INDIA'S FOREIGN PORTFOLIO INVESTMENT POLICY: A ROADMAP FOR GLOBAL COMPETITIVENESS

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ABSTRACT

The Foreign Portfolio Investment (FPI) framework is essential for the Capital market growth and to attract foreign investors. However, it continues to face challenges such as regulatory complications, excessive tax burden, restricted market access, and inadequate dispute resolution mechanisms. This paper evaluates the legal and regulatory complications faced by FPIs in India and proposes suggestions drawn from global best practices from countries like the USA, Luxembourg, Australia, and Singapore. The paper suggests reforms such as streamlined onboarding process, reduced capital gain tax, and improved data protection mechanism, which can enhance India's global competitiveness by fostering foreign investors' confidence and attracting foreign capital.

Keywords: Foreign Portfolio Investment (FPI), Regulatory Framework, SEBI, RBI, KYC, Capital Gains Tax, Dispute Resolution, Market Access.

INTRODUCTION

Foreign Portfolio Investment (FPI)[1] plays a crucial role in strengthening a nation's financial market by improving capital availability and enhancing economic growth. In the Indian context, FPI has emerged as an essential source of capital inflow, fostering liquidity and encouraging foreign investors. Over the past two decades, India has seen a steady increase in foreign portfolio investments, owing to its large and diverse market, promising economic growth, and liberalized investment policies.[2] Despite the growing prominence of FPI in India's financial landscape, structural and regulatory complications continue to hinder its full potential.

Background and Evolution of FPI in India

Foreign Portfolio Investment refers to the inflow of foreign capital into a country's financial markets by purchasing securities such as stocks, bonds, and other financial instruments.[3] FPI primarily targets short-term financial gains through passive investments unlike, Foreign Direct Investment (FDI), where significant ownership and control of assets are involved. Multiple regulatory bodies and legislation such as the **Securities and Exchange Board of India (SEBI)[4], Reserve Bank of India (RBI)[5]**, and **Foreign Exchange Management Act (FEMA), 1999[6].**

Liberalization of India's FPI regime took place in the early 1990s with the initiation of economic reforms intended to open the market for foreign investors.[7] The former regulations governing the FPI were consolidated and replaced by the **SEBI (Foreign Portfolio Investors) Regulation of 2014[8].** However, complications and fragmentation remained in the FPI framework, despite these reforms, imposing constant barriers for foreign investors.

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[1]Foreign Portfolio Investment, Nirmal Bang, https://www.nirmalbang.com/knowledge-center/foreign-portfolio-investment.html.

[2] Reports Listing, NSDL, https://www.fpi.nsdl.co.in/Reports/ReportsListing.aspx.

[3]*Foreign Portfolio Investors: Destination India*, PWC, https://www.pwc.in/assets/pdfs/featured-insights/foreign-portfolio-investors-destination-india.pdf.

[4] Securities and Exchange Board of India (SEBI), https://www.sebi.gov.in/.

[5] Reserve Bank of India (RBI), https://www.rbi.org.in/.

[6] *FEMA*, Directorate of Enforcement, https://enforcementdirectorate.gov.in/fema.

[7] Ajay Shah & Ila Patnaik, *Foreign Portfolio Investment and Financial Stability: Evidence from India* (2019) (IGIDR Working Paper), http://igidr.ac.in/pdf/publication/WP-2019-034_old2.pdf.

[8] *SEBI (Foreign Portfolio Investors) Regulations, 2014* (Last Amended on March 6, 2017), SEBI, https://www.sebi.gov.in.

Significance of FPI in India's Economic Growth

In recent years, Foreign Portfolio Investment (FPI) has become an essential instrument for Indian capital markets providing liquidity and enhancing market efficiency. Over the past decade, FPI investment in India has exceeded **1.1 trillion USD**[9], according to the **National Securities Depository Limited (NSDL)**[10] and **Central Depository Services Limited (CDSL)**[11] data, which highlights a growing reliance on foreign capital to finance economic development.[12] The inflow of FPI investments boosts market liquidity, strengthens the currency, and aids capital formation in sectors such as technology, finance, and infrastructure.

