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EY Regulatory Alert

SEBI consultation paper proposing to relax regulatory compliances for Foreign Portfolio Investors investing only in Indian Government Bonds

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Executive summary

This alert summarizes a recent consultation paper released, for public comments, by the Securities and Exchange Board of India (SEBI) on 13 May 2025, proposing to enhance the ease of doing business by relaxing regulatory compliances, for Foreign Portfolio Investors (FPIs) investing only in Indian Government Bonds under the Voluntary Retention Route or Fully Accessible Route.

The last date to provide comments is 3 June 2025.

Background

- Presently, as per the SEBI (FPI) Regulations, 2019 (FPI Regulations 2019), FPIs can invest, *inter-alia,* in debt securities as may be permitted by the Reserve Bank of India (RBI).

- The Foreign Exchange Management (Debt Instruments) Regulations, 2019 provides the type of debt securities a FPI can invest in, which includes Government securities, treasury bills, non-convertible debentures, bonds, etc.

- Further, the RBI has issued various circulars outlining the terms, conditions and directions with respect to investments by FPIs in debt securities. The same have been consolidated in Master Direction – RBI (Non-resident Investment in Debt Instruments) Directions, 2025[1] issued on 7 January 2025 and updated from time to time.

- Currently, non-residents are permitted to make investments in debt instruments including Indian Government Bonds (IGBs) under the following routes:

  - General Route
  - Voluntary Retention Route (VRR)
  - Fully Accessible Route (FAR)

  While the investment in IGBs under the General Route and VRR are subject to restrictions such as availability of investment limits, security-wise limit, concentration limit, minimum retention period, etc, FAR enables non-residents to invest in IGBs without any conditions/ limitations.

- Recently, the inclusion of IGBs in major global bond indices[2] has attracted significant foreign investment into the country. The holding of FPIs in FAR eligible IGBs has increased from USD 4.428 billion as on 31 March 2021 to USD 35.732 billion as on 28 March 2025[3] i.e. an increase of approx 700%.

- To simplify the onboarding process for FPIs investing only in IGBs under VRR and FAR (IGB-FPIs) and rationalize the ongoing regulatory compliances for such FPIs, SEBI has on 13 May 2025 released a Consultation Paper (CP), for public comments, proposing certain amendments to the FPI Regulations 2019.

- This alert summarizes the key aspects of the CP.

Proposals in the CP

Proposal I - Rationalizing KYC Periodicity

- As per the prevailing FPI Regulations 2019 read with the Master Circular dated 30 May 2024[4], custodians are periodically required to carry out the Know Your Client (KYC) review process of an FPI (1 year/ 3 years based on risk categorization).

- Further, RBI also mandates regulated entities to periodically update KYC for their clients. The same is to be done every 2 years for high-risk, 8 years for medium-risk, and 10 years for low-risk customers.

- Given the above different timelines involved, the CP proposes to align the timeline for KYC review for IGB-FPIs, as provided in the Master Circular, with the timelines prescribed by RBI (i.e. 2 years/ 8 years/ 10 years based on risk classification).

- Further, the CP also proposes that an IGB-FPI is permitted to invest solely in IGBs under VRR and FAR. As IGBs are primarily traded through RBI's Negotiated Dealing System – Order Matching platform and trades are settled through Clearing Corporation of India Limited, it is proposed that IGB-FPIs should not be required to open trading and demat accounts or obtain a Custodial Participant code.

Proposal II – Exemption from providing details of Investor Group

- Presently, FPIs are required to provide details of its investor group[5] to the Designated Depository Participant. The same is required as investments by an FPI along with its investor group are subject to several investment restrictions, such as a 10% cap on equity shares and concentration limits for debt instruments[6].

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[1] Notification No. FMRD.FMD.10/14.01.006/2024-25

[2] JP Morgan Global EM Bond Index (starting June 2024), Bloomberg EM Local Currency Government Index (starting January 2025) and FTSE Russell Emerging Markets Government Bond Index (starting September 2025).

[3] Based on data available on The Clearing Corporation of India Limited portal and provided in the consultation paper.

