Vol 3 Issue 3 Dec 2013

Impact Factor : 1.6772 (UIF)

ISSN No : 2249-894X

Monthly Multidisciplinary Research Journal

Review Of Research Journal

Chief Editors

Welcome to Review Of Research

RNI MAHMUL/2011/38595 **ISSN No.2249-894X**

Review Of Research Journal is a multidisciplinary research journal, published monthly in English, Hindi & Marathi Language. All research papers submitted to the journal will be double - blind peer reviewed referred by members of the editorial Board readers will include investigator in universities, research institutes government and industry with research interest in the general subjects.

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Review Of Research
Vol. 3, Issue. 3, Dec. 2013
ISSN:-2249-894X
Available online at www.ror.isrj.net

ORIGINAL ARTICLE

REGULATIONS FOR FOREIGN INSTITUTIONAL INVESTORS

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Abstract:

Foreign capital flows are indispensable to growth of emerging market economies to finance the capital needed for excess of investment over the domestic savings. It helps to develop nascent financial markets and overall financial development. Foreign institutional investment is an important component in the capital flows available to a country to pursue its trajectory of economic growth. Foreign Institutional Investment brings in a flow of non-debt creating foreign inflows into any market. Since 1992, when Foreign Institutional Investors were allowed to invest in India, Foreign Institutional Investment flows into India has increased manifold. The aim of this study is to see how foreign institutional investors are regulated. Foreign institutional investment is crucial for an emerging country like India to augment the fund requirement for financial markets and to enhance the economic growth of the country. I have also reviewed the regulatory changes taken by the Securities Exchange Board of India and trends in Foreign Institutional Investment. Over a period of time SEBI has taken many steps to promote the Foreign Institutional Investment. I have presented all the regulatory steps taken by SEBI on yearly basis, this will help the reader to understand how Foreign Institutional Investors has been boosted over a period of time and how the Regulatory body, SEBI has taken steps to stimulate this growth.

KEYWORDS:

Foreign Institutional Investors, Foreign Institutional Investment, Regulatory Changes, Trends.

List of Abbreviations:

AUC- Assets under custody
BSE – Bombay Stock Exchange
FII - Foreign Institutional Investment
FIIs - Foreign Institutional Investors
GOI - Government of India
KYC - Know Your Client
MFs - Mutual Funds
NSE – National Stock Exchange
ODI - Offshore Derivatives Instrument
OTC – Over the Counter
PN - Participatory Notes
QFI - Qualified Foreign Investors
RBI - Reserve Bank of India

Title: REGULATIONS FOR FOREIGN INSTITUTIONAL INVESTORS Source: Review of Research [2249-894X]
ANSHIKA AGARWAL AND PREM LATA yr:2013 vol:3 iss:3

SEBI - Securities and Exchange Board of India
USD – United States Dollar

INTRODUCTION

FIIs are entities established or incorporated outside India and make proposals for investments in India. These investment proposals by the FIIs are made on behalf of sub accounts, which may include foreign corporates, individuals, fund etc. In order to act as a banker to the FIIs, the RBI has designated banks that are authorized to deal with them. The biggest source through which FIIs invest is the issuance of PN, which are also known as Offshore Derivatives.

Emerging economies like India are focusing on investment from external financing agencies or say inflow of foreign capital to create foreign exchange reserve in the nation, to meet their trade deficit and for the development of the economy via international trade. As every coin always has the two sides likewise foreign capital inflow brings economical threats as well as opportunities in the country. On the one hand due to the entry of foreign capital, domestic industries may face stiff competition from multinational companies whereas, on the other hand the inflow of foreign capital would lead to enhancement of the skills, knowledge and technology of Indian industries. Foreign direct investment and FIIs are main source of attracting the foreign investment in a nation. FII's includes "Overseas pension funds, mutual funds, investment trusts, Asset Management Companies, Nominee Companies, Banks, Institutional Portfolio Managers, University Funds, Endowments, Foundations, Charitable Trusts, and Charitable Societies etc. The term FIIs is used most commonly in India to refer outside companies investing in the financial markets of India. After 1991 Economic reforms, which leads to liberalization of Indian economy in world market, In September, 1992 FIIs were allowed to invest in Indian stock market. Since then, India has witnessed a significant rise in capital Inflows. The variation in the cost of capital is also one of the important factors resulting in attracting foreign capital in India.

Strong risk adjusted returns of Indian markets led FIIs to make more allocations to India. Institutional investors have a superior capacity to absorb and process information and their ability to conduct a large volume of transactions, lowers the cost of intermediation and benefits investors' and issuers' alike. Institutional investors also contribute to better transparency and governance for the improvement of market micro-structure. FIIs have come to occupy an important role in Indian Capital Market. Even yearly investment transaction value and cumulative investment by FIIs have gone up substantially during the year.

REGISTRATION OF FIIS/ SUB-ACCOUNTS AND CUSTODIANS

Traditionally, most of the institutions registered as FIIs have been from the United States of America and the United Kingdom. Though the trend continues, the registration of FIIs from countries like Denmark, Italy, Belgium, Canada, Sweden, Ireland, etc. , went up in the year 2004-05. Now, FIIs registration is also coming from unconventional countries like Slovenia, Brussels, Guernsey, Cyprus, Oman, Sweden, etc. Category wise, FIIs such as MFs, Investment Trusts, managers of such funds, banks have in dominance. In the last decade, foreign pension funds, widely accepted as Long term investors, showing increased interest in Indian securities markets and many of them got registered as FIIs. Some of the important pension funds, registered as FIIs are CAIPERS, UN Employee's Pension Fund, US State government pension funds, Commonwealth of Mass Achusetts pension reserves investment trusts, Public school retirement system of Missouri, etc.

During 2012-13, there was a decrease in the number of FIIs registered with SEBI. As on March 31, 2013, there were 1,757 FIIs registered with SEBI as compared to 1,765 year ago. However, the number of registered sub-accounts had increased marginally to 6,335 as on March 31, 2013 compared to 6,322 as on March 31, 2012. The number of Custodians remains the same (19).

During the financial year, a total of 78 fresh FIIs were registered. Further 581 fresh sub-accounts were registered with SEBI during the year 2012-13. FIIs from 56 different jurisdictions have been registered by SEBI out of which United States of America has the maximum number of 578, followed by United Kingdom (207), Luxemburg (125), Mauritius (101), Canada (79) and Singapore (75) respectively. Status of registration of FIIs, Sub-account and custodians during the year 2012-13 as shown below:

STATUS OF REGISTRATION OF FII, SUB-ACCOUNT AND CUSTODIAN

Particulars	FII			Sub Account			Custodian		
	Fresh Regi-stration	Renewal	Total	Fresh Regi-stration	Renewal	Total	Fresh Regi-stration	Renewal	Total
1	2	3	4	5	6	7	8	9	10
I. Application received for fresh registration / renewal	106	422	528	571	1458	2029	0	17	17
a. Applications registered / renewed	78	384	462	581	1416	1997	0	16	16
b. Applications pending#	26	79	105	107	277	384	2	1	3
c. Application rejected / returned*	3	0	3	5	0	5	NA	NA	NA

* Some of the applications that were returned due to various reasons may have been resubmitted and would have got subsequently registered or rejected.

Represents total cumulative number of pending applications as on March 31, 2013. The figure also contains those applications which were received before FY 2012-13.

Source: SEBI annual report 2012-13, NA: Not Available

TRENDS IN FII FLOWS

Sustained capital inflows, Portfolio and direct, is a sine qua non for any economy. The persistence of high current account deficit in India underscores the dire need for capital inflows. Reinvigorated foreign institutional inflows to the emerging markets like India in the wake of EURO area concerns boosted liquidity and asset prices. The challenge is particularly to create favourable conditions for a continuous inflow of foreign capital, retaining it and utilising them for productive purposes like infrastructure and other investment needs.