Additionally, FPIs foster increased market participation, promoting competition among domestic firms and contributing to enhanced corporate governance standards.[13] A well-regulated FPI framework strengthens the capital markets, attracts institutional investors, and ensures financial stability.[14] However, despite these benefits, the FPI market remains burdened by several challenges that undermine investor confidence and deter sustained capital inflow, especially in the Indian context.

India's Foreign Portfolio Investment (FPI) framework has a significant role in strengthening the country's capital markets and attracting foreign capital.[15] Despite potential growth, the FPI regime of India faces multiple challenges, such as regulatory complications, excessive tax burden, restricted market access, and inadequate dispute resolution mechanisms. These issues create barriers for foreign investors lead to reduced investor confidence, and limit India's global competitiveness in the financial market. to make India's FPI market more efficient and competitive.[16] This paper evaluates the legal and regulatory complications faced by FPIs in India and proposes suggestions drawn from globally successful practices from countries like

[9] Drishti IAS, FPIs Investment Exceeds USD 1 Trillion in Indian Securities, DRISHTI IAS (Jan. 9, 2025), https://www.drishtiias.com/daily-updates/daily-news-analysis/fpis-investment-exceeds-usd-1-trillion-in-indian-securities
[10] NSDL, https://nsdl.co.in/.
[11] CDSL, https://www.cdslindia.com/.
[12] Monthly Reports, NSDL, https://www.fpi.nsdl.co.in/Reports/Monthly.aspx.
[13] Foreign Portfolio Investment, The Unique Academy, https://theuniqueacademy.com/news/5330/foreign-portfolio-investment.
[14] Current Affairs 2024: Foreign Portfolio Investment, Superkalam, https://superkalam.com/current-affairs/article/current-affairs-2024-foreign-portfolio-investment.
[15] Foreign Portfolio Investment (FPI), Next IAS, https://www.nextias.com/blog/foreign-portfolio-investment-fpi.
[16] Foreign Portfolio Investment (FPI), Vajiram & Ravi, https://vajiramandravi.com/quest-upsc-notes/foreign-portfolio-investment-fpi.

the USA, Luxembourg, Australia, and Singapore to enhance the Indian market's efficiency and competitiveness.

AIMS AND OBJECTIVES

The primary objectives of this paper are –

1. To evaluate the present regulatory framework governing the Indian FPI and its efficiency.

2. To ascertain the hurdles faced by foreign portfolio investors in India.

3. To evaluate the globally successful practices to regulate their financial market effectively.

4. To propose recommendations to improve the Indian FPI framework's effectiveness.

LITERATURE REVIEW

1. **FOREIGN PORTFOLIO INVESTMENT IN INDIA AND ITS CONSEQUENCE ON ECONOMIC PORTRAYERS by Dr. J Udhayakumar, Shankar R (2018):** For this study, secondary data collected from sources like the RBI, Indian Securities Market Review, and the Reserve Bank of India's annual reports, primarily focusing on FPI capital flows, current account deficit, and 2007-2008 to 2016-2017 GDP report. It concluded that India's step towards FPI, which is part of its liberalization efforts, is essential for the economic growth of India. While dealing with FPI volatility is challenging, enhanced foreign exchange reserves through export trading and fostering a strong economy can sustain foreign investments.[17]

2. **EFFECT OF FPI IN DIFFERENT SECTORS IN INDIA by Nirav Panara, Jayprakash Patidar, Satyajitsinh Gohil (2022):** This study focuses on FPI in various sectors of the Indian stock market, specifically NIFTY sectors, and collects data from 2012 to 2020. Index values derived from BSE and NSE along with secondary data from SEBI, NSDL, CDSL, and other sources were used. The analysis shows a significant positive correlation between FPI and Nifty indices. In conclusion, it stated, that FPI directly

[17] Dr. J Udhayakumar, Shankar R, *Foreign portfolio investment in India and its consequence on economic portrayers (2018)* ResearchGate, https://www.researchgate.net/publication/373718820_Foreign_portfolio_investment_in_India_and_its_consequence_on_economic_portrayers

supports stock market growth by enhancing size, transparency, technology, and operational standards.[18]

