# RBI’s Framework for Reclassification of FPI to FDI

**Source: IE**

## Why in News?

Recently, the **Reserve Bank of India (RBI)** introduced a framework to allow **foreign portfolio investors** to convert their investments to **foreign direct investment (FDI)**.

## What are the Key Highlights of the Framework?

- **Threshold Crossing**: Any **foreign portfolio investor** investing above 10% of the total paid-up equity has the option of **divesting their holdings or reclassifying** such holdings as **FDI.**
    - FDI is the investment through **capital instruments** by a person resident outside India.
        - In an **unlisted Indian company** or
        - In **10% or more of the paid-up equity** capital of a **listed** Indian company (Below 10% is considered **Foreign portfolio investment (FPI)**).
- **Timely Conversion**: The reclassification must be completed within **five trading days** from the transaction that results in **breaching the 10% limit.**
- **Compliance Requirements**: FPIs must adhere to reporting obligations under the **Foreign Exchange Management (Mode of Payment and Reporting of Non-Debt Instruments) Regulations, 2019** (FEM (NDI) Rules, 2019).
    - FEM (NDI) Rules, 2019 mandates that investments by non-residents in India must follow **entry routes, sectoral caps, or investment limits** unless specified otherwise.
- **Sector Restrictions**: Reclassification is not permitted in sectors where **FDI is restricted** E.g., Gambling and betting, **Real Estate Business**, **Nidhi company** (Mutual Benefit Funds Company) etc.
- **Complementary Measures**: It complements a similar update from the **Securities and Exchange Board of India (SEBI)** which mandates that once an **FPI exceeds the 10%** equity threshold, it may opt to convert the holdings to FDI.

## Note

In order to curb **opportunistic takeovers/acquisitions** of Indian companies due to the **Covid-19** **pandemic**, Government amended the **FDI policy 2017 vide Press Note 3 (2020)**.

- It required **entities** from countries sharing a **land border with India**, or whose **beneficial owner** is from such countries, can **only invest** in India through the **Government route.**
- For the purpose of **Press Note 3,** India recognises **Pakistan, Afghanistan, Nepal, Bhutan, China (including Hong Kong), Bangladesh and Myanmar** as countries sharing land border with India (Bordering Countries).

## What is the Difference Between FDI and FPI?

| Parameter | FDI (Foreign Direct Investment) | FPI (Foreign Portfolio |
|---|---|---|

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|---|---|---|
| | | **Investment)** |
| **Nature of Investment** | **Direct investment** and **business ownership** in India by a foreigner. | **Indirect** investment in financial assets like **stocks and bonds.** |
| **Investor Role** | Active role | Passive role |
| **Control and Influence** | **High degree of control** over management and business operations. | **No significant control** over day-to-day operations of the company. |
| **Asset Type** | **Physical assets** of the foreign company. | Financial assets like **stocks, bonds, and** **Exchange-Traded Fund (ETF).** |
| **Investment Approach & Time Frame** | **Long-term** approach. It can take years to progress from planning to implementation. | **Shorter term** than FDIs. It is focused on market-linked gains. |
| **Motive** | Securing **market access or strategic interests** in a foreign country for long-term gains. | Short-term returns and **market-linked gains**. |
| **Risk Factor** | Generally **more stable**, but affected by the host country's policies, political environment, and regulations. | Generally **more volatile** due to fluctuations in asset prices. |
| **Entry and Exit** | Entry and exit are **difficult.** | Entry and exit are **easy** due to **liquidity** and wide trading of assets. |

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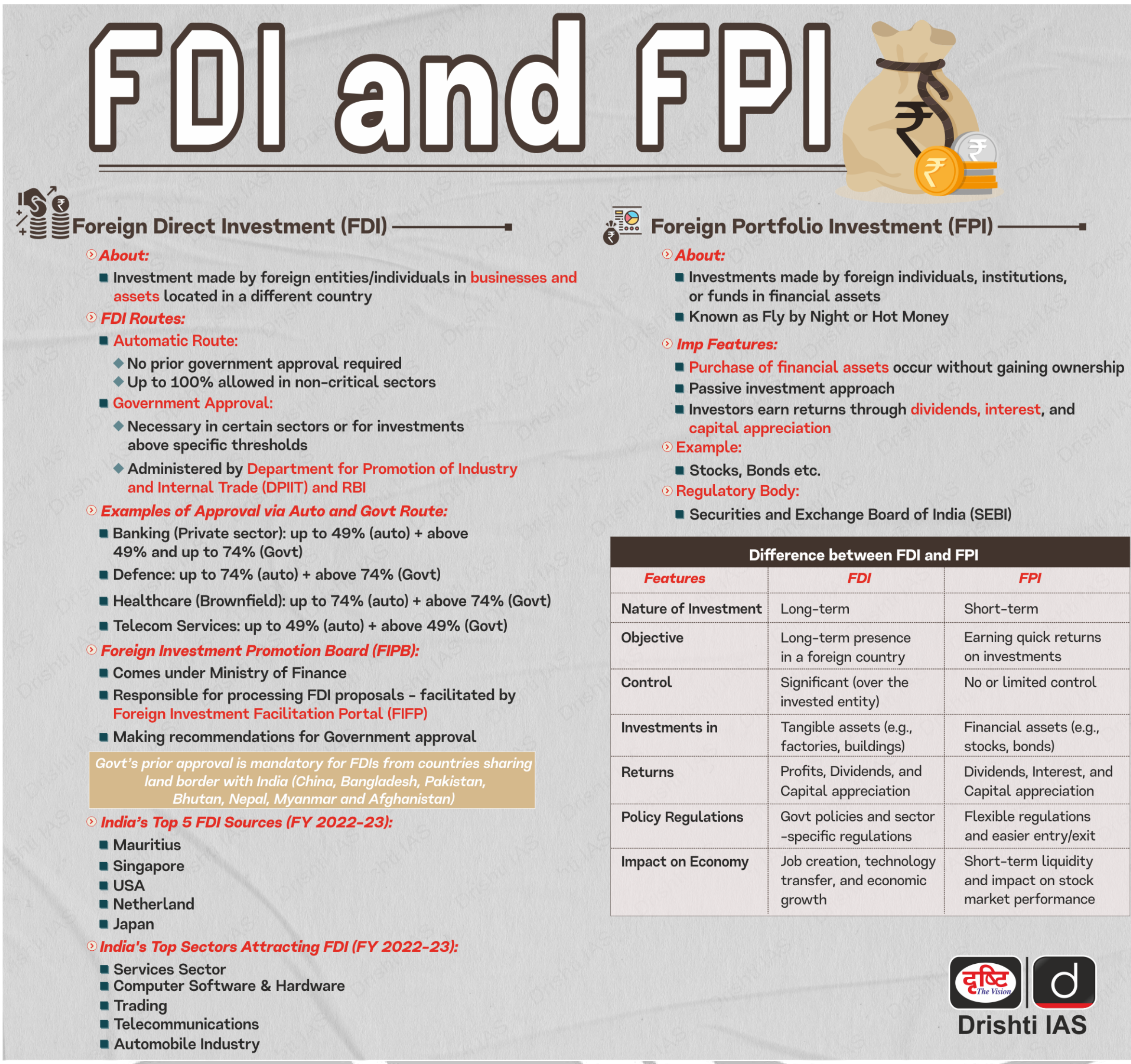