FIIs play an important role in Indian securities market. Since 1992-93, when FIIs were allowed entry into financial markets, FII has increased over the years except in the year 1998-99 and 2008-09. In tandem with the boom in the stock markets and a better global scenario, investment by FIIs into India were quite high in last few years, particularly since 2003-04.

FII flows into India have grown remarkably since 2009-10. In 2012-13, India received a total net FII inflow of Rupees 1,68,367 crore compared to Rupees 93,725 crore in the year 2011-12 showing a rise of 79.6%. This was the highest net FII inflow in rupee terms in any year since the FIIs were allowed to invest in Indian markets. In USD terms, the net inflow amounted to USD 31,047 million in the year 2012-13. The combined gross purchases of debt and equity by FIIs declined by 1.8% to Rupees 9,04,845 crore in the year 2012-13 from Rupees 9,21,285 crore in the year 2011-12 as shown in Table 1. The combined gross sales by FIIs declined by 11% to Rupees 7,36,481 crore from Rupees 8,27,562 crore during the same period in previous year. The cumulative net investment of FIIs in Indian markets amounted to USD 171,529 million as at the end of March 2013 compared to USD 140,482 million in the year 2011-12, indicating a rise of 22.1%.

TABLE 1: INVESTMENTS BY FIIS

Year	Gross Purchase (₹ crore)	Gross Sales (₹ crore)	Net Investment (₹ crore)	Net Investment (USD mn.)	Cumulative Investment (USD mn.)
1	2	3	4	5	6
1992-93	18	4	13	4	4
1993-94	5,593	467	5,127	1,634	1,638
1994-95	7,631	2,835	4,796	1,528	3,167
1995-96	9,694	2,752	6,942	2,036	5,202
1996-97	15,554	6,980	8,575	2,432	7,635
1997-98	18,695	12,737	5,958	1,650	9,285
1998-99	16,116	17,699	-1,584	-386	8,899
1999-00	56,857	46,735	10,122	2,474	11,373
2000-01	74,051	64,118	9,933	2,160	13,532
2001-02	50,071	41,308	8,763	1,839	15,372
2002-03	47,062	44,372	2,689	566	15,937
2003-04	1,44,855	99,091	45,764	10,005	25,943
2004-05	2,16,951	1,71,071	45,880	10,352	36,294
2005-06	3,46,976	3,05,509	41,467	9,363	45,657
2006-07	5,20,506	4,89,665	30,841	6,820	52,477
2007-08	9,48,018	8,81,839	66,179	16,442	68,919
2008-09	6,14,576	6,60,386	-45,811	-9,837	59,081
2009-10	8,46,438	7,03,780	1,42,658	30,251	89,333
2010-11	9,92,599	8,46,161	1,46,438	32,226	1,21,559
2011-12	9,21,285	8,27,562	93,725	18,923	1,40,482
2012-13	9,04,845	7,36,481	1,68,367	31,047	1,71,529

Source: SEBI annual report 2012-13

The composition of net FII inflows shows that majority of the FII inflows are invested in equity markets. This has been the trend over the years except in the year 2011-12. In the year 2012-13, the net FII inflows into equity segment increased by 220.1% to Rupees 1,40,033 crore from Rupees 43,738 crore in the year 2011-12 as shown in Table 2. In the debt segment, the net FII inflows declined by 43.3% to Rupees 28,334 crore in the year 2012-13 from Rupees 49,988 crore in the year 2011-12.

The net FII investment was the highest in the last quarter of the financial year 2012-13. FII was the highest for the month of February 2013 followed by December 2012 and January 2013. In all these months, the dominant share of FII investment was in equity markets, that is, 85.9%, 91.3% and 88.2% respectively. In the debt segment too, net inflows were the highest in the last quarter of 2012-13.

A comparison of FII net inflows and MF net inflows in the equity and debt segment showed the contrarian investment positions. MFs traditionally invest most in debt segment while FIIs mostly are heavy investors in the equity segment. This comparison has been shown in Table 2.

TABLE 2: INVESTMENTS BY MFS AND FIIS

(₹ crore)

Year / Month	Net Investment by Mutual Funds			Net Investment by FIIs		
	Equity	Debt	Total	Equity	Debt	Total
1	2	3	4	5	6	7
2008-09	**6,984**	**81,803**	**88,787**	**-47,706**	**1,895**	**-45,811**
2009-10	**-10,512**	**1,80,588**	**1,70,076**	**1,10,220**	**32,438**	**1,42,658**
2010-11	**-19,802**	**2,49,153**	**2,29,352**	**1,10,121**	**36,317**	**1,46,438**
2011-12	**-1,358**	**3,34,820**	**3,33,463**	**43,738**	**49,988**	**93,725**
2012-13	**-22,749**	**4,73,460**	**4,50,711**	**1,40,033**	**28,334**	**1,68,367**
Apr-12	-539	37,129	36,590	-1,109	-3,788	-4,897
May-12	-398	23,559	23,161	-347	3,569	3,222
Jun-12	296	78,465	78,761	-501	1,682	1,181
Jul-12	-1,988	2,985	997	10,273	3,392	13,664
Aug-12	-1,631	28,863	27,232	10,804	265	11,069
Sep-12	-3,199	50,110	46,911	19,262	623	19,884
Oct-12	-2,520	16,998	14,478	11,364	7,852	19,216
Nov-12	-2,397	42,868	40,471	9,577	292	9,869
Dec-12	-2,699	43,625	40,926	24,464	1,704	26,792
Jan-13	-5,212	40,652	35,439	22,059	2,947	25,006
Feb-13	-848	40,092	39,244	24,439	4,001	28,441
Mar-13	-1,614	68,114	66,501	9,124	5,795	14,919

Source: SEBI annual report 2012-13

Pursuant to the budget announcements 2012-13, QFIs have been allowed to access Indian Corporate Bond Market. QFI can invest in corporate debt securities (without any lock-in or residual maturity clause) and MF debt scheme upto USD 1 billion. The definition of QFI has been expanded to also include residents of the member countries of Gulf Co-operation Council (GCC) and European Commission.

The total net investment of QFIs in equity and corporate debt was Rupees 692 crore and Rupees 473 crore respectively in the year 2012-13. USD million terms, this represented USD 127 million and USD 87 million respectively as shown in Table 3.

TABLE 3: QFI INVESTMENTS DURING 2012-13

Year	Instrument	Gross Purchase (₹ crore)	Gross Sales (₹ crore)	Net Investment (₹ crore)	Net Investment (US $ mn.) *
2012-13	Equity	695	3	692	127
	Corporate Debt	478	5	473	87

** RBI reference rate as on March 28, 2013 from RBI website. (1 US $ = ₹ 54.3893).*

Source: SEBI annual report 2012-13

The debt investment limits prescribed for FIIs and Sub-accounts in the year 2012-13 are shown in Table 4.

