspects of FPIs, including eligibility, registration, categorization, and cancellation. The key regulatory framework under SEBI comprises the *SEBI (Foreign Portfolio Investors) Regulations, 2019*<sup>6</sup>. This framework is further supported by the *Master Circular for FPIs, Designated Depository Participants (DDPs), and Eligible Foreign Investors (EFIs)*<sup>7</sup>, which consolidates operational and compliance requirements.

**RBI** focuses on regulating the composition and volume of investments made by FPIs, particularly in the debt market. Its regulatory framework includes the *Foreign Exchange Management* rules and regulations, with specific emphasis on the *Foreign Exchange Management (Debt Investment) Regulations*<sup>8</sup>. These regulations govern the limitations on debt investments, ensuring adherence to macro-prudential norms and safeguarding financial stability.

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<sup>3</sup> Securities and Exchange Board of India (Foreign Portfolio Investors) Regulations 2019 (notified on 23 September 2019) SI No. 1/2019.

<sup>4</sup> Foreign Exchange Management (Borrowing and Lending in Foreign Exchange) Regulations 2018 (17 December 2018) Notification No. FEMA 3(R)/2018-RB; Reserve Bank of India, 'Master Direction - External Commercial Borrowings, Trade Credits and Structured Obligations' (26 March 2019) Master Direction No. 5/2018-19.

<sup>5</sup> Securities and Exchange Board of India, 'Consultation Paper on Proposal to Enhance Trust in the Alternative Investment Funds ('AIF') Ecosystem to Facilitate Ease of Doing Business Measures' (19 January 2024).

<sup>6</sup> Ibid n.3

<sup>7</sup> Securities and Exchange Board of India, 'Master Circular for Foreign Portfolio Investors, Designated Depository Participants and Eligible Foreign Investors' (30 May 2024) SEBI/HO/AFD/AFD-PoD-2/P/CIR/2024/70.

<sup>8</sup> Foreign Exchange Management (Debt Instruments) Regulations 2019 (notified on 17 October 2019) Notification No. FEMA. 396/2019-RB.

This *dual regulatory approach* ensures comprehensive oversight, balancing investor participation with economic and market stability. SEBI provides a structured entry and operational framework for FPIs, while RBI ensures that debt and equity investments remain within prescribed financial and regulatory limits. Together, they maintain a robust and transparent environment for foreign investments in Indian markets.

The regulations not only affect the entering entity, but also affect the manner and composition of prospective lenders and related volumes of debt targeted by Indian *borrowers*, i.e., they also influence the composition and structure of debt portfolios targeted by Indian borrowers. Borrowers must ensure compliance with these norms, as adherence is critical to avoiding potential regulatory challenges in the future and further maintain smoother operations and foster greater confidence among prospective lenders.

### Registration Process

*Regulation 2(j) FPI Regulations*<sup>9</sup> defines a Foreign Portfolio Investor as a person who has been registered under Chapter II of these regulations and shall be deemed to be an intermediary in terms of the provisions of the Act<sup>10</sup>. To operate, an FPI must register with a *Designated Depository Participant (DDP)*, which issues a *Certificate of Registration* on behalf of SEBI. This certificate is valid for three years. The process and criteria for registration are elaborated in SEBI's *Master Circular for Foreign Portfolio Investors, Designated Depository Participants, and Eligible Foreign Investors*<sup>11</sup>. This circular provides detailed guidance to DDPs for assessing applicants before granting registration.

Applicants must satisfy below *criteria*, including:

1. Being a non-resident of India, or not classified as an Overseas Citizen of India.
2. Belonging to a Financial Action Task Force (FATF) compliant jurisdiction and not being listed under FATF sanctions.

Additional conditions apply to certain entities such as banks and central banks, requiring adherence to their specific regulatory guidelines.

Applicants may register under one of the following *categories*:

- Category I:

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<sup>9</sup> Ibid n.3

<sup>10</sup> Securities and Exchange Board of India Act, 1992

<sup>11</sup> Ibid n.7

- Foreign governments and government-related investors
- International and multilateral organisations
- Pension and university funds
- Banks, brokers, asset managers and other appropriately regulated entities
- Other entities where the investment manager is from a FATF member country and registered as a Category I FPI
- Entities that are at least 75% owned by a Category I FPI
- Category II:
  - Appropriately regulated funds not eligible as Category I FPI
  - Endowments, foundations and charitable organisations
  - Corporate bodies, family offices, individuals and unregulated funds in the form of limited partnerships and trusts
  - Appropriately regulated entities investing on behalf of clients

### **FPI Investment avenues**

Before analysing the legal mechanisms for debt investment by FPIs, it is essential to understand the breadth of instruments in which such investors are permitted to invest under Indian law. The investment avenues for FPIs, which are allowed vide the FPI Regulations 2019, broadly spans two categories—(A) Equity and equity-linked instruments, and (B) Debt instruments.

