



# Coromandel Law

Striding Forward Together

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## **IGB-FPIs – SEBI's proposed bond market reforms**

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## **IGB-FPIs – SEBI’s proposed bond market reforms<sup>1</sup>**

### **I. Executive Summary**

1. On 13<sup>th</sup> May 2025, the Securities and Exchange Board of India (“SEBI”) released a consultation paper<sup>2</sup> proposing the relaxation of compliance norms for Foreign Portfolio Investors (FPIs), investing exclusively in Indian Government Bonds (IGBs) via the Voluntary Retention Route (VRR) or the Fully Accessible Route (FAR).
2. The proposed amendments propose:
  - (a) Revising the Know Your Customer (KYC) regime for FPIs;
  - (b) providing an exemption in investor group disclosures;
  - (c) providing freedom in control restrictions for Non-Resident Indians (NRIs); Overseas Citizens of India (OCIs), and Resident Indians (RIs);
  - (d) extending timelines for material disclosure of information; and
  - (e) enabling smooth transitions between regular and this special category of investors, i.e., IGB-FPIs.
3. The proposed amendments come in the context of a sharp rise in investments in IGBs through the VRR and FAR routes by FPIs. The aim is to streamline the investment process into IGBs to catalyse further investment in these securities.

### **II. Introduction**

4. India’s capital market has seen an uptick in FPI led investments in the last few years, data published by Clearing Corporation of India Limited (CCIL), indicates that the total investment by FPIs in VRR and FAR-eligible securities amounted to INR 2.05 lakh crores and INR 3.06 lakh crores (as on 28<sup>th</sup> March 2025), respectively.
5. However, the regulations which govern FPIs are often subjected to criticism due to their uniform approach in regulating all transaction types undertaken by FPIs

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<sup>1</sup> We acknowledge and thank Mr. Kartikey Narang, Hidayatullah National Law University for his assistance in co-authoring this insight.

<sup>2</sup> *Consultation Paper on Proposal to Facilitate Relaxation in Regulatory Compliances for FPI Applicants Investing Only in Indian Government Bonds* (May 13, 2025),

<https://www.sebi.gov.in/sebiweb/publiccommentv2/PublicCommentAction.do?doPublicComments=yes>

thereby failing to differentiate between different risk profiles across various asset classes and investment options.

6. SEBI's consultation paper represents India's alignment with these international trends, which involve a risk and asset class based differentiated approach to regulation. The consultation paper also attempts to address specific concerns surrounding the current regulatory regime for debt investment in government bonds, particularly the compliance requirements to be undertaken prior to such an investment.

### **III. Evolution of FPI Regulations**

7. The FPI framework's evolution in India has been a gradual process and has been divided into three phases: -
  - (i) FPIs have been investing in the Indian market since 1992, when the regulations related to Foreign Institutional Investor (FII), which grouping included FPIs, were characterised by a maze of regulations that treated all investment classes uniformly.
  - (ii) The process of streamlining FPI regulations began in 2014, with the release of SEBI's Foreign Portfolio Investors Regulations (SEBI FPI Regulations).
  - (iii) An amendment to the SEBI FPI Regulations in the year 2019 were aimed at further streamlining but the uniformity for the different categories of FPI investments persisted. One of the most significant steps which was made in the 2019 regulations was the classification of investors into two categories: Category I and Category II. This marked the first step towards investor differentiation. The compliance requirement for all the FPIs remained the same regardless of their risk category or asset class.

### **IV. Proposed Reforms: An Analysis**

8. In the course of the Consultation Paper, SEBI has provided numerous proposed reforms, which are discussed in detail below. These reforms not only deal with compliance requirements but also lift certain restrictions on investments in government securities.

#### **A. Simplification of KYC norms**

9. The Consultation Paper aims to simplify the Know Your Customer (KYC) norms applicable to the FPIs investing exclusively in IGBs (IGB-FPIs), to align these norms with RBI's existing framework of KYC requirements based on risk assessment.
10. The proposed changes include:
- (a) Exemption to IGB-FPIs from opening trading and Demat accounts and obtain the Custodial Participant (CP) code. A CP code<sup>3</sup> is a unique code which is assigned to every NRI customer by the clearing member.
  - (b) Harmonises the proposed regulations with Rule 9 of the Prevention of Money Laundering (Maintenance of Records) Amendment Rules, 2023, which provides for Client Due Diligence by maintaining updated records of KYC and their transactions.