Table 4: Allocation of Debt Investments Limits to FIIs and Sub-Accounts during 2012-13

(₹ crore)

Date	Govt. Debt Old	Govt. Debt Long Term	Corporate Debt Old	Corporate Debt Long Term Infra	Corporate Debt Long Term
April 23, 2012	1,203	1,321	4,547	Na	Na
May 21, 2012	3,028	1,875	3,929	Na	Na
June 20, 2012	1,464	2,437	1,599	6,381	Na
July 04, 2012	Na	20,469	Na	19,777	Na
July 20, 2012	1,264	3,669	4,357	4,219	Na
August 21, 2012	2,275	4,698	4,591	2,132	Na
September 20, 2012		13,255	3,736	5,794	Na
October 22, 2012	2,442	12,035	4,053	4,247	Na
November 20, 2012	1,094	4,451	5,071	Na	Na
December 20, 2012	1,985	10,264	4,301	Na	Na
January 21, 2013		13,707	3,954	Na	Na
February 20, 2013	1,919	33,959	3,866	Na	26,925
March 20, 2013	1,061	9,847	5,331	Na	Na

Source: SEBI annual report 2012-13, Na- Not applicable

The FIIs were permitted to trade in the derivatives market since February 2001. The notional value of open interest help by FIIs in derivatives was Rupees 17,38,526 crore as on March 31, 2013 as compared to Rupees 20,19,367 crore as on March 31, 2012. Open interest position of FIIs in index options was the highest at Rupees 10,10,032 crore by end-March 2013, followed by Stock futures, Index futures and Stock Options as shown in Table 5.

Table 5: Notional Value of Open Interest of FIIs in Derivatives during 2012-13

(₹ crore)

Items	Apr.	May.	Jun.	Jul.	Aug.	Sep.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.
1	2	3	4	5	6	7	8	9	10	11	12	13
Index Futures	2,01,459	2,48,631	2,24,531	3,14,454	3,35,517	2,47,879	2,91,134	1,96,239	2,23,175	1,74,560	1,90,750	1,99,621
Index Options	6,69,987	8,56,901	8,80,682	8,84,763	9,52,034	9,25,246	9,43,383	10,23,694	8,18,693	10,39,704	8,99,574	10,10,032
Stock Futures	4,53,531	4,73,449	4,74,343	5,60,770	5,26,430	5,34,335	5,98,962	5,94,704	6,23,980	7,34,081	5,83,925	4,77,993
Stock Options	18,116	25,605	22,186	30,359	39,734	32,122	37,826	45,974	33,050	77,798	50,821	50,879
Interest rate Futures	0	0	0	0	0	0	0	0	0	0	0	0
Total	13,43,092	16,04,586	16,01,743	17,90,345	18,53,714	17,39,582	18,71,304	18,60,611	16,98,898	20,26,144	17,25,070	17,38,526
Change in open position	-6,76,275	2,61,494	-2,843	1,88,602	63,369	-1,14,132	1,31,722	-10,692	-1,61,713	3,27,246	-3,01,074	13,456
% Change	-0.33	0.19	0.00	0.12	0.04	-0.06	0.08	-0.01	-0.09	0.19	-0.15	0.01

Source: SEBI annual report 2012-13

Participatory Notes are a major conduit of Channelizing offshore portfolio investment into India. The total value of investment in PNs inclusive of equity, debt and derivative as underlying stood at Rupees 1,47,905 crore as at end March 2013 compared to Rupees 1,65,832 crore at the end of March 2012 as shoen in Table 6. This outstanding value of PNs as percentage of AUC of FIIs had reached its lowest level since 2008-09. IN 2012-13, the value of PNs inclusive of derivatives stood at 11.1% of AUC of FIIs. Excluding derivatives as underlying, value of PNs as proportion of AUC of FIIs stood at 7.8 percentage in 2012-13.

Table 6: Notional Value of PNs versus Assets under Management of FIIs

Year/Month	Total value of PNs on Equity & Debt including PNs on derivatives (₹ crore)	Total value of PNs on Equity & Debt excluding PNs on derivatives (₹ crore)	Assets Under Custody of FIIs (B) (₹ crore)	Total value of PNs on Equity & Debt including PNs on derivatives as % of B	Total value of PNs on Equity & Debt excluding PNs on derivatives as % of B
2008-09	69,445	55,640	3,91,954	17.7	14.2
2009-10	1,45,037	1,32,557	9,00,869	16.1	14.7
2010-11	1,75,097	1,33,098	11,06,550	15.8	12.0
2011-12	1,65,832	1,15,332	11,07,399	15.0	10.4
2012-13	1,47,905	1,04,229	13,36,557	11.1	7.8
Apr-12	1,30,012	86,785	10,93,955	11.9	7.9
May-12	1,28,895	65,472	10,40,547	12.4	6.3
Jun-12	1,29,851	69,523	10,90,359	11.9	6.4
Jul-12	1,29,586	68,677	10,96,492	11.8	6.3
Aug-12	1,41,710	68,450	11,13,894	12.7	6.1
Sep-12	1,46,600	82,379	12,19,163	12.0	6.8
Oct-12	1,75,829	95,536	12,21,900	14.4	7.8
Nov-12	1,77,164	94,658	12,89,612	13.7	7.3
Dec-12	1,51,084	1,01,666	13,35,189	11.3	7.6
Jan-13	1,62,139	1,05,910	13,70,866	11.8	7.7
Feb-13	1,64,271	1,05,258	13,32,496	12.3	7.9
Mar-13	1,47,905	1,04,229	13,36,557	11.1	7.8

Source: SEBI annual report 2012-13

REGULATORY CHANGES FOR FOREIGN INSTITUTIONAL INVESTORS

The buoyancy in the secondary market coupled with strong macro-economic fundamentals. Active institutional support led by FIIs and MFs encouraged large number of companies to raise resources from the primary market. Indian market with strong economic growth and corporate profitability continued to attract FIIs. Emerging markets in general and India in particular, have attracted huge portfolio flows in recent years. India is became an attractive destination for FIIs among the emerging markets since 1992-93. During last few years there has been an increase in the investment by FIIs in the Indian securities market. Notwithstanding the signs of global recession and sub-prime crisis, India attracted a sizeable investment from FIIs in 2007-08 as well. The major through has come up in the year 1995, when SEBI notified the SEBI (FIIs) Regulations, 1995, these regulations has been amended from time to time.

REGULATIONS IN THE YEAR 1992-93:

In a major step towards globalisation of our markets, the government allowed FIIs such as MFs, Pension Funds, Investment Trusts, Assets Management Companies to invest in tradable securities in the primary market and secondary market under the Guidelines issued by government in September, 1992. These FIIs are required to be registered by SEBI under these guidelines. Towards the end of the year, the FIIs began to show serious interest in investing in the Indian Markets and there was an increase in the flow of applications received by SEBI. These applications were being scrutinised by SEBI within a reasonably short period and 18 FIIs were registered by SEBI by the end March, 1993.

REGULATIONS IN THE YEAR 1993-94:

A.SEBI and RBI allowed FIIs to maintain separate cash and security accounts for each sub-accounts to avoid commingling of these accounts.
B.Ceiling on investment in debt securities: FIIs were initially not allowed to invest in debt securities in excess of 30% of the total investments made by single sub-accounts. This provision was later relaxed to allow FIIs to invest in debt securities up to 30% of their aggregate investments, in all sub-accounts. In other words, the 30% ceiling on investment in debt securities is now applicable at the FII level, as opposed to the sub-account level earlier. The relaxation is expected to provide additional flexibility to the FIIs, in terms of structuring their investment pattern across their various sub-accounts. Inspite of these facilities, FIIs had not invested in debt securities in 1993-94.
C.Custodians: The GOI and SEBI have been taking steps to remove bottlenecks in settlement systems. Jumbo transfer deeds and bulk payment of stamp duty were permitted. Banks and financial institutions were encouraged to set up custodial services. The State Bank of India and ICICI began to provide these services, though in a small way. These steps helped in speeding up work at the custodian end, though not to a completely adequate extent and custodians still resorted to imposing restrictions on investments by their client FIIs. SEBI also proposed to introduce institutional board lots (larger than market lots) to help lessen paper work for transactions by all institutional investors, including FIIs.

REGULATIONS IN THE YEAR 1994-95:

The guidelines for FIIs require FIIs to be broad based funds or to invest on behalf of broad based funds. FIIs are required to appoint a domestic custodian, who is responsible for submitting various reports to SEBI regarding FIIs investments.