3. **A CRITICAL STUDY OF SEBI (FOREIGN PORTFOLIO INVESTOR) REGULATION, 2019 vis-a-vis Globalisation by Shahnawaz Ali:** The adoption of the LPG model of globalization in India has led to rapid growth in the Indian Capital Market, which has closely aligned with global trends. Foreign Portfolio Investments (FPIs) market, have experienced significant growth in the last two decades despite the hardships imposed by the global recession. The study concluded that increase in FDI significantly impact stock market fluctuations, aligning with findings from similar research in the literature.[19]

4. **A STUDY ON THE GROWTH AND EFFECTS OF FOREIGN PORTFOLIO INVESTMENTS IN INDIA DURING THE POST ECONOMIC REFORMS PERIOD by Kishan Egurla, Prof. V. Usha Kiran, (2017):** This study tried to analyze the relationship between Foreign Portfolio Investments (FPI) in India's equity and debt segments. utilizes secondary data from sources like statisticstime, NSDL, and NSE, to explore the link between FPIs and the capital markets by applying correlation. data were collected or a period from 1992- 2017 targeted on annual figures for market capitalization, net FPI investments and GDP. It concluded that FPIs in India are significantly influenced by GDP and Nifty 50 capitalization, with investments reaching record highs in 2014-15 due to expectations of economic recovery and improving outlooks. Further, suggested strong government support and economic growth potential make India an attractive destination for FPIs, with expectations for continued growth in foreign investments.

5. **STUDY ON FPI INFLOWS IN INDIA – A SECTOR WISE ANALYSIS by Rahul Jacob Kuruvila, Asha Mariam Thomas (2024):** This study examines the flow of Foreign Portfolio Investments (FPI) into five key sectors in India: healthcare, oil and gas, automobile, metal and mining, and telecommunications. Data from 2015 to 2022 collected secondary sources was analyzed using tables and graphs to depict sectoral trends. The

[18] Nirav Panara, Jayprakash Patidar, Satyajitsinh Gohil, *Effect of FPI in different sectors in India* (2022), IRJMETS, https://www.irjmets.com/uploadedfiles/paper/issue_3_march_2022/20439/final/fin_irjmets1648886348.pdf

[19] Shahnawaz Ali, *A critical study of SEBI (FOREIGN PORTFOLIO INVESTOR) REGULATION, 2019 vis-a-vis Globalisation,* Research Gate, https://www.researchgate.net/publication/346969093_A_critical_study_of_SEBI_Foreign_Portfolio_Investment_vis-a-vis_Globalisation

analysis identified each sector, presented its values, and interpreted the flow of funds and concluded that FPI inflows were generally low in most sectors, with the oil and gas sector standing out. Economic events such as demonetization, the GST regime, and COVID-19 significantly influenced these trends, leading to fluctuating FPI flows, showing that economic conditions play a crucial role in FPI dynamics.

STATEMENT OF PROBLEM

Challenges such as regulatory complications, tax burden, inefficient data protection, and dispute resolution mechanisms create barriers to a well-regulated FPI in India.[20] The multiplicity of regulatory bodies creates overlapping guidelines and policies leading to increased cost of compliance and excessive tax burden and inefficient mechanisms discourage foreign investors and deter foreign capital investment in Indian FPI, making it an unfavorable market environment.[21] This paper attempts to analyze these structural weaknesses, assess their impact on investors' decisions, and present favorable suggestions to improve India's market competitiveness.

RESEARCH GAPS

1. The **absence of a comprehensive regulatory framework** for India to address all challenges holistically remains a challenge for creating an efficient market.

2. There is **no integrated comparative model** drawn from global best practices to form a unified regulatory model for India.

3. Different studies have suggested reforms, but there is **no structured roadmap** for long-term capital flow in the market.

RESEARCH QUESTIONS

1. What impact does India's present FPI regulatory framework have on foreign capital inflow in the Indian market?

2. What barriers do the FPIs encounter in the Indian market, particularly in terms of market

[20] Supra Note 15
[21] Supra Note 16

compliance and accessibility?