#### A. Equity and other securities:

- Listed shares or ‘to be listed’ shares
- Exchange-traded derivatives (stock, index, currency, and commodity)
- Units of mutual funds
- Indian depository receipts
- Units of real estate trusts (REITs), infrastructure investment trusts (InvITs) and Category III alternative investment funds (AIF)
- Commodity derivatives (nonagricultural)
- Offshore derivative instruments (ODIs)
- Convertible notes issued by Indian startups

#### Debt instruments

- Dated government securities and treasury bills
- Listed and unlisted nonconvertible debentures (NCDs), and commercial papers
- Units of specified debt-oriented mutual funds

- Securitised debt instruments and security receipts
- Listed non-convertible/ redeemable preference shares
- Rupee-denominated bonds/units issued by infrastructure debt funds
- Municipal bonds
- Debt securities issued by REITs and InvITs

### **FPI Routes for debt investments**

To facilitate diverse foreign investments in Indian markets, multiple routes have been established under the Foreign Portfolio Investor (FPI) framework. These include the Voluntary Retention Route (VRR), Medium-Term Framework (MTF), and Fully Accessible Route (FAR). Each serves distinct objectives and offers tailored conditions to diverse investor needs while maintaining market stability and aligning with regulatory objectives.

#### **a. Voluntary Retention Route (VRR)**

The VRR was introduced by SEBI to promote long-term investments by FPIs in Indian debt markets. It is a special investment channel introduced by RBI to encourage Foreign Portfolio Investors to make long-term investments in Indian debt markets by voluntarily committing to retain a significant portion of their investments for a minimum period.

Exemptions: Investments via VRR are exempt from macro-prudential and regulatory norms, including general investment limits, minimum residual maturity requirements, and single/group investor-wise concentration limits.

Aggregate Limit: The total VRR investment limit is ₹2,50,000 crore (or higher), allocated by RBI across VRR-Govt, VRR-Corp, and VRR-Combined categories. Each FPI is allowed to invest a specified amount, known as the *Committed Portfolio Size (CPS)*, allocated either on a tap or auction basis.

CPS Requirements: FPIs must maintain a minimum of 75% of their CPS invested at all times during the three-year retention period, calculated on an end-of-day basis. Successful allottees must invest at least 75% of their CPS within three months of allotment.

Conditions for Participation: The retention period for investments is a minimum of three years. Further, Adherence to VRR-specific requirements is the joint responsibility of the FPI and its custodian.

#### **b. Medium-Term Framework (MTF)**

The MTF is a regulatory mechanism set by the RBI to manage and regulate FPI investments

in Indian debt markets over a medium-term horizon. The MTF provides FPIs with a channel to invest in government and corporate debt securities under predefined limits. It aims to balance the inflow of foreign portfolio investments with the stability of the Indian debt market.

Annual Limits: Investment limits under the MTF are prescribed by RBI for each financial year and are expressed both as a percentage of the outstanding stock of securities and in monetary terms.

Sub-Categorization: RBI circulars detail the allocation of limits between different sub-categories of securities. For instance, for the financial year 2024-25, the April 26, 2024 circular specifies a 50:50 split between long-term and short-term government securities (G-secs).

Sector-Specific Focus: The framework allows sector-specific investments, ensuring balanced participation and minimizing systemic risks.

### ***c. Fully Accessible Route (FAR)***

The FAR was introduced to provide unrestricted access for FPIs to invest in specified government securities (G-secs). It is a regulatory framework introduced by the Reserve Bank of India (RBI) to facilitate unrestricted foreign portfolio investment in Indian Government Bonds (IGBs). Unlike the MTF, the FAR allows investments in select government securities without being subject to any investment limits. The FAR simplifies investment in government securities, fostering enhanced foreign participation and liquidity in sovereign debt markets.