REGULATIONS IN THE YEAR 1995-96:

As a part of the amendment to the SEBI Act carried out through the Securities Laws (Amendment) Act, 1995, FIIs are now required to be registered with SEBI under regulations made under the Act. Accordingly SEBI notified the SEBI (FIIs) Regulations, 1995 on November 14, 1995. The provision in the government guidelines of September' 1992 under which SEBI was hitherto registering FIIs and the changes that have been made from time to time in those guidelines have been incorporated in the regulations. The regulations, therefore, do not envisage any change either in the FIIs investment policy or the operational procedures which have hitherto been followed by SEBI.

REGULATIONS IN THE YEAR 1996-97:

Several changes have been made to the SEBI (FIIs) Regulations, 1995 to diversify the foreign institutional investor base and to further facilitate inflow of foreign portfolio investment. The changes have also aimed at facilitating investment in debt securities through the FII route. The changes are as follows:

The eligible categories of FIIs have been expanded to include university funds, endowments, foundations, charitable trusts and charitable societies which have a track record of 5 years and which are registered with a statutory authority in their country of incorporation or establishment
Each FIIs or sub-account of the FIIs has been permitted to invest upto 10% of the equity of any one company, subject to the overall limit of 24% on investments by all FIIs, Non-Resident Indians and OCBs.
The 24% limit has been raised to 30% in the case of individual companies who have obtained shareholder approval for the same.
FIIs have been permitted to invest in unlisted securities.
FIIs have been allowed to invest their proprietary funds.
FIIs who obtain specific approval from SEBI have been permitted to invest 100% of their portfolios in debt securities. Such investment may be in listed or to be listed corporate debt securities or in dated government securities, and is treated to be part of the overall limit on External Commercial Borrowings.

Foreign investment in Indian securities has also been made possible through the purchase of Global Depository Receipts, Foreign Currency Convertible Bonds and Foreign Currency Bonds issued by Indian issuers who are listed, traded and settled overseas. Foreign investors, whether registered as FIIs or not, may also invest in Indian securities outside the FII route. Such investment requires case by case approval from the Foreign Investment Promotion Board (FIPB) and the RBI, or only by the RBI which depends on the size of investment and the industry in which this investment is to be made. Foreign financial services institutions have also been allowed to set up joint ventures in stock broking, asset management companies, merchant banking and other financial services firms along with Indian partners.

REGULATIONS IN THE YEAR 1997-98:

In 1997-98, measures were taken to further facilitate debt investments by FIIs. The SEBI (Foreign Institutional Investors) Regulations, 1995 were amended in the following ways:
FIIs making investment through the 100 per cent debt route were permitted to deal directly with Subsidiary General Ledger (SGL) counterparties, as prescribed by the RBI, without dealing through brokers.
The regulations were also amended to permit all FIIs (not just those investing through the 100 per cent debt route) to invest in dated Government securities. FIIs investing through the 100 per cent debt route were also permitted by the RBI to hedge their foreign exchange exposure by taking forward cover.
The third amendment relating to FII's Regulations came into force with effect from December 5,1997 inserting a new clause (d) to Regulation 15(3), inter alia, providing those FIIs or their subaccounts having an aggregate of securities worth more than 10 crore shall settle their transactions entered after January 15, 1998 only in a dematerialised form. Further, the eligibility criteria for registration of FIIs have been amended by incorporating the concept of 'fit and proper person'.

REGULATIONS IN THE YEAR 1998-99:

The SEBI continued to encourage FIIs to invest in India and took measures to improve the regulatory framework for FIIs to facilitate FII investments into the securities market. The following changes have been made to the FII regulations during the year 1998-99:
A.Stock lending permitted: The stock lending scheme was introduced by SEBI in 1996. The FIIs, which are active participants in the Indian securities market, have been allowed to lend stocks through an approved intermediary. However, presently the FIIs are not permitted to borrow securities which could result into covered short sales by the FIIs.
B.Investments in Treasury bills allowed: While announcing the policy measures relating to the Government securities market in the credit policy announcement on April 29, 1998, the RBI allowed FIIs to invest in treasury bills within the overall approved debt ceiling. A previous amendment in 1997 had permitted FIIs to invest in proprietary funds and also to invest in dated government securities.
C.Investments in unlisted securities permitted: The Finance Minister in his Budget Speech for 1998-99 announced that foreign institutional investors investing through the 100 per cent debt route would be permitted to invest in unlisted securities. Amendments to this effect have been approved and notified by the SEBI.
D.FIIs participation in open offers directly: The SEBI (FIIs) Regulations, 1995 require FIIs to enter into secondary market transactions only through stock brokers registered with SEBI. To facilitate the participation of FIIs in open offers, the FIIs have now been permitted to tender their securities directly in response to an open offer made in terms of SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997.
E.Investments in derivatives permitted: As FIIs are potential participants in the derivatives markets; it was felt that the presence of FIIs and domestic institutions would be critical to the success of the market. It was, therefore, decided to permit FIIs to buy and sell derivative contracts traded on a stock exchange.
F.Simplification of application procedure: In terms of regulations 12 and 13 of the SEBI (FIIs) Regulations, 1995, FIIs may invest on behalf of sub-accounts which are registered with SEBI. When considering an application for registration of sub-accounts, the Regulations required submission of detailed information for registration. Under this procedure, considerable time was sometimes taken in determining whether the applicant was "broad based" as required by the Regulations. To simplify the registration process for sub-accounts it has been decided that the determination of fulfilment of broad base criteria be done by the foreign institutional investor itself and a declaration to this effect be submitted to SEBI. The Regulations have been amended to incorporate a simplified format for registration of sub account under which registration is now granted within three days of receipt of application.
G.Web page for the FIIs: The FIIs operate through their offices located abroad. To facilitate better exchange of information with the FIIs as well to provide information on the policy developments, a separate page on FIIs has been created on the official web site of SEBI. The page contains the FII regulations, the applications forms, details of the registration procedures and list of the FIIs registered with the SEBI. a lot of details are also provided under the head frequently asked questions. The FIIs or their representatives can also contact the FII division personnel in SEBI through this page.

REGULATIONS IN THE YEAR 1999-00:

A.FIIs were allowed to directly participate in the public offer of takeover and buy-back offer of companies.
B.The criteria for broad based funds was modified to mean a fund which has atleast 20 investors (instead of 50) and with no single investor holding more than 5% (instead of 10%) of the shares or units in the funds.
C. Registration fee by FIIs is payable through appropriate mode of instrument.
D.Domestic Assets Management Companies/ Domestic Portfolio managers were permitted to manage foreign instruments through portfolio management route and are to be deemed FIIs but no fees has been specified.
E.Foreign corporate or high net worth individual investors were allowed to invest as sub-account. However, Non-Resident Indians, Overseas Corporate Body registered with RBI are not eligible to invest as sub-account.
F.Foreign corporate or individuals are not eligible to invest through 100% debt route.
G.Investment by foreign corporate or individuals shall not exceed 5% of total issued capital of company.
H.Additional information and undertakings by foreign corporates or individuals have been specified.

REGULATIONS IN THE YEAR 2000-01:

In March 2001, with an objective to increase FIIs participation the FII ceiling under special procedure enhanced to 49%.