3. How other global markets are creating an attractive environment for the FPI?

4. What changes in policy and legal framework can be introduced to attract more investors in the Indian market?

RESEARCH METHODOLOGY

1. **Research Type: Doctrinal and Comparative Research.**

A. ***Doctrinal Research Approach***

The doctrinal research method would entail analysing and interpreting FPI rules in India.

• Analysing modifications in FPI regulations, policies, and judicial interpretations.

• Assessing the legislative compliance of the FPI regulations and recognising deficiencies or ambiguities in legislative norms.

B. ***Comparative Research Approach***

The comparative research technique shall involve: • Studying the FPI policies of various nations (e.g., the UK, Hong Kong, Singapore, the US, Australia, and Canada).

• Recognition of productive approaches and market-friendly policies employed by certain nations.

• The assessment of the feasibility and relevancy of existing best practices in the Indian context.

• Examining the regulatory framework, compliance requirements, tax treatment, and dispute resolution methods in foreign markets.

2. Data collection: Secondary data analysis includes legal frameworks, rules, and policy reports from regulatory organisations such as SEBI and RBI.

3. Place of research: India.

4. Data Analysis: Comparing India's FPI framework to global best practices and implementing them while considering India's socio-economic conditions.

• Comparative analysis of regulatory frameworks and policy mechanisms in various countries.

• Identifying parallels and disparities in multinational FPI models.

• Evaluating the influence of foreign best practices on Indian financial markets.

ISSUES AND SUB-ISSUES

1. **Complicated Regulatory Framework and Time-consuming Burden of Compliance pose significant barriers to India's Foreign Portfolio Investment.**

A. Overlapping jurisdiction due to the multiplicity of regulatory bodies, such as SEBI, RBI, and others, creates conflicting guidelines.

B. FPIs experience challenges in India as the Know Your Customers (KYC) process is stringent and increases the compliance cost.

C. Setting up an FPI account in India is complicated and time-consuming due to multiple documentation and lengthy approval processes.

D. Unpredictable frequent changes in the government's policies regarding FPI create uncertainty in the investment decisions of long-term investors.

2. **Restrictions on Foreign Ownership and Investment Caps limit the access of foreign investors to the Indian Market.**

A. Prohibition of FPI in sectors like the telecom sector due to government-imposed sectorial caps leads to restricted capital inflow.

B. Investing in High- cap sectors bring challenges for FPIs, due to complex investment structure and delayed approval process.

C. Limited access to Derivative Instruments creates challenges for FPIs in risk management particularly in volatile markets.

3. **High tax rates on capital gains and lack of clarity in DTAA create a significant financial burden on FPIs.**

A. Higher tax rates for both short-term and long-term Capital gains along with the Withholding tax are making India unfavorable for FPIs.

B. Lack of clarity and inconsistency regarding DTAA with other countries leads to disputes due to double taxation on the same income by FPIs.

4. **Inadequate information protection and dispute resolution mechanisms shake foreign investors' confidence in the Indian volatile market**.

A. The absence of an efficient dispute resolution mechanism and limited access to international arbitration leads to delays and complications in resolving disputes, making FPIs hesitant to invest.

B. Market Manipulation such as insider trading and price manipulation by FPIs can corrupt the market causing significant financial loss to other investors.

C. While UBO disclosure is essential for maintaining transparency, it may compromise the confidentiality and sensitive data of investors and their investment strategies.

SUGGESTIONS

ISSUE 1

Solution 1:

The establishment of an organization similar to the **Financial Conduct Authority (FCA)**[22] of the **UK** can streamline the overlapping regulations by offering a **single-window clearance**[23] and clear demarcation of regulatory roles of authorities.

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[22] Financial Conduct Authority (FCA), https://www.fca.org.uk/.

[23] HM Treasury, *A New Approach to Financial Regulation* (2011), https://assets.publishing.service.gov.uk.

Solution 2:

India can follow a **risk-based approach**[24] adopted by **Hong Kong's Securities and Futures Commission** (SFC)[25] where KYC levels[26] will be different on the basis of the investor's risk profile. This will reform the KYC process into less stringent and will make it cost-effective for low-risk profile holders.

