7. Foreign Investments in India

7.1 Introduction

Since 1990-91, the Government of India has undertaken several structural changes in its policies including liberalization, privatization and globalization with a view of bringing a rapid and substantial economic growth in the economy. As a part of the policy reform, the Government has allowed Foreign Institutional Investors (FIIs) to invest in all traded securities on the primary and secondary markets, including shares, debentures and warrants issued by companies listed or to be listed on the major stock exchanges of India and in schemes floated by domestic mutual funds in 1992 through Portfolio Investment Scheme (PIS).

In the budget speech of 2011-12, the Government announced that Qualified Foreign Investors (QFIs), who met the "Know Your Customer" (KYC) norms would be allowed to directly invest in Indian equity and debt mutual fund (MF) schemes. This was the first time that QFIs were allowed to directly participate in the Indian capital market. In January 2012, the Government issued a press note stating that QFIs would now be allowed to invest in the equity shares of Indian companies. Later on, in the budget speech of 2012-13, the Government announced its intention to permit QFIs to invest in corporate bonds in India. When implemented, the QFI framework is extended to all three important segments of the Indian Capital markets, i.e., Mutual Funds, Equity Market and Corporate Bond Market.

SEBI introduced a new class of foreign investors in India known as the Foreign Portfolio Investors (FPIs) effective from June 2014. It was formed by merging the following existing classes of investors, namely, FIIs, QFIs, and sub-accounts of FIIs.

Under the SEBI (Foreign Portfolio Investors) Regulations, 2014, it is mandated that the purchase of equity shares of each company by a single FPI or an investor group should be below ten percent of the total issued capital of the company. Further, the regulations require that in case the same set of ultimate beneficial owner(s) invest through multiple entities, such entities are treated as part of same investor group and the investment limits of all such entities should be clubbed at the investment limit as applicable to a single foreign portfolio investor.

SEBI has been revising its guidelines from time to time to tighten regulations regarding issuance and subscription of Offshore Derivative Instruments (ODIs), and at the same time encouraging investment through direct access route by easing FPI registration norms. In the Circular dated 7th July, 2017, SEBI has disallowed ODIs with derivatives as underlying except those derivative positions that are taken for hedging the equity shares held by the FPI.[1]

Further, SEBI issued a circular on April 10, 2018 that mandates all FPIs to disclose KYCs of all investors. In case of companies/ trusts represented by service providers like lawyers/ accountants, FPIs has to provide information of the real owners/ effective controllers of those companies / trusts.

[1] The FPIs issuing ODIs should fulfil the following conditions for issuance of ODIs with derivatives as underlying:

- The FPIs cannot issue ODIs with derivative as underlying, with the exception of those derivative positions that are taken by the FPI for hedging the equity shares held by it, on a one to one basis.
- The FPI has to liquidate its existing ODIs with derivatives as underlying in excess of those held for hedging purpose before the date of maturity of the ODI instruments or by 31st December, 2020, whichever is earlier.
- For any fresh ODI issuance with derivatives as underlying, the compliance officer of the FPI has to certify that the derivative position on which the ODI is being issued is only for hedging purpose on one to one basis.

On the other hand, Reserve Bank of India, in its Statement on Developmental and Regulatory Policies, released on August 02, 2017, proposed to allocate a separate limit of Rs50bn to Foreign Portfolio Investors (FPIs) for taking long position in Interest Rate Futures (IRFs) in order to facilitate future market development and to ensure that FPIs' access to bond futures remains uninterrupted during the phase when FPI limits on Government securities are under auction. Besides, SEBI in its circular on June 15, 2018 has relaxed several criteria in debt market to encourage more FPIs in that segment. It has been decided to withdraw minimum residual maturity restriction of three years for investment by FPIs in G-Secs and SDLs. The investments and purchases of FPIs in both equity and debt segments have been further discussed below.