#### **B. Investor Group Disclosure Requirements**

11. The Consultation Paper also proposed to exempt Investor Group Disclosures for IGB FPIs. Currently, since FPIs make investments in both, the equity and the bond markets, they are required to make disclosures on an investor group level. They are also subject to investment limits, such as 10% in equity instruments.
12. The rationale for this change is that unlike investments in equity instruments, IGB investments do not pose the risk of takeovers of corporations or other concentration risks.
13. Additionally, Regulation 22(1)(l) of SEBI (FPI) Regulations, 2019<sup>4</sup> imposes disclosure obligations to monitor the investment limits. Since VRR and FAR do not impose such limits, the necessity of imposing these limits on IGB-FPIs becomes irrelevant.

#### **C. Restrictions on NRI/OCI/RI**

14. SEBI proposes to remove restrictions on Non-Resident Indians and Overseas Citizens of India on contributing to the corpus of an IGB-FPI, which for FPIs that also undertake equity investments, is restricted to certain limits.
15. SEBI also proposes to permit these categories of investors to be in control of these FPIs rather than being mere beneficiaries. Given that NRI deposits in Infia are

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<sup>3</sup> Investorgain, *What Is a Custodial Participant Code?*, <https://www.investorgain.com/faq/what-is-a-custodial-participant-code/24729/> (last visited May 29, 2025).

<sup>4</sup> Securities and Exchange Board of India, *SEBI (Foreign Portfolio Investors) Regulations, 2019*

currently estimated at USD 164.7 Billion as of March 2025<sup>5</sup>, these reforms have the potential to boost the IGB market if these funds find their way to FPI channels.

16. The danger of round-tripping needs to be addressed by harmonising the proposed reforms with the Foreign Exchange Management Act, 1999 (FEMA) which contains provisions that are aimed at curtailing the practice.
17. Round tripping is when an Indian investor makes an investment in a tax haven and the same investment is routed back into India as an FDI or an investment by an FPI.

#### **D. Extension of Disclosure Timelines**

18. SEBI proposes to extend disclosure timelines for material changes in relevant information submitted by the IGB-FPI.
19. Currently, FPIs are required to disclose such material changes, classified as Type I and II changes based on their relevance within timelines that can be as short as 7 working days from the date of the change.
20. The Consulting Paper proposed to extend the disclosure timelines for both Type I and II changes in respect of an IGB-FPI to 30 days from the date of change, provided that supporting documents are furnished by the IGB-FPI along with its disclosure.

#### **E. Transition Between regular FPI and IGB-FPI**

21. Recognizing that existing FPIs with a strong bond portfolio might want to demerge their government bond investment business from their equity investment business to operate in the relaxed regulatory regime, SEBI has proposed a mechanism for a transition from an FPI to an IGB-FPI.
22. FPIs will be required to divest all of their holdings except for government securities permitted for IGB-FPIs and close their regular DEMAT and trading accounts. Thereafter, a declaration along with prescribed supporting documentation must be furnished to the SEBI, before the transition is approved.

### **V. Comparative Foreign Jurisdiction Analysis**

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<sup>5</sup> **India Brand Equity Foundation**, Inflows in NRI Deposits Increases Nearly 10% in FY25, Shows RBI Data, IBEF <https://www.ibef.org/news/inflows-in-nri-deposits-increases-nearly-10-in-fy25-shows-rbi-data#:~:text=Total%20outstanding%20NRI%20deposits%20reached,outstanding%20deposits%20were%20at%20Rs.>

23. To understand the merit of the proposed regulations by SEBI on different compliance requirements for government securities, it is necessary to compare them with different jurisdictions for evaluation.

