



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 <u>Exchange-Traded Fund (ETF)</u> .
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.

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 FDI 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
- Netherlands
- Japan

India's Top 5 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)

- Foreign currency convertible bonds
- Foreign institutional investment with certain conditions
- Global depository receipts
- Non-resident external deposits

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

- 1, 2 and 3
- 3 only
- 2 and 4
- 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)

PDF Refernece URL: <https://www.drishtiias.com/printpdf/rbi-framework-for-reclassification-of-fpi-to-fdi>