Solution 3:

A **streamlined digital onboarding** procedure for foreign investors like the **UK's FCA**[27] regulations can provide relief and attract investors. Additionally, setting up a **Digital application system** such as the **Monetary Authority of Singapore** (MAS)[28] for speedy and efficient registration will reduce the wait for prolonged approval.

Solution 4:

Designing a **long-term policy roadmap** that shall include Stakeholder consultation and periodical regulatory stability and conducting a Regulatory Impact Assessment (RIA)[29] inspired by **Canada's Ontario Securities Commission** (OSC)[30] for the stable and long-term investors will ensure investors' trust in the Indian market.

ISSUE 2

Solution 1:

Following a similar approach as **Australia's FIRB Foreign Investment Review Board** (FIRB) where foreign investments are allowed with certain specified conditions instead of total restriction. Assessing investment while considering the national interest will ensure security and encourage foreign investors.

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[24] AML/KYC Laws and Regulations in Hong Kong, Sumsub, https://sumsub.com/blog/aml-kyc-laws-and-regulations-in-hong-kong/.
[25] *Guidelines on Online Distribution and Advisory Platforms*, Securities and Futures Commission, https://www.sfc.hk.
[26] Supra Note 21
[27] Supra Note 19
[28] Monetary Authority of Singapore (MAS), https://www.mas.gov.sg/.
[29] Regulatory Impact Assessment, OECD, https://www.oecd.org/en/publications.
[30] Ontario Securities Commission (OSC), https://www.osc.ca/en.

Solution 2:

Allowing FPIs to invest in high-cap sectors with certain disclosure requirements with a more flexible and transparent approach identical to the **US's Securities and Exchange Commission** (SEC)[31]will reduce the need for a restricted complex structure.[32] This would simplify the investment process along with reducing the administrative costs making it an attractive investment option to FPIs.

Solution 3:

The **Commodity Futures Trading Commission** (CFTC)[33] of the US offers **broader access to derivative markets** for foreign investors. Similarly, India can create a transparent and well-regulated Derivative Instruments market, including currency futures, interest rate swaps, and equity options for FPIs efficient risk management.

ISSUE 3

Solution 1:

Adopting simplified tax compliance with **low capital gains tax policies** on FPIs like **Ireland**[34] will make the Indian market an attractive investment option for foreign investors. This approach will ensure capital inflow in the market by foreign investors without being worried about excessive tax burdens

Solution 2:

Incorporating a well-defined **Double Tax Avoidance Agreement** (DTAA) like **Luxembourg**[35] which provides clear tax treaties and exemptions for foreign investors. Enforcement of treaties and exemptions will build trust in foreign investors and encourage more foreign capital inflow

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[31] Press Release, *SEC Announces Modernized Rules to Facilitate Capital Formation* (Dec. 22, 2020), U.S. Securities and Exchange Commission, https://www.sec.gov/newsroom/press-releases/2020-247.

[32] Latham & Watkins, *SEC Explores Regulatory Changes to Facilitate Capital Formation* (Feb. 2025), https://www.lathamreg.com.

[33] Commodity Futures Trading Commission (CFTC), https://www.cftc.gov/.

[34] Calculating Capital Gains Tax, Revenue, https://www.revenue.ie.

[35] India's ITAT Ruling on PPT in India-Luxembourg Tax Treaty, TPA Global (Jan. 22, 2025), https://tpa-global.com.

in India.[36]

ISSUE 4

Solution 1:

Through the adoption of the **Singapore International Arbitration Centre** (SIAC)[37] model India can introduce a **fast-track arbitration process[38]** that ensures speedy and efficient resolution, curtailing prolonged legal battles. Legislative reforms and collaboration with international arbitration bodies will improve India's ADR mechanism.

Solution 2:

India by enhancing the surveillance system of the Securities and Exchange Board of India (SEBI) can adopt a similar to **Japan's Financial Services Agency (FSA)[39]** where the issue of market abuse can be ascertained with **real-time monitoring** of FPI transactions[40], allowing immediate detection and intervention of any suspicious activity in the market.