7.2 FPI investments in India

FPIs hold a significant share of Indian equity shares (about 28.9% in 2018-19), as developing economies like India provide a high growth potential compared to developed economies. Thanks to the high growth trajectory and potential, net capital inflows remained positive over the period 2011-15. However, inflows turned negative in 2015-16 as the Indian economy started dipping from the third quarter of 2015. Global rate normalization, especially in the developed markets, also contributed to the drag on inflows. This was the third time since FPIs entered Indian markets that they became net sellers for the year. The first time was seen in 1998-99 during the Asian crisis (Rs-16bn), while the second time was during the Global Financial Crisis in 2008-09 (Rs-458bn). In 2016-17 and 2017-18, FPIs had been net buyers as seen below, whereas FPIs became net sellers in Apr-Dec'18 due to several macroeconomic factors including increase in the US Fed rate, decline in world economic growth, ongoing US-China trade war and rise in the probability of no-deal Brexit.

Table 7.1: Trends in FPI Investment

Period	Purchases (Rsbn)	Sales (Rsbn)	Net Investment (Rsbn)	Net Investment (US$bn)
2010-11	9,926	8,462	1,464.4	32.2
2011-12	9,213	8,276	937.3	18.9
2012-13	9,048	7,365	1,683.7	31.0
2013-14	9,029	9,694	450.1	8.9
2014-15	15,213	12,439	2,774.6	45.7
2015-16	13,244	13,426	-181.8	-2.6
2016-17	**15,070**	**14,586**	**484.1**	**7.6**
2017-18	**17,287**	**15,837**	**1,450.7**	**22.5**
Apr-18	1,347	1,503	-155.6	-2.4
May-18	1,275	1,573	-297.8	-4.4
Jun-18	1,451	1,609	-157.9	-2.3
Jul-18	1,286	1,263	22.6	0.3
Aug-18	1,195	1,144	51.5	0.8
Sep-18	1,311	1,521	-210.3	-2.9
Oct-18	1,345	1,734	-389.1	-5.3
Nov-18	1,282	1,166	116.0	1.6
Dec-18	1,295	1,216	78.9	1.1
Apr-Dec 2018	**11,788**	**12,730**	**-941.8**	**-13.4**

Source: SEBI Bulletin.

7.2.1 Category-wise: Equity and Debt investments

In 2017-18, FPI inflows were largely dominated by debt segment at Rs1,190bn vs. equity segment of Rs256bn (Table 7.2). However, this trend has reversed in the current fiscal year with FPI outflows equally in both debt and equity segments (Rs470bl). The global turmoil has deeply impacted foreign investors' sentiments, especially for emerging markets. Moreover, higher bond yields in US economy and depreciating Indian rupee have negative impacts towards FPI investments in the bond market in India.

Table 7.2: Net Investments by FPIs in Equity and Debt in Equity and Debt

Year	Net Investment in Equity (Rsmn)	Net Investment in Debt (Rsmn)	Net Investment in Equity (US$mn)	Net Investment in Debt (US$mn)
2015-16	-141,690	-40,030	-2,131	-602
Apr-16	84,160	64,180	1,266	965
May-16	25,430	-44,090	380	-659
Jun-16	37,130	-62,200	552	-924
Jul-16	126,120	68,450	1,877	1,019
Aug-16	90,710	-26,250	1,393	-403
Sep-16	104,430	97,890	1,604	1,503
Oct-16	-43,060	-60,000	-661	-922
Nov-16	-182,440	-211,520	-2,802	-3,249
Dec-16	-81,760	-189,350	-1,256	-2,908
Jan-17	-11,770	-23,190	-181	-356
Feb-17	99,020	59,600	1,521	915
Mar-17	309,060	253,550	4,747	3,894
2016-17	**557,030**	**-72,930**	**8,555**	**-1,120**
Apr-17	23,940	203,640	368	3,128
May-17	77,110	191,550	1,184	2,942
Jun-17	36,170	256,850	556	3,945
Jul-17	51,610	188,670	793	2,898
Aug-17	-127,700	154,470	-1,961	2,372
Sep-17	-113,920	13,490	-1,750	207
Oct-17	30,550	160,640	474	2,492
Nov-17	197,280	5,310	3,061	82
Dec-17	-58,830	23,500	-913	365
Jan-18	137,810	85,230	2,138	1,322
Feb-18	-114,230	-2,540	-1,772	-39
Mar-18	116,540	-90,440	1,808	-1,403
2017-18	**256,350**	**1,190,360**	**3,978**	**18,470**
Apr-18	-55,520	-100,360	-861	-1,557
May-18	-100,600	-196,540	-1,561	-3,049
Jun-18	-48,310	-109,700	-750	-1,702