REGULATIONS IN THE YEAR 2001-02:

A.For FIIs (where FIIs, itself is the investing entity) and their sub-accounts, SEBI registration number of FIIs and Sub-accounts to be used until the Permanent Account Number is allotted.
B.FIIs trading in all exchange traded derivative contracts: In February 2002, the SEBI prescribed position limits for trading by FIIs and their sub-accounts to permit them to trade in all exchange traded derivative contracts. The FIIs were also permitted by the RBI to trade in all exchange derivative contracts subject to the prescribed position limit for them and their sub-accounts. They are also required to comply with the procedure of trading, settlement and reporting as prescribed by the derivative exchange/ clearing house/ clearing corporation from time to time.
C.In June 2000, FIIs were, hitherto, allowed to trade only in index futures to the extent of their exposure in the cash market according to restrictions laid down by the RBI. In order to encourage FIIs to participate in the derivative market in all products, it was decided that FIIs might be allowed to trade in all derivative products subject to the position limits now applicable to a trading member. These position limits would be monitored by the exchanges as in case of any other trading member. The SEBI took up the matter with RBI and GOI to issue suitable instructions to allow FIIs to trade in all derivative products. Accordingly the RBI has issued the instructions and permitted the FIIs to trade in all derivatives product.
D.SEBI (FIIs) Regulations, 1995 wherein FIIs or their employees were restricted to render directly or indirectly any investment advice about any security in the publicly accessible media, whether real-time or non-real-time, unless a disclosure of their interest including long or short position in the said security had been made. Further, the employees of the FII were also required to disclose the interest of their dependent family members and their employers including their long or short position in the security.

REGULATIONS IN THE YEAR 2002-03:

A.Simplification of documentation required for registration as a FIIs: SEBI (FIIs) Regulations, 1995, was amended to reduce the requirement for documentation the list was specified for documents requirement and the registration fee was also reduced to USD 5,000 from USD 10,000.
B.Adoption of Straight through Processing:
Straight through Processing ("STP") involves capturing and processing transactions in one pass, from the point of first deal to final settlement. This will obviate the need for manual entry and re-entry of data of trade particulars which is time consuming and prone to error.
In order to examine the feasibility of STP in the Indian Markets, SEBI constituted a committee of representatives from various market intermediaries and the RBI. The Committee in its report recommended the following:

i.Adoption of ISO15022 messaging standards by the market participants.
ii.Electronisation of Contract notes.

iii.Connectivity among the market participants and implementation of STP.
SEBI's accepted the committee's recommendations and introduced STP for electronic trade processing with a common messaging standard, that is, ISO15022 with effect from December 2002 on a voluntarily basis. After gaining some experience it is intended to make STP mandatory across all segments of market.

REGULATIONS IN THE YEAR 2003-04:

A.In May 2003, SEBI issued guidelines in respect of divestment of securities by the FIIs in response to an offer by Indian Companies in accordance with the operative guidelines for disinvestment of shares by Indian Companies in the overseas market through issue of American Depositary receipts or Global Depositary Receipts and directions issued by RBI from time to time, the transactions will not be required to be done through a stock broker.
B.In August 2003, SEBI made it mandatory for an FII to fully disclose information concerning the terms of and the parties to the transactions of off-shore derivative instruments, that is, participatory notes, equity linked instruments and any instruments of the like nature, entered into by it or it's sub-accounts at the time and in the form required by the Board. The detailed code of conduct for FIIs specified.
C.In January 2004, FIIs/ Sub-account allowed to deal in off-shore derivative instruments viz., participatory notes, equity linked notes or any other similar instruments against underlying listed securities only in favour of those entities which are regulated by any regulatory authority in the countries of their incorporation or establishment subject to compliance of "KYC" requirements. The FIIs/ Sub-accounts are also required to ensure that no further downstream issue or transfer of such instruments is made to an unregulated entity.
D.In February 2004, FIIs allowed to directly sell the securities in response to an offer made by any promoter or acquirer in accordance with the SEBI (Delisting of securities) Guidelines, 2003 and directly participate in bid for, or acquiring of, securities in response to an offer for disinvestment of shares made by the Central government or any State government. Such transactions can be made without routing them through a stock broker.

REGULATIONS IN THE YEAR 2004-05:

A.The Union Government announced, within an overall External Commercial Borrowing ceiling of USD 9 billion, a sub-ceiling of USD 1.75 billion for FIIs investment in dated government securities and Treasury bills, both under 100% debt route and normal 70:30 route. Further, a cumulative sub-ceiling of USD 500 million for FII investment in corporate debt was announced over and above the sub-ceiling of USD 1.75 billion. Both the sub-ceilings are separate and not fungible.
B.FII position limits in the equity index derivative contracts were revised. Accordingly, FII position limit in all index options and future contracts on a particular underlying index shall be Rupees 250 crore (separately for Futures and Options) or 15% of the total open interest of the market in index future and index options, whichever is higher per exchange.
C.The frequency of reporting of offshore derivative instruments by registered FIIs has been made monthly.
D.The MFs and FIIs have been advised to enter the Unique Client Code (UCC) pertaining to the parent entity at the order entry level and enter the UCCs for their individual schemes/ sub-accounts on post clearing session.

REGULATIONS IN THE YEAR 2005-06:

The cumulative debt investment limit for FIIs investment in debt securities for 2006-07 has been revised upward by the government within the overall limit of External Commercial Borrowing. While such limit for government securities, including Treasury Bills, was raised from USD 1.75 billion to USD 2 billion, the same for the corporate debt was increased from USD 0.5 billion to USD 1.5 billion.

REGULATIONS IN THE YEAR 2006-07:

A.In April 2006, cumulative debt investment limits of USD 2 billion and USD 1.5 billion for FIIs/ Sub-accounts in government securities and corporate debt respectively were allocated as USD 1.75 billion in Government securities/ Treasury bills and USDb1.35 billion for 100% debt. For general 70:30 FIIs/ Sub-accounts the allocation to be USD 0.25 billion in Government securities/ Treasury bills and USD 0.15 billion in corporate debt.
B.In June 2006, Validity period of the certificate of FIIs and subsequent renewals reduced to 3 years from 5

years. FIIs were also allowed to invest in security receipts but not on behalf of Sub-accounts. Fees for FIIs/ Sub-accounts registration revised.
C.In August 2006, Insurance company or Reinsurance Company, an international or multilateral organisation or an agency thereof, a foreign government agency or a foreign central bank and investment manager or advisor were included in the eligible categories that can be registered as FIIs.
D.In September 2006, the investment limit of USD 500 million by FIIs in upper Tier II instruments should be allocated as USD 390 million in 100% debt and USD 110 million in general 70:30 FIIs/ Sub-accounts
E.In November 2006, SEBI permitted portfolio managers to manage portfolios of SEBI registered FIIs and Sub-accounts.
F.On December 14 2006, after reviewing the utilisation versus allocation, the earlier mentioned investment limits allocated to 100% debt and 70:30 FIIs/ Sub-accounts in debt securities revised.
G.On December 22, 2006, foreign investment upto 49% allowed in infrastructure companies with a separate Foreign Direct Investment cap of 26% and FII cap of 23%. Investment in respect of recognized stock exchange subject to a limit of 5% shareholding by any person, directly or indirectly as prescribed under SC(R) (Manner of increasing and marinating public shareholding in Recognized Stock Exchanges) Regulations, 2006. But here FIIs were allowed only through purchases in the secondary market and FIIs shall not seek and will not get representation on the Board of Directors.
H.In January 2007, SEBI (FIIs) Regulations 1995 were amended to revoke the deemed FIIs provisions. Prior to this amendment Regulation 15(3)(d) required FIIs to deliver securities in the dematerialised form, if the aggregate value of securities held by the FIIs was Rupees 10 crore or more. By the above amendments, the clause was substituted whereby :

The ceiling of Rupees 10 crore was omitted. Thus now all FIIs have to deliver securities in dematerialised form.
A new exception was provided to this requirement in respect of securities whose issuer has not established connectivity with all the depositories.