Solution 3:

India can implement a similar framework as the **EU's Anti Money Laundering** (AML)[41] directives[42] which ensures the **Ultimate Beneficiary Owner (UBO)[43]** information is disclosed to certain authorities for transparency while safeguarding the investors' anonymity in public records. This approach will help in preventing money laundering, minimizing the risk of discouraging the FPIs.

FINDINGS

India's FPI framework has immense potential to drive capital inflows and market growth.

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[36] India-Luxembourg Tax Treaty, Taxsutra, https://www.taxsutra.com.
[37] SIAC Gateway, https://siac.org.sg/siac-gateway.
[38] Expedited Procedure Provisions, *Int'l Chamber of Com.*, https://iccwbo.org/dispute-resolution/dispute-resolution-services/arbitration/rules-procedure/expedited-procedure.
[39] Financial Services Agency (Japan), https://www.fsa.go.jp/en/.
[40] Team FOCAL, *What is Real-Time Transaction Monitoring: Steps & Prevention* (Jan. 1, 2025), https://www.getfocal.ai/blog/real-time-transaction-monitoring.
[41] AMLA, https://www.amla.europa.eu.
[42] EU Anti-Money Laundering Directive, London Stock Exchange Group, https://www.lseg.com.
[43] Ultimate Beneficial Ownership (UBO), LexisNexis, https://www.lexisnexis.com.

However, challenges such as regulatory complexity, high tax burdens, and lack of market access hinder its global competitiveness. By adopting best practices from global markets and implementing targeted reforms, India can create a more transparent, efficient, and investor-friendly FPI ecosystem.

- The research identifies significant barriers to FPI inflows in India due to complex regulations, tax burdens, restricted market access, and weak investor protection.
- Key issues include overlapping jurisdiction of SEBI and RBI, high compliance costs, lack of dispute resolution mechanisms, and inconsistent tax treatment under DTAA.
- Comparative analysis reveals that markets like **Hong Kong, Singapore, the UK, and the US** have adopted risk-based KYC processes, simplified tax frameworks, and transparent dispute resolution mechanisms, making them more attractive to FPIs.
- The study proposes a comprehensive roadmap, including the creation of a unified regulatory body, risk-based KYC, streamlined digital onboarding, and enhanced investor protection measures.

Research Area	**Findings**	**Proposed Solutions in Prior Studies**	**Gaps Identified**
Regulatory Complexity	Overlapping guidelines from SEBI and RBI create conflicts	Establish single-window clearance system	No model proposed for single-window clearance
KYC and Compliance	Stringent KYC increases costs for low-risk investors	Risk-based KYC model (Hong Kong SFC)	No clarity on implementation strategy
Taxation and DTAA	High capital gains tax and inconsistent DTAA create financial uncertainty	Align tax policies with Ireland and Luxembourg	No structured tax reform strategy proposed
Market Access	Restrictions on sectoral investments limit capital inflow	Conditional FPI access (Australia FIRB)	No sector-specific guidelines proposed

Dispute Resolution	Delayed resolution and lack of arbitration deter FPIs	SIAC-based fast-track arbitration	No mechanism for enforcement of arbitration awards proposed

CONCLUSION

The existing literature identifies regulatory complexity, market restrictions, tax policies, and weak dispute resolution as key barriers to FPI growth in India. However, there is a lack of comprehensive policy recommendations based on comparative global models and empirical investor feedback. This study aims to bridge these gaps by offering a structured, evidence-based strategy to enhance India's global competitiveness in FPI markets.

India's Foreign Portfolio Investment (FPI) structure has considerable capacity for attracting international funding and strengthening its financial sector. Nevertheless, legislative inaccuracies tax costs, limited accessibility to markets, and inadequate safeguards for investors erode its competitive edge. This report examines worldwide standards from jurisdictions such as the United States, Luxembourg, Australia, and Singapore to identify essential changes which may transform India's FPI framework into more effective, unambiguous as well as investor friendly.

The implementation of a seamless legislative structure, risk-based KYC, simpler tax structures, improved dispute settlement processes, and sector-specific investment modifications may greatly boost the trust of investors. Adopting a single-window regulatory agency, harmonising taxation practices pursuant to the DTAA, and improving arbitration processes would result in a secure and foreseeable investment culture.