Year	Net Investment in Equity (Rsmn)	Net Investment in Debt (Rsmn)	Net Investment in Equity (US$mn)	Net Investment in Debt (US$mn)
Jul-18	22,640	430	351	7
Aug-18	17,750	34,140	275	530
Sep-18	-108,250	-101,980	-1,680	-1,582
Oct-18	-289,210	-99,780	-4,487	-1,548
Nov-18	59,810	56,100	928	870
Dec-18	31,430	47,490	488	737
Apr-Dec 2018	**-470,260**	**-470,200**	**-7,297**	**-7,296**

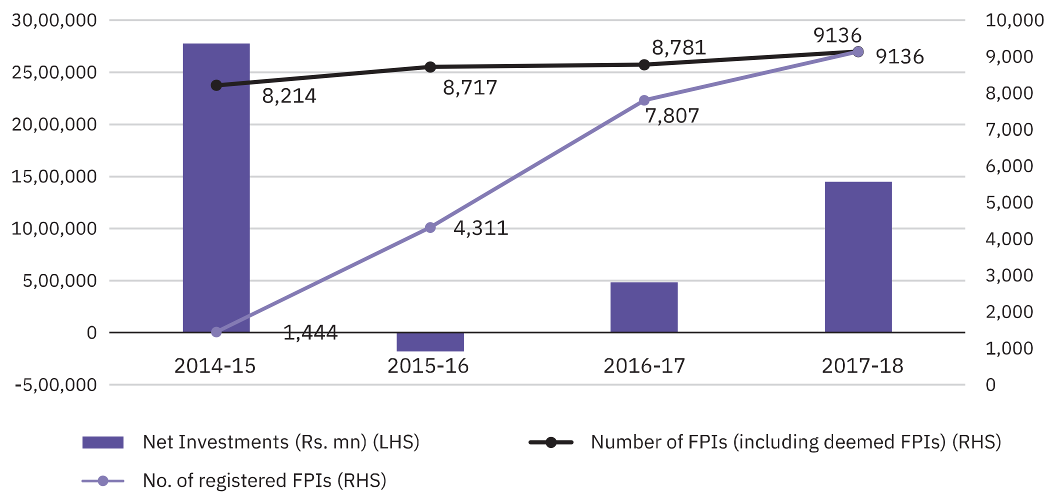
Source: NSDL, FPI Monitor.

7.2.2 Number of FPIs

The FPIs investing in India have increasingly been from diverse locations, with an increase in the number of FPIs registered in India. During 2015-17, a large number of deemed FPIs and sub-accounts were registered under SEBI. As a results, total number of SEBI-registered FPIs increased significantly from 7,807 in 2016-17 to 9,136 in 2017-18 (Chart 7.1).

On the basis of their sources of incorporation, portfolio investments in India were from 56 different countries, as on March 31, 2018 (SEBI Annual Report, 2017-18). There were 18 registered custodians of securities as well as 18 SEBI approved designated depository participants (DDPs) as on March 31, 2018. 3,191 FPIs are registered from US, followed by Luxembourg (1,050), Canada (652) and Mauritius (597).

Chart 7.1: Number of FPIs and Net Investment



Source: SEBI.