# FDI and FPI

## Foreign Direct Investment (FDI)

- ***About:***
  - Investment made by foreign entities/individuals in businesses and assets located in a different country
- ***FDI Routes:***
  - Automatic Route:
    - No prior government approval required
    - Up to 100% allowed in non-critical sectors
  - Government Approval:
    - Necessary in certain sectors or for investments above specific thresholds
    - Administered by Department for Promotion of Industry and Internal Trade (DPIIT) and RBI
- ***Examples of Approval via Auto and Govt Route:***
  - Banking (Private sector): up to 49% (auto) + above 49% and up to 74% (Govt)
  - Defence: up to 74% (auto) + above 74% (Govt)
  - Healthcare (Brownfield): up to 74% (auto) + above 74% (Govt)
  - Telecom Services: up to 49% (auto) + above 49% (Govt)
- ***Foreign Investment Promotion Board (FIPB):***
  - Comes under Ministry of Finance
  - Responsible for processing FDI proposals - facilitated by Foreign Investment Facilitation Portal (FIFP)
  - Making recommendations for Government approval

*Govt's prior approval is mandatory for FDIs from countries sharing land border with India (China, Bangladesh, Pakistan, Bhutan, Nepal, Myanmar and Afghanistan)*

- ***India's Top 5 FDI Sources (FY 2022-23):***
  - Mauritius
  - Singapore
  - USA
  - Netherland
  - Japan
- ***India's Top Sectors Attracting FDI (FY 2022-23):***
  - Services Sector
  - Computer Software & Hardware
  - Trading
  - Telecommunications
  - Automobile Industry

## Foreign Portfolio Investment (FPI)

- ***About:***
  - Investments made by foreign individuals, institutions, or funds in financial assets
  - Known as Fly by Night or Hot Money
- ***Imp Features:***
  - Purchase of financial assets occur without gaining ownership
  - Passive investment approach
  - Investors earn returns through dividends, interest, and capital appreciation
- Example:
  - Stocks, Bonds etc.
- Regulatory Body:
  - Securities and Exchange Board of India (SEBI)

**Difference between FDI and FPI**

| *Features* | *FDI* | *FPI* |
|---|---|---|
| Nature of Investment | Long-term | Short-term |
| Objective | Long-term presence in a foreign country | Earning quick returns on investments |
| Control | Significant (over the invested entity) | No or limited control |
| Investments in | Tangible assets (e.g., factories, buildings) | Financial assets (e.g., stocks, bonds) |
| Returns | Profits, Dividends, and Capital appreciation | Dividends, Interest, and Capital appreciation |
| Policy Regulations | Govt policies and sector -specific regulations | Flexible regulations and easier entry/exit |
| Impact on Economy | Job creation, technology transfer, and economic growth | Short-term liquidity and impact on stock market performance |

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## UPSC Civil Services Examination, Previous Year Question

**Q. Consider the following: (2021)**

1. Foreign currency convertible bonds
2. Foreign institutional investment with certain conditions
3. Global depository receipts
4. Non-resident external deposits

**Which of the above can be included in Foreign Direct Investments?**

(a) 1, 2 and 3

(b) 3 only

(c) 2 and 4

(d) 1 and 4

**Ans: (a)**

**Q. With reference to Foreign Direct Investment in India, which one of the following is considered its major characteristic? (2020)**

(a) It is the investment through capital instruments essentially in a listed company.

(b) It is a largely non-debt creating capital flow.

(c) It is the investment which involves debt-servicing.

(d) It is the investment made by foreign institutional investors in the Government securities.

**Ans: (b)**