#### **A. United Kingdom**

24. The United Kingdom's financial market is regulated by the Financial Conduct Authority (FCA), whose functions are similar to SEBI. The FCA supervises the conduct of financial firms while ensuring that all the compliance requirements are met.
25. The UK's regime provides a risk-based approach to identify investments and focusses on differentiating between the asset classes by the corresponding risk level of each investment.
26. In the United Kingdom, Gilt-edged securities<sup>6</sup> are issued by the Bank of England on behalf of His Majesty's Treasury. These are the bonds issued by the UK Government open for subscription to foreign investors. These bonds generally have a low rate of return, but they are considered relatively risk-free because they have a very low correlation with the equity markets.
27. Moreover, these securities are exempt from capital gains tax<sup>7</sup>. Due to their low-risk differentiation, these bonds have very streamlined and reduced disclosure requirements. This risk-based approach places less burden on the regulatory compliance of government bonds.
28. Further, to enhance the data reporting process, FCA also introduced a dedicated platform, RegData<sup>8</sup>, for this purpose. It allows the firms to have a smooth compliance process. It provides multiple ways to submit the regulatory data, depending on the type of information, which further enhances the user experience.

#### **B. Singapore**

29. Singapore's financial management system, regulated by the Monetary Authority of Singapore (MAS)<sup>9</sup>, the country's central bank, along with the chief financial

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<sup>6</sup> UK Debt Management Office, *About Gilts*, <https://www.dmo.gov.uk/responsibilities/gilt-market/about-gilts/> (last visited May 29, 2025).

<sup>7</sup> The Taxation of Chargeable Gains (Gilt-edged Securities) Order 2025, SI 2025/553 (UK), <https://www.legislation.gov.uk/ukxi/2025/553/made> (last visited May 29, 2025).

<sup>8</sup> Financial Conduct Authority, *RegData*, <https://www.fca.org.uk/firms/regdata> (last visited May 29, 2025).

<sup>9</sup> Monetary Authority of Singapore, *Monetary Authority of Singapore*, <https://www.mas.gov.sg/> (last visited May 29, 2025).

regulator and supervisor, also adopts a risk-based approach to regulatory compliance.

30. The government of Singapore releases Singapore Government Securities (SGS) Bonds<sup>10</sup>, which pay a fixed rate of interest and have a maturity period ranging from 2 years to 50 years. FPIs are permitted to invest in these bonds.
31. The government securities and bonds are placed under a simplified regulatory compliance system. Singapore uses a risk assessment system called CRAFT (Comprehensive Risk Assessment Framework and Techniques)<sup>11</sup> to assess the risks of a financial institution irrespective of the financial sector it operates in. It uses the main business activities of the institutions to do risk assessments.
32. Through this activity-based approach, CRAFT provides flexibility to be applied to different risk-based and asset classes supervised by MAS.

### **C. Learnings from other jurisdictions**

33. While SEBI's Consultation Paper proposes the idea of a risk-based approach that prescribes regulatory regimes based on asset classification, the lessons learnt by the UK and Singapore's experiences with this system could be useful policy guideposts.
34. Further, the tools like CRAFT help in monitoring the risk based on the actual beneficiary's activities, which could evolve to be a practical solution to tackle issues like round-tripping. Differentiating the compliance requirements based on firm size, client type, and other such parameters can also help in the smooth application of the proposed regulation's objectives.

## **VI. Conclusion**

35. SEBI's Consultation Paper is a step towards a more liberalised compliance framework concerning FPIs. It specifically provides relaxations to a special category of FPIs who only invest in IGBs, labelling them as IGB-FPIs.
36. An IGB-FPI is defined under the proposed draft amendment to Regulation 2(k)(a) of SEBI (FPI) Regulations, 2019 as "a foreign portfolio investor that invests only in Indian Government Bonds in accordance with the conditions specified by the Board".

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<sup>10</sup> Monetary Authority of Singapore, *Singapore Government Bonds: Information for Individuals*, <https://www.mas.gov.sg/bonds-and-bills/singapore-government-bonds-information-for-individuals> (last visited May 29, 2025).

<sup>11</sup> Monetary Authority of Singapore, *MAS' Framework for Impact and Risk Assessment of Financial Institutions*, <https://www.mas.gov.sg/-/media/mas/news-and-publications/monographs-and-information-papers/monograph--mas-framework-for-impact-and-risk-assessment.pdf> (last visited May 29, 2025).

37. The proposed amendments aim to contribute to the ease of doing business, along with the optimisation of regulations through a risk-based framework. The regulations will make some exceptions, especially for IGB-FPIs that invest exclusively through VRR and FAR.
38. Globally, there are various successful models which allow smooth and relaxed compliance in the case of government bonds. These models have great differentiation between different asset classes and risk, along with the types of investors. SEBI's step towards this direction shows its commitment towards empowering India as an attractive investment destination.