

# Investment Funds: Monthly Digest

January 31, 2020

## SEBI'S INFORMAL GUIDANCE: ON (OR NO?) FDI BY FPIS

On November 21, 2019, a Singapore based Category II Foreign Portfolio Investor ("FPI") registered with the Securities and Exchange Board of India (SEBI) under the new SEBI (Foreign Portfolio Investors) Regulations, 2019 (the "FPI Regulations") wrote to SEBI, requesting for its informal guidance as an interpretive letter on *inter alia* investment by the FPI in equity shares of an Indian company (through purchase from another foreign investor) which is neither listed on any stock exchange in India, nor proposed to be listed.

SEBI's response to the request suggests that FPIs are permitted to purchase or sell equity instruments of an Indian company listed or to be listed on any recognized stock exchange subject to conditions provided under applicable laws. However, SEBI has stopped short of confirming that so is the case under the FPI route of foreign investments in India.

The position summarized by SEBI, therefore, seems inconsistent with the prevailing regulatory framework provided by the Reserve Bank of India ("RBI") for foreign direct investments ("FDI") and FPI investments in India.

In this issue of the monthly digest, we have analysed SEBI's response in light of the prevailing regulations which are also referred in the applicant's letter as well as SEBI's response. Before getting into the facts and merits, we have first briefly explained SEBI's informal guidance scheme and the disclaimers that come with it.

### SEBI'S INFORMAL GUIDANCE SCHEME

Pursuing its broader objectives, SEBI introduced its SEBI (Informal Guidance) Scheme, 2003 (the "Informal Guidance Scheme") in June, 2003 to protect the interests of investors in securities market and to promote the development of, and to regulate the securities market, by such measures as it thinks fit.<sup>1</sup>

Any response issued by SEBI under the Informal Guidance Scheme is not to be construed as a decision or conclusion by SEBI, and accordingly, SEBI is not liable for any loss or damage arising out of such response by SEBI, or any different views taken by SEBI in different cases.<sup>2</sup>

### FDI BY FPIS

Foreign investments (of any kind) in India are governed by the RBI under Foreign Exchange Management Act, 1999 ("FEMA") and different rules and regulations issued thereunder. Recently, the erstwhile RBI regulations governing FDI in India were amended by Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 (the "NDI Rules").

The regulatory framework of NDI Rules (and the erstwhile regulations that it supersedes) is such, that it provides different entry routes to foreign investors for investing in non-debt instruments<sup>3</sup> in India but does not require such routes to be used in a mutually exclusive manner by such foreign investors.

In other words, a foreign entity may invest in Indian securities under the FDI route (under Rule 6(a), read with Schedule I of the NDI Rules, and the prevailing FDI policy of the Government of India) and also upon obtaining an FPI certificate from SEBI, invest in Indian securities as an FPI; *provided*, it does not breach sectoral caps.

To this effect, under paragraph (iii) of Schedule II of NDI Rules (which governs investments by FPIs in India under the FPI route when read with Rule 10 from a foreign exchange perspective), it has been stated that in case FPIs breach their investment limits, their entire investment in the investee entity is to be recharacterized as FDI.

### FOREIGN INVESTMENT IN EQUITY SHARES OF AN UNLISTED (AND NOT 'TO BE LISTED') INDIAN COMPANY

While both SEBI and FEMA are clear that FPIs are permitted to invest in equity shares of Indian companies which are listed or to be listed, such clarity is limited to the extent of a foreign entity choosing to invest under the FPI route.

Under the FDI route, persons resident outside India are permitted to invest in equity shares of companies which are neither listed, nor to be listed, subject to restrictions such sectoral norms, pricing guidelines.

Regulation 20(8) of the FPI Regulations allows FPIs to invest in Indian securities as 'a person resident outside India' in accordance with FEMA and the rules and regulations made thereunder. Rule 6(a) of NDI Rules as explained above, covers 'persons resident outside India', and upon reading it with Regulation 20(8) of the FPI Regulations should allow foreign entities holding an FPI registration to invest under the FDI route as long as they are not using their FPI registration to make such investment.

### SEBI'S INFORMAL GUIDANCE

While SEBI has referred to Regulation 20(8) of the FPI Regulations while providing its response to the request for the informal guidance, it has concluded stating "as far as equity instruments are concerned, FPI may only purchase or sell equity instruments of Indian company listed or to be listed on any recognized stock exchange subject to conditions provided under applicable laws".

## Research Papers

### Horizon Technologies

January 21, 2025

### Compendium of Research Papers

January 11, 2025

### FAQs on Setting Up of Offices in India

December 13, 2024

## Research Articles

### INDIA 2025: The Emerging Powerhouse for Private Equity and M&A Deals

January 15, 2025

### Key changes to Model Concession Agreements in the Road Sector

January 03, 2025

### The Revolution Realized: Bitcoin's Triumph

December 05, 2024

## Audio

### Securities Market Regulator's Continued Quest Against "Unfiltered" Financial Advice

December 18, 2024

### Digital Lending - Part 1 - What's New with NBFC P2Ps

November 19, 2024

### Renewable Roadmap: Budget 2024 and Beyond - Part I

August 26, 2024

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October 31, 2024

### Analysing SEBI's Consultation Paper

SEBI has stopped short of clarifying that the above position is when the foreign entity holding the FPI registration is using the FPI route to make the investment.

CONCLUSION

SEBI’s informal guidance should not be misconstrued to mean that foreign entities holding FPI registration are not permitted to invest under the FDI route.

It comes as a rather confusing guidance because SEBI has made a specific reference to Regulation 20(8) of the FPI Regulations but nevertheless concluded without any qualifiers limiting the conclusion to FPI route. While SEBI may lack the locus to provide guidance on FEMA or the FDI route, it would be well within its scope to clarify that its conclusion is limited to the FPI route.

– Nandini Pathak & Kishore Joshi  
You can direct your queries or comments to the authors

<sup>1</sup> Clause 2.1 of the Informal Guidance Scheme read with Section 11(1) of the Securities and Exchange Board of India Act, 1992.  
<sup>2</sup> Clause 13 and Clause 16 of the Informal Guidance Scheme.  
<sup>3</sup> See Rule 2(ai) of the NDI Rules.

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September 26, 2024

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September 22, 2024