I.In January 2007, limit of FII in debt securities was further enhanced to USD 2.6 billion from USD 2 billion. Incremental limit of USD 0.6 billion was added to the existing headroom of USD 55 million available for investment by 100% debt FII in Government securities/ Treasury bills (FIIS were allowed to invest in security receipts).

J.The year 2006-07 saw SEBI taking a number of steps with regard to FIIs. The steps taken were:

Opening of the Indian securities market to new categories of FIIs.
The fee for registration as FIIs and Sub-accounts was revised from USD 5,000 and USD 1,000 to USD 10,000 and USD 2,000 respectively.
FIIs were allowed to settle their transactions in the physical settlement mode where the issuer of such securities has not established connectivity with all depositories registered with SEBI.
Security Receipts' issued under the Securitisation Act of 2002was made an eligible category of securities for investment by FIIs (but not for Sub-accounts).

REGULATIONS IN THE YEAR 2007-08:

SEBI took various initiatives addressing issues relating to registration of FIIs and sub-accounts, the issuance of P-Notes/ODIs by FIIs/Sub-accounts. The important measures are detailed below:

A.Registration of FII/Sub-Accounts:
ØThe “broad-based” criteria were modified to include entities having atleast 20 investors, with no single investor holding more than 49 per cent (instead of 10 per cent at present).
ØTrack record of individual fund managers to be considered for the purpose of ascertaining the track record of a newly set up fund, subject to such fund manager providing disciplinary track record details.
ØFII and sub-account registrations to be perpetual, subject to payment of fees and requirement of renewal was removed.

B.Issuance of Participatory Notes (P-Notes):
FIIs/ Sub-accounts were prohibited from issuing new Offshore Derivative Instruments (ODIs) with derivatives as underlying and existing positions with regard to such ODIs to be wound up over 18 months.
Sub-accounts were barred from issuing new ODIs with existing sub-accounts required to wind up

outstanding instruments within 18 months.

With a view to capping the volume of outstanding P-Notes/ODIs, following measures were introduced:

i.Those FIIs currently issuing ODIs with notional value of ODIs outstanding (excluding derivatives) as a percentage of their AUC in India of less than 40 per cent would be allowed to issue further ODIs only at the incremental rate of 5 per cent of their AUC in India.
ii.Those FIIs with notional value of ODIs outstanding (excluding derivatives) as a percentage of their AUC in India of more than 40 per cent shall issue ODIs only against cancellation / redemption / closing out of the existing ODIs of at least equivalent amount.
iii. The effective date for calculation of the AUC for the purpose of determining the notional value of ODIs issued as a percentage of AUC, for the above proposals would be September 30, 2007.

Issuance of PNs/ODIs would be limited Issuance of PNs/ODIs would be limited to only "regulated" entities and not "registered" entities.

C.Change in Investment Limit in Debt Securities: The investment limit for FIIs in Government Securities (including Treasury Bills) was enhanced from USD 2.6 billion to USD 3.2 billion. It was decided that investments by FIIs/Sub-Accounts in debt oriented mutual fund units (including units of money market and liquid funds) would be considered as corporate debt investments and reckoned within the stipulated limit of USD 1.5 billion, earmarked for FII/Sub-account investments in corporate debt. The following would be applicable in this regard:
There should be no demarcation between 100 per cent debt and normal 70:30 FIIs/Sub-Accounts for the purposes of allocation of debt investment limits. The individual limits allocated to the 100 per cent debt FIIs/Sub-Accounts stood cancelled.
The allocation of unutilised/unallocated limits for investment in Government Securities/T-Bills would be on first-come-first-serve basis.

D.SEBI specified the broad regulatory framework for short selling by institutional investors and a full-fledged securities lending and borrowing scheme. Accordingly, relevant amendments were made to SEBI (FIIs) Regulations, 1995, enabling FIIs to participate in short selling and securities selling and lending schemes.

E.SEBI introduced mini contracts in equity indices and options contracts with longer life/ tenure, and permitted exchanges to compute and disseminate volatility indices and bond indices. Clearing members were permitted to accept foreign sovereign securities with 'AAA' rating as collateral from FIIs for exchange traded derivative transactions.

REGULATIONS IN THE YEAR 2008-09:

A.Restriction and Relaxation on Issuance of Participatory Notes:

In October 2007, it was decided to put quantitative restrictions on the quantum of PN issuance by the FIIs. The decision was taken against the backdrop of growing concern/ perception of high inflows in general and particularly through the PN route, as reflected by total value of outstanding P-Note figures visa-vis assets under custody which showed a rising trend. Accordingly, Regulation 15A was suitably amended to provide for the quantitative restrictions and more concise definitions of "regulated entity" and "overseas derivative instruments".
The impositions of these restrictions and its impact, if any, were reviewed in October 2008, and the following factors were considered:

i.The PN positions reported represented an inflated figure because of the reasons like a) The FIIs were reporting PNs when it was merely referenced to Indian securities, or even when it was referenced to a product with Indian weightage, e.g., MSCI Index. b) In the case of ODI, it was not possible to establish any correlation between inflows and ODIs as some of the FIIs were reporting their ODI positions based on notional positions while others on the premium/ margin paid towards the ODI contracts.
ii.Further clamping down on the ODI issuance capabilities of the PN issuers on the derivatives had led to the unintended effect of exporting markets abroad.

In view of the above, the quantitative restrictions imposed on the ODI issuance capabilities and the restrictions on ODI were removed from October, 2008.

B.Disapproval of Lending/Borrowing Activity Abroad by FIIs:

As per the legal framework for lending and borrowing of shares, only exchange offered mechanism was to be availed by the market participants and OTC deals of such nature were not allowed.
However, sales in the Indian market by foreign institutional investors (FIIs) and their sub-accounts are also possible on account of the securities being lent by these FIIs / sub-accounts abroad. In order to lend more transparency to the market, it was decided that the position of the securities lent, if any, by FIIs/ subaccounts abroad shall be disseminated on a consolidated basis twice a week i.e., on Tuesday and Friday of every week
The first such information was provided on the SEBI website on Friday October 17, 2008 covering the activity for the period October 10, 2008 to October 14, 2008 and periodically thereafter. Further, the scrip-wise position of the FIIs which had the effect of lending shares abroad, as on October 9, 2008 was also disseminated to the public. SEBI continuously reviews data submitted by the FIIs with regard to their stock lending activities abroad.
It was observed that the exchange offered stock lending mechanism, though operational in the Indian market, was not being used by the institutions, including FIIs. At the same time, apparently the FIIs were engaged in similar activities in the overseas OTC markets.
It was, therefore, decided to disapprove the activity of the FIIs which had the effect of lending of shares abroad in an OTC market, an activity which was not allowed onshore.

C.Enhancement of Debt Investment Limits for FIIs:

During 2008-09, the investment limit for FIIs was enhanced from USD 3.2 billion to USD 5 billion for Government Securities (including Treasury Bills) and from USD 1.5 billion to USD 15 billion for Corporate Debt, as under:

(USD billion)

Sr. No.	Month	Government debt		Corporate debt	
		From	To	From	To
1	June 2008	3.2	5.0	1.5	3.0
2	October 2008	5.0	–	3.0	6.0
3	January 2009	5.0	–	6.0	15.0
Limit at end of FY 2008-09			5.0		15.0

The limits for investment in upper tier II instruments has remained unchanged at USD 0.5 billion. To enable better utilisation of the allocated limits, it was decided to allow the entities five working days to rollover their debt investments upon sale of debt securities held by them.