## **Investment Limits**<sup>12</sup>

The regulatory framework for Foreign Portfolio Investors (FPIs) in India prescribes specific investment limits to ensure balanced market participation and minimize systemic risks. These limits are categorized into 4 types: security-wise limits, concentration limits, investment utilization limits, and per-issue limits.

### ***a. Security-Wise Limits***

FPIs are permitted to invest only a defined percentage of the available *outstanding stock of debt securities*. These limits are periodically set by the Reserve Bank of India (RBI) under the Medium-Term Framework (MTF) and are expressed in both percentage and monetary terms.

Limits for FY 2025-26:

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<sup>12</sup>Reserve Bank of India, 'Investment by Foreign Portfolio Investors (FPI) in Debt - Review' (15 June 2018) RBI/2017-18/199 A.P. (DIR Series) Circular No. 31.

- Government Securities (G-secs): 6%
- State Development Loans (SDLs): 2%
- Corporate Bonds: 15%

**b. Investment Utilization Limits**

Investment pools of FPIs must adhere to restrictions based on the *maturity profile* of their holdings:

- Long-Term Securities: With a minimum maturity of one year, these can constitute the remaining 70% or more of the pool.
- Short-Term Securities: These have a maturity of less than one year and were earlier capped at up to a maximum of 30% of the total investment pool. The RBI has recently made a significant policy change by removing the 30% cap on short-term investments.<sup>13</sup> Previously, FPIs were restricted from allocating more than 30% of their overall debt investment portfolio to instruments with a residual maturity of less than one year. This change provides investors with greater operational flexibility, especially in managing the maturity profile of their debt portfolios.

By removing this cap, the RBI has effectively tackled two operational challenges FPIs regularly encountered: *forced diversification and premature selling*. The earlier rule had the unintended consequence of pressuring FPIs to artificially rebalance portfolios by purchasing longer-tenure instruments just to stay within compliance limits. In cases where suitable instruments were unavailable or concentration limits were already exhausted, FPIs were often left with no choice but to liquidate their maturing positions. Since selling to other FPIs wasn't a viable option—given their similar constraints—sales had to be made to domestic investors, sometimes at suboptimal prices or timing. The removal of this cap reduces these frictions and supports a more efficient and stable investment environment for long-term FPI participation.<sup>14</sup>

**c. Single FPI/Group Per-Issue Limits**

No single FPI or a related group of FPIs may hold more than 50% of an individual issue of debt securities. This rule is designed to prevent dominance by any single investor or group, ensuring a diversified investor base and reducing issuer dependency on specific FPIs.

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<sup>13</sup> Ibid.

<sup>14</sup> Resolut Partners, 'RBI Fine Tunes FPI Regime For Debt Investments' (Resolut Partners, 20 May 2025) <https://resolutpartners.com/research/rbi-fine-tunes-fpi-regime-for-debt-investments>

**d. Concentration Limits**

Concentration limits define the maximum share of a security that can be held by a *single FPI* or a *group of related FPIs*. This prevents undue influence by any single investor or group on the availability and pricing of a security. *Earlier* limits (prior to May 8th 2025 notification<sup>15</sup>)

- Short-Term Securities: 10%
- Long-Term Securities: 12%

Vide RBI Notification dated May 8th, 2025, the provisions relating to concentration limits have been removed, thereby allowing greater flexibility for FPI investment.

### **Clubbing of Investment Limits<sup>16</sup>**

The clubbing of investment limits is a regulatory mechanism introduced by SEBI to prevent circumvention of FPI regulations. This system ensures that investments made through multiple FPIs, controlled or owned by the same investor(s), are treated as a single FPI for the purpose of calculating investment limits.

SEBI designed this framework to "lift the veil" of control and ownership, thereby preventing entities from bypassing prescribed limits by setting up multiple FPIs. By consolidating such investments, SEBI ensures the true intent of the regulatory framework is upheld, fostering transparency and accountability.

Clubbing is based on the following **two conditions**:

Common Ownership: When more than 50% ownership of multiple FPIs is held by the same investor(s).

Common Control: When an investor or group has the right to appoint a majority of directors or influence the management and policy decisions directly or indirectly.

These criteria help identify FPIs that are effectively operating as a single entity under different registrations.