FPIs registered from US have the assets under custody (AUC) in the equity segment for the year 2018, while FPIs in Singapore have the highest amount of AUC in debt and hybrid categories. At the end of 2018, US-based entities have 33% of total AUC, followed by Mauritius (14%), Luxembourg (10%) and Singapore (9%).

Table 7.3: Assets under Custody 2017: Top 10 Countries as of December 2018

Sr. No.	Country	AUC (Rsmn)			
		Equity	Debt	Hybrid	Total
1	USA	9,658	610	1.72	10,269
2	Mauritius	4,086	332	1.31	4,419
3	Luxembourg	2,481	683	0.2	3,165
4	Singapore	1,867	1,026	7.26	2,900
5	UK	1,444	36	1.69	1,482
6	Japan	917	206	0	1,123
7	Ireland	992	39	2.65	1,033
8	Canada	886	122	0	1,008
9	Netherlands	507	233	0	740
10	Norway	546	131	0	677
11	Others	3,892	670	5.8	4,567
	Total	27,275	4,086	21	31,382

Source: NSDL.

7.3 Turnover of FPIs

7.3.1 Equity, Debt and Hybrid

In 2018, the gross turnover of FPIs in the equity market segment on major Indian stock exchanges (NSE and BSE) was Rs27.1tn, with an increase of 2% from the previous year (Table 7.4). Besides, gross turnover in the debt segment increased by 5% to Rs6.1tn in 2018. FPIs started investing in Hybrid segment as well from 2017 with Rs361mn gross turnover. It has grown tremendously to reach Rs14bn in 2018.

Table 7.4: Gross Turnover of FPIs in Equity, Debt and Hybrid Segments

Year	Buy Value (Rsbn)	Buy Value (US$bn)	Sell Value (Rsbn)	Sell Value (US$bn)	Gross Turnover of FPIs (Rsbn)	Gross Turnover of FPIs (US$bn)
Equity						
2015	11,609.6	189.9	11,431.6	187.0	23,041.2	376.9
2016	11,074.5	167.0	10,868.8	163.9	21,943.3	330.8
2017	13,505.9	207.4	12,993.3	199.6	26,499.2	407.0
2018	13,405.9	208.0	13,736.0	213.1	27,141.9	421.1
Debt						
2015	2,619.3	40.6	2,160.8	33.5	4,780.1	74.2
2016	2,789.1	43.3	3,225.5	50.0	6,014.6	93.3
2017	3,636.0	56.4	2,147.9	33.3	5,783.9	89.7
2018	2,807.1	43.6	3,285.1	51.0	6,092.2	94.5

Year	Buy Value (Rsbn)	Buy Value (US$bn)	Sell Value (Rsbn)	Sell Value (US$bn)	Gross Turnover of FPIs (Rsbn)	Gross Turnover of FPIs (US$bn)
Hybrid						
2015	-	-	-	-	-	-
2016	-	-	-	-	-	-
2017	0.1	0.0	0.2	0.0	0.4	0.0
2018	6.5	0.1	7.6	0.1	14.0	0.2

Source: NSDL FPI Monitor.
Note: Data combine both NSE and BSE turnover.

7.3.2 Derivatives Market

On the other hand, total turnover for FPI in derivatives segment rose sharply by 80% on y-o-y basis to Rs575.4tn in 2018 (Table 7.5).

Table 7.5: FPI turnover in FO market segment of Stock Exchanges

Year	Buy Side			Sell side			Gross No. of Contracts traded (mn)	Gross Turnover of FPIs	
	No. of Contracts (mn)	Amount (Rsbn)	Amount (US$bn)	No. of Contracts (mn)	Amount (Rsbn)	Amount (US$bn)		Amount (Rsbn)	Amount (US$bn)
2015	237	65,468	1,071	231	64,165	1,049	468	129,633	2,120
2016	208	124,789	1,881	207	123,789	1,866	415	248,579	3,747
2017	210	160,021	2,458	208	158,891	2,440	418	318,912	4,898
2018	368	288,790	4,481	366	286,596	4,447	734	575,385	8,928

Source: NSDL FPI Monitor.
Note: F&O includes index futures and options, stock futures and options and interest rate futures.

