Episode 3:

FPI-FDI

About the episode

Resolüt Audio is our initiative to present to you our analysis on legal and tax issues in a simple and de-jargonized manner through free-flowing conversations.

In this podcast, host Payaswini Upadhyay talks with Samaahith Addoor on some problems faced by investors while investing through the FDI and FPI route. These are not new problems, but recurring ones that foreign investors constantly run into.

Transcript

Payaswini: The definition is anything less than 10% is foreign portfolio investment (FPI) in a listed entity. Anything more is foreign direct investment (FDI). Anything unlisted is foreign direct investment. By way of background, how did these positions come to be?

Samaahith: So, these are terms that are not just in India, but I think there's a global understanding of some of these terms. So, whenever you say, 'direct investment,' earlier, the FDI policy used to have a preamble that used these terms, saying it's a lasting interest in an Indian enterprise, and so on and so forth. So, the idea of FDI was long-term capital.

Portfolio investments, on the other hand, are usually subject to a threshold of 10%. These are opportunistic investments made by social investors. Your idea is usually not that strategic. Your idea is just to come and make money. So that's the history of FDI and FPI.

Now, I'll just cover this 10% thing as well – less than 10%, more than 10%. What happens in India is generally that to make portfolio investments, you need a registration called the Foreign Portfolio Investment registration. A few years back (or maybe long now, many years ago), a committee report came out and said, "Look, we need to move away from this investor-based regime to an investment-based regime." The idea was that, at some stage, you would deregulate the system, and you wouldn't really need to have a registration to be a portfolio investor.

If you're below 10%, then by design, you are not strategic, and if you don't take any controlling rights and so on and so forth, then you can very well be a portfolio investor without needing to be registered as one. If you're holding more than 10%, then even if you have a registration, it doesn't matter, because now you are strategic in nature, since your interest, voting rights, etc., get enhanced beyond 10%.

So, FDI was earlier an investor-based regime. RBI came up with a diktat, based on a certain consultation paper, to meet an investment-based regime. That law, even though it found its way into the regulations, RBI then realized that no, no, no, these operational guidelines are not in play. I really can't have somebody without registration come and take foreign portfolio investor benefits, because there are certain benefits that a portfolio foreign investor has. For instance, in real estate, there's a certain lock-in that FDI investors have. But if you come in as a portfolio investor, there is no lock-in of three years – things like that.

So, RBI said, “No, no, no, this is not okay.” We go back to the same position where FPI is only through registration, and FDI is without registration.

Payaswini: That sort of muddied the waters, right? We want to stick to the thresholds, yes, but those thresholds are not sacrosanct, as we’ve seen play out in some of the trades. There have been trades in the market where people holding less than 10% have done it via the FDI route.

Samaahith: Let’s start there for a bit so people can understand. So, first principles, let’s go back. Okay? There are no operational guidelines in play. If you do not have an FPI registration, you will not get the FPI benefits. Never mind the fact that the regulations say very clearly that anything below 10% is foreign portfolio investment – you should destroy that idea in your mind. Then, some technicalities exist.

Now, as I said, the waters are muddied. What happens is that some of the authorized dealers, in a convoluted understanding (and I don’t know what discussions they’ve had with RBI, none of this comes in public), some of them went and believed that if you are investing below 10%, then by definition you should be a foreign portfolio investor. Which, as I said, is not entirely correct.

And they said, “Oh, but if you are below 10%, you must be categorized as a foreign portfolio investor, so please go and procure an FPI registration.” We had to take it up in a big way. We said, “Look, this doesn’t work.” There are enough instances where people are doing primary investments in listed companies, even with less than 10%.

For example, Carlyle and Yes Bank, where even below 10%, you subscribe under the FDI route, because you see, an FDI investor can subscribe to listed securities as well under the FDI route. So, it’s a little bit muddy. And I want to go with a certain directional pattern that is clear in my mind, so that others also get it, otherwise this “less than 10% or more than 10%” will get us all confused.

Payaswini: But I also want to note that when you say most primary issuances happen via the FDI route, right, IPOs seem to be an outlier there. We’ve gotten the understanding in the market that only FPI entities can invest in the IPO rounds.

Samaahith: Yes, generally, primary issuances can be subscribed to by an FDI investor, even if the underlying shares are listed. But in IPOs, the way the regulatory perspective has evolved is that it is an issuance in the public domain. And to some extent, even though it’s a primary issuance (which legally, by the way, should be possible to put under the FDI route), I don’t think the regulated entities, like merchant bankers, etc., are comfortable letting foreign investors subscribe under the FDI route.

For them, it’s practically listed, and therefore they prefer, there’s a strong preference, that foreign investors must have an FPI license to purchase under an IPO. So, you can’t do FDI in an IPO.

Payaswini: Another common problem I want to call out is what happened with Zomato. Some investors were there when Zomato was unlisted, and they then wanted to invest in the listing of Zomato. The regulators came back and said that you can’t be invested in a company both as FDI and FPI. How are people getting over this problem?

Samaahith: The law is very clear. After the NDI rules came in, the NDI rules very clearly say you can either be an FPI or an FDI in the same entity. The regulatory intent is also very clear. So, are you opportunistic? Are you strategic? You can't be both, philosophically. So, if you're an FDI investor in one company, don't do an FPI in the same entity. If you're an FPI in one entity, don't do FDI in the same entity.

But again, this is entity-specific, so the restriction doesn't apply to the group as such. So, if you have one FDI and another FPI entity in the group, and you're investing into the same entity, then that's fine. The idea is to be clear about who you are, because an FPI-registered entity can technically make FDI investments as well. No problem with that. But don't do it in the same company. Don't muddy the characterization in the same company. So that's the Zomato case.

Payaswini: I hope that clears it up. And of course, if you need a deeper analysis of this FDI/FPI problem, head over to Resolüt's research page. We've discussed this in much, much detail. Thank you so much for listening.