A.Changes made in the Methodology for Allocation of Debt Investment Limits:
SEBI allocated debt investment limits to the FIIs on first-come-first-served basis. This method of allocation was used in June 2008 and October 2008 when the limits for holding government and the corporate debt by FIIs were enhanced.
As per this methodology, requests for investment limits were called from the entities in a dedicated mail box thrown open on a particular day subject to a maximum limit per entity. The limits were then allocated based on the time the e-mails were received in the designated mailbox. In the interest of transparency, the list of the entities and the time at which the mails were received in the mail box were disseminated to the public by way of press release.
These limits were to be utilised within a specified time; however, if the same were not utilised fully or

partially within the specified time, the unutilised limits were withdrawn from the entity and allocated to other entities further down in the list of requests received.
This revised system was transparent and considered a step better than the earlier system used for allocation. But there were some inherent drawbacks, that is, non-optimal matching of investment opportunity with allocation of limits, inefficient utilization of limits.
To address these issues, SEBI introduced an auction based methodology where the registered FIIs/sub-accounts could bid through their trading members for getting the debt limits. The features of this methodology are:

i.The allocation is done on an open screen based bidding platform wherein bidders pay a fee for taking the limits.
ii.The allocation is on a price time priority, where the highest bidder would take away the given limit subject to a minimum of Rs.250 crore and a maximum of Rs.10, 000 crore.
iii.The successful bidders pay a minimum of Rs.1,000 or the bid premium, whichever is higher.
iv.The premium amount collected through this mechanism is paid to the Consolidated Fund of India.
v.45 days period is provided to the entities for utilization of limits under this allocation method.

In the first such auction conducted, total limits to the extent of Rs 29,350 crore were allocated to 43 bidders. The total bidding premium generated from this allocation amounting to Rupees 22,33,535 was remitted to the Consolidated Fund of India.
Further to accommodate the FIIs/subaccounts who require smaller debt limit upto Rs.249 crore), the first-come-first-serve methodology is being continued.

B.Efficient Allocation of Debt-Equity in the Portfolio of FIIs in order to accord better flexibility for efficient allocation of debt and equity in the portfolio, the restriction of 70:30 ratio of investment in equity and debt was done away from October 2008.

REGULATIONS IN THE YEAR 2009-10:

A.Based on the allocations and the utilisation of the allocated debt limits by the entities, a status of utilisation is drawn. If sufficient limits are available for allocation, the same are again put up for allocation through prevalent allocation procedures. The allocation of the limits and its utilisation status is drawn from respective custodians of the entities. Combinations of two methods, that is, open bidding and first-come-first-served is used for allocation of debt limits. However during 2009-10 in corporate debt category all the allocation was through first-come-first-served basis only.
B.In December 2009, an investment limit of Rupees 350 crore in government debt was allocated among the FIIs/ Sub-accounts on a first-come-first-served basis in terms of SEBI Circular dated January 31, 2008, subject to a ceiling of Rupees 50 crore per registered entity.
C.In June 2009, the registration fees of 3 years for FIIs were reduced from USD 1,000 to USD 5,000 and from USD 2,000 to USD 1,000 for Sub-accounts FIIs.

REGULATIONS IN THE YEAR 2010-11:

A.FIIs Permitted to Offer Domestic Government Securities as Collateral for Margins: RBI vide A. P. (DIR Series) Circular no. 47 dated April 12, 2010, permitted FIIs to offer domestic Government securities and foreign sovereign securities with AAA rating, as collateral to the recognised stock exchanges in India, in addition to cash, for their transactions in the cash segment of the market. However, SEBI has specified that cross-margining of Government securities (placed as margins by the FIIs for their transactions in the cash segment of the market) shall not be allowed between the cash and the derivative segments of the market.
B.Vide circular dated April 15, 2010, all FIIs were advised to provide declarations and undertakings that they conform to the broad based criteria as specified in regulations. Further, all those entities that were broad based and were structured as Multi Class Share Vehicles were required to seek prior permission before a share class is added for directing investments into India. All registered FIIs were mandated to provide the requisite declarations and the undertakings about their structures to SEBI by September 30, 2010.
C.Change in Reporting Format of ODIs/ PNs Activity: Vide Circular No. IMD/CUST/15/2004, dated April 02, 2004. Monthly PN reporting format required the issuer to report the immediate owner of PN and in case the PN is issued onward to another entity then the details of the second level owner of PN. The new reporting format was announced by Circular - CIR/IMD/FIIC/1/2011 issued on January 17, 2011 ensured

that the PN issuing FIIs:

Report the information about the name and jurisdiction of the end beneficial owner of PNs at all times.
Provide information of the PN issuer's transactions that are hedged and referenced in India.
Compliance of PN issuer with KYC norms for PN end beneficial owner.
Provide confirmation on regulatory compliance with the KYC norms.
Undertaking by PN issuer that PNs are not issued to Non Resident Indians or Indian Residents.

D.Reporting of Short Lending:

By issuance of Circular IMD/ FII&C/32/2008 on October 16, 2008 FIIs and subaccounts were required to submit information about the quantity of securities which they have lent to entities other than in the Indian securities market, i.e., where the ODIs are issued which have the effect of a short sale in the Indian security (including Future and Options)/synthetic shorts, twice a week. Subsequently, vide circular no. IMD/FII&C/34/2008 dated October 20,2008, SEBI prohibited the activity of the FII lending shares abroad. SEBI continued to monitor the existing outstanding positions which were continuously decreasing over a period of time. Subsequently, on a review on March 04, 2011, it was observed that there were no outstanding short positions reported by FIIs. As the prohibition on the activity of short lending continued since October 2008, there were no outstanding positions reported in March 2011. Hence, with effect from issuance of circular no CIR/IMD/FIIC/4/2011 dated March 29, 2011, reporting of synthetic shorts in ODI by FIIs was discontinued.

E.Allocation of Debt Investment Limits:

Vide circular dated November 26, 2010, a new debt category viz. Government debt - long term with residual maturity of over 5 years was introduced with a limit of USD 5 billion. Another new category viz. corporate debt – long term infra with residual maturity of over 5 years issued by companies in the infrastructure sector was introduced with a limit of USD 5 billion.

i.FIIs were permitted to invest in corporate debt - long term infra as per the definition of infrastructure as governed by (External Commercial Borrowings) Policy.
ii.It has been decided to allow a single FII entity to make bidding on behalf of multiple entities.
iii.FIIs were allowed to make investment in primary debt issues of "to be listed" securities. In case the debt issue is not listed within 15 days, FIIs were allowed to sell debt holdings only to domestic investors until such securities are listed.

In line with the budget proposal made on February 28, 2011 by the Government of India, SEBI, vide circular dated March 31, 2011 increased the limit of corporate debt long term infrastructure by an additional amount of USD 20 billion, thereby taking the overall limit to USD 25 billion.

i.FIIs have now been permitted to invest in unlisted bonds issued by companies in the infrastructure sector.
ii.Investments in such bonds shall have a minimum lock-in period of three years. However, during the lock-in period, FIIs will be allowed to trade amongst themselves. During the lock-in period, the investments cannot however, be sold to domestic investors.
iii.To facilitate the FIIs during the lock-in period a special trading window for FIIs shall be provided by exchanges on the same lines as is available for equities.
iv.Further, FIIs have also been allowed to avail investments under this category without obtaining SEBI approval till the quantum of overall investment reaches 90 % of the overall limit, that is, USD 22.5 billion.

D.The periodicity of the reporting of lending of securities bought in the Indian Market has been modified from daily submissions to weekly submissions. In accordance with this change in periodicity of reports, the FIIs shall now be required to submit the reports every Friday with effect from July 2, 2010. Further in January 2011, it has been decided that FIIs are no longer required to fi le weekly reports, with effect from March 29, 2011, as there are no outstanding short positions.