7.3.3 Offshore Derivative Instruments (ODIs)

Offshore derivative instruments include participatory notes (P-Notes), equity-linked notes, capped return notes, investment notes, and similar instruments issued by FPIs/sub-accounts outside India against their underlying investments in India, which are listed or are proposed to be listed on a stock exchange in India.

P-Notes are the most common type of ODIs. These are financial instruments used by investors that are not registered with SEBI to invest in the Indian stock market. P-Notes have Indian shares or derivatives as underlying assets and, the holders of P-Notes are entitled to the income or capital appreciation from such investment. P-Notes are issued by brokers and FPIs registered with SEBI. The investment is made on behalf of the foreign investors by the already registered brokers and FPIs in India. Any dividends or capital gains arising from the underlying securities accrue to the foreign investors. The foreign investor pays the P-Note issuer a certain basis point(s) of the value of P-Notes traded by him (her) as cost(s).

While popular during initial phase, ODIs have lost their charm over time. The share of ODIs in the assets under custody of FPIs has witnessed a continuous fall after reaching a peak in June 2007, as tightening of regulations by SEBI has made it difficult to use these instruments. In a recent move, SEBI has banned P-notes on derivatives with the exception that the P-note would be used for hedging purpose and underlying shares are held by FPIs. Where the said underlying derivatives position are not for purpose of hedging the equity shares held by it, the ODI issuing FPI has to liquidate such ODIs latest by the date of maturity of the ODI instrument or by December 31, 2020. In the case of issuance of fresh ODIs with derivatives as underlying, a certificate has to be issued by the compliance officer (or equivalent) of the ODI issuing FPI, certifying that the derivatives position, on which the ODI is being issued, is only for hedging the equity shares held by it, on a one to one basis.

As of December 2018, total value of ODIs with underlying Indian securities as a percentage of AUC of FPIs has declined to 2.5 percent from 11.5 percent in March 2015 (Table 7.6).

Table 7.6: Total Value of ODIs Compared to Assets Under Management of FPIs

Year/ Month	Notional value of ODIs on Equity, Debt & Derivatives (Rsbn)	Notional value of ODIs on Equity & Debt excluding Derivatives (Rsbn)	Assets Under Custody of FPIs/Deemed FPIs (Rsbn)	Notional value of ODIs on Equity, Debt & Derivatives as % of Assets Under Custody of FPIs/Deemed FPIs	Notional value of ODIs on Equity & Debt excluding Derivatives as % of Assets Under Custody of FPIs/ Deemed FPIs
2014-15	2,721	2,116	24,118	11.3	8.8
2015-16	2,231	1,695	22,245	10.0	7.6
2016-17	**1,784**	**1,243**	**27,057**	**6.6**	**4.6**
2017-18	**1,064**	**1,027**	**31,483**	**3.4**	**3.3**
Apr-18	1,002	996	33,192	3.0	3.0
May-18	935	900	31,777	2.9	2.8
Jun-18	837	803	31,883	2.6	2.5
Jul-18	803	768	33,345	2.4	2.3
Aug-18	846	809	34,315	2.5	2.4
Sep-18	795	756	31,383	2.5	2.4
Oct-18	666	651	29,823	2.2	2.2
Nov-18	792	780	31,089	2.5	2.5
Dec-18	795	786	31,382	2.5	2.5

Source: SEBI.

Note: Figures are compiled based on reports submitted by FPIs/deemed FPIs issuing ODIs.
Column 4 Figures are compiled on the basis of reports submitted by custodians & does not includes positions taken by FPIs/deemed FPIs in derivatives.
The total value of ODIs excludes the unhedged positions & portfolio hedging positions taken by the FPIs/deemed FPIs issuing ODIs.