[4] SEBI/HO/AFD/AFD-PoD-2/P/CIR/2024/70

[5] Multiple entities registered as FPIs and directly/ indirectly, having common ownership of more than 50% or common control, shall be treated as part of the same investor group and the investment limits of all such entities shall be clubbed at the investment limit as applicable to a single FPI.

[6] Investment by FPIs (including FPIs forming part of the same investor group) in Government securities under the General Route should not exceed 15% of prevailing investment limit for long-term FPIs (Sovereign Wealth Funds, Multilateral Agencies, Pension / Insurance / Endowment Funds and foreign Central Banks) and 10% of prevailing investment limit for other FPIs.

- Considering that IGB-FPIs will be permitted to invest only in IGBs through VRR and FAR, where no such limits and clubbing requirements are applicable, the CP proposes that IGB-FPIs shall not be required to furnish investor group details unlike other FPIs.

Proposal III – Revisions to contribution restrictions for (NRI), Overseas Citizen of India (OCI), or Resident Indian Individual (RII) in IGB-FPI: Allowing Unrestricted Participation and Control

- As per the existing regulatory framework, subject to certain exceptions, an individual NRI, OCI, or RII is allowed to contribute no more than 25% of the total corpus of an FPI. Furthermore, the total contributions from all NRIs, OCIs, and RIIs combined cannot exceed 50% of the FPI's corpus. Also, NRIs, OCIs, and RIIs are not allowed to exercise control over the FPI applicant.

- Given that NRIs and OCIs are already permitted to invest in IGBs without any limits under the FAR, the CP proposes to allow NRIs/ OCIs/ RIIs[7] to contribute to the corpus of an IGB-FPI without any restriction and also be in control of the IGB-FPI.

Proposal IV –Relaxation of timelines for disclosure of material changes

- At present, FPIs are mandated to disclose any material changes in information within 7 working days / 30 days from the date of change for Type I / Type II[8] changes, respectively.

- To facilitate ease of compliance for IGB-FPIs, the CP proposes to relax the timeline for intimation of material changes (both Type I and Type II) and submission of supporting documents to 30 days.

Proposal V – Transitioning between regular FPIs and IGB-FPIs: Registration and Compliance Requirements

- At the time of obtaining registration, an applicant shall need to confirm whether it shall be an IGB-FPI or a regular FPI (i.e. non IGB-FPI).

- Regular FPIs (existing as well as prospective) may be permitted to transition to IGB-FPIs subject to:
  - making appropriate declaration
  - divesting their entire holdings (except the securities permitted for IGB-FPIs) and
  - closing their demat account before transition.

- Similarly, an IGB-FPI may also transition to being a regular FPI by making appropriate declarations. Subsequent to the transition, the FPI shall be mandated to comply with all regulatory requirements as are applicable to regular FPIs.

Comments

Foreign investment in IGBs, particularly under the FAR route (which allows non-residents to invest only in specified IGBs) has seen an impressive growth - from USD 4.428 billion as on 31 March 2021 to USD 35.732 billion as on 28 March 2025 (based on the data available on The Clearing Corporation of India Limited portal and provided in the CP). This is primarily on account of IGBs being included in several global indices since 2024 which has and is expected to attract substantial passive inflows into the country.

To further boost investment in IGBs, SEBI has released the CP which aims to provide relaxations to FPIs, investing only in IGBs under VRR and FAR, at the time of onboarding, periodic KYC review and ongoing compliances.

The proposals contained in the CP are a step in the direction of optimizing the regulatory framework through a risk-based approach and should improve ease of doing business in India for IGB-FPIs thereby creating a more favourable investment climate and attracting more stable and long-term capital into sovereign debt.

[7] The requirement of RIIs to contribute through the Liberalised Remittance Scheme and in global funds whose Indian exposure is less than 50%, shall continue to apply.

[8] Type I material changes include alterations in jurisdiction, compliance status, restructuring or regulatory penalties. Type II material changes include any changes other than Type I material changes.

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ED None.