### **Exemptions to Clubbing Provisions**

When clubbing provisions were introduced in April 2018, they faced criticism for their broad

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<sup>15</sup> Reserve Bank of India, 'Investments by Foreign Portfolio Investors in Corporate Debt Securities through the General Route – Relaxations' (Notification No RBI/2025-26/35 FMRD.FMD.No.01/14.01.006/2025-26, 8 May 2025) <https://rbi.org.in/Scripts/NotificationUser.aspx?Id=12847&Mode=0>

<sup>16</sup> Clarification on clubbing of investment limits of Foreign Portfolio Investors ("FPIs") ( 13 December 2018) SEBI/HO/IMD/FPIC/CIR/P/2018/150.

applicability. In response, SEBI issued a clarification in December 2018, which provided exemptions to the common ownership condition for:

Appropriately Regulated Public Retail Funds: Funds that are subject to stringent regulatory oversight in their home jurisdiction.

Public Retail Funds Majorly Owned by Appropriately Regulated Public Retail Funds: Such ownership ensures the funds are indirectly subject to regulatory scrutiny.

Funds Managed by Appropriately Regulated Investment Managers (IMs): If the fund manager is appropriately regulated, the funds under their management may qualify for exemption.

These exemptions reflect SEBI's effort to balance strict regulatory oversight with the need to attract credible, well-regulated foreign investors.

### **Monitoring of Investment Limits**

Monitoring FPI investment limits is a critical aspect of maintaining regulatory compliance and ensuring market stability. The responsibility for overseeing these limits lies with the Designated Depository Participants (DDPs), who track investments at both individual and group levels.

The National Securities Depository Limited (NSDL)<sup>17</sup> and the Central Depository Services Limited (CDSL) update the debt utilization status of FPIs on a daily basis. This real-time tracking mechanism ensures transparency and provides critical insights into the extent of market participation by FPIs.<sup>18</sup> The below actions are undertaken when threshold limits are reached<sup>19</sup>:

When Utilization Exceeds 95%: If the debt utilization crosses 95% of the allowed limit, the depositories take immediate action. Custodians are instructed to halt further FPI purchases. Stock exchanges are informed of the remaining unutilized limits to conduct an auction for reallocating the limits.

When Utilization Drops Below 92%: If debt utilization falls below 92%, the auction process is discontinued. The available limits are then reopened for fresh investments without requiring an auction.

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<sup>17</sup> National Securities Depository Limited, 'Foreign Investment Limit Monitoring' (NSDL) < [<sup>18</sup> Securities and Exchange Board of India, Monitoring of Foreign Investment limits in listed Indian companies \(5 April 2018\) IMD/FPIC/CIR/P/2018/61](https://issuer.nsdl.com/filimitmonitoring.html#:~:text=The%20monitoring%20of%20Foreign%20Investment,monitor%20the%20foreign%20investment%20limits.></a></p></div><div data-bbox=)

<sup>19</sup> Securities and Exchange Board of India, 'Investments by FPIs in Corporate Debt' (20 July 2017) IMD/FPIC/CIR/P/2017/81 July 20, 2017

This robust monitoring framework ensures that investment activities remain within prescribed boundaries, preventing overconcentration and promoting equitable access for FPIs. By linking utilization levels to proactive regulatory responses, the system safeguards market integrity while maintaining flexibility for investors.

### **Conclusion**

For investors, India's FPI framework presents a well-structured opportunity to diversify portfolios both for investors as well as borrowers. The availability of multiple investment routes, such as VRR, MTF, and FAR, ensures flexibility to align investments with long-term or short-term goals. Defined limits and clear categorization, coupled with exemptions like the Voluntary Retention Route's relaxed norms, offer strategic entry points. Transparent mechanisms like real-time monitoring of debt utilization instill confidence, reducing risks of regulatory breaches or sudden market disruptions.

For borrowers, particularly Indian entities seeking foreign capital, the FPI framework facilitates access to diversified funding sources, especially in the debt market. The VRR Route particularly ensures that there is no sudden withdrawal and provides a sense of security to borrowers. The well-defined concentration and utilization limits prevents over-reliance on single investors, promoting sustainable funding practices. Borrowers benefit from predictable frameworks, which aid in planning and structuring debt portfolios without compromising regulatory compliance.

While the regulatory oversight ensures stability, the framework provides room for maneuvering within defined boundaries, enabling both investors and borrowers to achieve financial goals effectively. This balance, supported by the government's broader intent to attract credible foreign investments, underscores the system's strength as a mutually beneficial model fostering growth and stability in Indian financial markets.