E.In September 2010, it was communicated to FIIs through their custodians that those entities that do not fi le the requisite declarations and the undertakings about their structures to SEBI by the stipulated date shall not be able to take fresh positions in the cash as well as the derivatives market from October 1, 2010. From this date, non- compliant entities could either, retain their current positions or sell off / unwind.

REGULATIONS IN THE YEAR 2011-12:

A.Formation of QFI framework: SEBI allowed foreign investors termed as QFIs, who meet the prescribed KYC norms, to invest in equity schemes of Indian MFs, permitted Infrastructure Debt Fund schemes of MF and India's Equity shares subject to the prescribed terms and conditions. The QFI framework has the objectives of reducing regulatory arbitrage on account of different categories, increase in transparency, simplification of account opening, reduction in time taken to make investment, decrease in transaction cost coupled with Financial Action Task Force level KYC for foreign investors to participate in Indian capital market and to encourage indirect participants to directly participate in Indian capital market. All these aspects will enhance the projection of Indian securities markets and help it make a preferred investment destination by global funds.

B.Revision of Debt re-investment policy: Vide SEBI Circular dated January 2012, it has been decided to discontinue the re-investment mechanism. Henceforth, for all new allocations of debt limits to FIIs/ Sub-accounts, no re-investment period shall be allowed and the limits shall come back to the pool once the investment is sold/ redeemed. These limits shall again be allocated in subsequent bidding process. The FIIs were allowed to re-invest sale proceeds within a period of 5/ 15 days, in order to hold on to their purchased investment limits. This re-investment facility had the following unintended effects:

Allowed FIIs to retain the debt investment limits till perpetuity by rolling over their investment during the re-investment period window. The ability to retain limits till perpetuity made the phenomenon anti-competitive.
Existing allottees continued to hoard debt limits at relatively higher costs through the stock exchange bidding platforms. These costs could be amortised by them over a long period of time, in view of the perpetual nature of limits.
The cost of debt seemed uneconomical for the new fund based FIIs entities to participate in the bidding.
Tendency to invest in short-term papers.

Due to above factors, it was felt that there is no reason to continue with the facility of reinvestment window. Hence, vide SEBI circular dated January 3, 2012, it has been decided to discontinue the re-investment mechanism. Henceforth, for all new allocations of debt limits to FIIs/sub-accounts, no re-investment period shall be allowed and the limits shall come back to the pool once the investment is sold/ redeemed. These limits shall again be allocated in subsequent bidding processes.

The FIIs that have already obtained the debt limits or invested in debt were allowed to continue with the re-investment facility, that is, they may re-invest into debt securities within 5 to 15 business days of the sale or redemption of the earlier investments, until the occurrence of any of the following conditions:

The total sales made by an FII from its debt portfolio reaches twice the value of the entire debt portfolio (i.e. the total of the utilised and utilised limit available with the FII); or
A period of two years has elapsed since from the date of issue of the circular i.e. on January 2, 2014. It is envisaged that once the reinvestment facility is withdrawn, a schedule of auctions calendars would also be possible which would enable the foreign investors to plan their investments based on the bidding session's calendar.

C.In September 2011, the allocation procedure for FII debt limits was changed to the open bidding process wherein bifurcation in terms of lock in period and manner of allocation the long term infrastructure limits of USD 22 billion was advised.

REGULATIONS IN THE YEAR 2012-13:

A.QFI framework: Vide SEBI circular dated August 09, 2011 and January 13, 2013, the framework for QFI investment in MF and equity shares has been prescribed and subsequently it was revised as well. The revision in QFI framework primarily relates to the following:

The definition of QFI has been widened to include resident of a country which is a member of group which is a member of Financial Action Task Force and who is a signatory to International organization of Securities commission Multilateral Memorandum of Understanding or a signatory of a bilateral Memorandum of Understanding with SEBI.
QFIs are allowed to invest in debt schemes of Indian MFs and corporate debt.

QFIs can open a single non-interest bearing rupee account with any AD Category-I bank in India for making investment through this route, subject to the conditions as may be prescribed by RBI from time to time.
The QFI has been extended the option to appoint custodian of securities for clearing and settlement of its transactions, provided such custodian is also the qualified Depositary Participants of the QFI.
A separate investment limit of USD 1 billion created for QFI investment in corporate debt.
A separate investment limit of USD 3 billion created for QFI investment in MF Infrastructure Debt Scheme.

B.KYC Simplification: During September 2012, SEBI simplified the following KYC requirements for foreign investors making investment through the portfolio route:

KYC forms may be filled and signed by Global Custodian, if Power of Attorney is given by FIIs/ Sub-accounts to the global custodian.
The requirements to provide names, residential address, photograph, proof of identity and proof of address of individual promoters, partners/ trustees, whole time directors of foreign investors has been waived if the global custodian gives an undertaking to provide the documents as and when requested by the intermediary.
Special exemptions have been made for Sovereign Wealth Funds Entities, foreign government agencies, Central Bank, Government Provident Funds and International or Multilateral agencies.

C.Introduction to Auction Calendar: Vide Circular dated April 27' 2012, it was decided that the auction of debt limits would be conducted on 20th of every month (if 20th is holiday, auction shall be done on the next working day), based on availability of free limits at the end of respective previous month. The auction shall be conducted if the free limit in any category (Government Debt Long-term, Corporate Debt Long-Term Infra) is more than Rupees 1,ooo crore, in the manner summarized below:

Particulars	Details
Duration of bidding:	2 hours (15:30 to 17:30)
Access to platform	Trading members or Custodians
Minimum bid	Rupees one crore
Maximum bid	Rupee 250 crore or one-tenth of free limit whichever is higher
Tick Size	Rupees one crore
Allocation methodology	Price time Priority
Pricing of bid	Minimum flat fees of Rupees 1,000 or bid price whichever is higher
Bidding date	20th of every month (if 20th is holiday, auction shall be done on the next working day)
Time period for utilization of the limits	90 days for corporate debt old and corporate debt long term infra category and 45 days for Government debt old and Government debt long term category
Auction platform	Alternatively on BSE & NSE

Source: SEBI Annual Reports 2012-13

A.FII in government debt long term and corporate debt long term Infra categories:

Government debt long term category was enhanced to USD 10 billion. The residual maturity requirement for investment in this category was reduced uniformly from 5 years to 3 years.
For the corporate debt long term infra category, the lock- in period for investment was uniformly reduced to one year while the residual maturity requirement at the time of first purchase was set to 15 months.
The additional limit for FIIs investment in Government debt long term category and the limit for corporate

debt long term infra category (with one year lock-in and 15 months residual maturity), were allocated through a special auction in July 2012.

B.FIIs debt investment provisions: Relaxations: SEBI has provided the facility of re-investment upto 2 years from the date of the circular or to the extent of twice the size of the debt portfolio, to those FIIs and Sub-accounts that had already acquired.

SEBI had provided the facility of reinvestment up to two years from the date of the circular or to the extent of twice the size of the debt portfolio, to those FIIs and sub-accounts that had already acquired limits and /or invested in debt in the manner prescribed in the said circular. With a view to provide operational flexibility, beginning January 01, 2014, it has been decided that the FIIs/ Sub-Accounts can re-invest during each calendar year to the extent of 50 % of their debt holdings at the end of the previous calendar year.
The time period for utilisation of the Government debt limits (for both old and long term limits) allocated through bidding process was reduced to 30 days while the time period for utilisation of the corporate debt limits (for both old and long term infra limits) allocated through bidding process shall be 60 days.
FII/sub-accounts may avail limits in the Corporate Debt Long Term Infra category without obtaining SEBI approval till the overall FII investments reaches 90%, after which the auction mechanism shall be initiated for allocation of remaining limits. SEBI will put in place a mechanism to monitor the utilisation of the limit.

C.FII Debt limits: Operational flexibility: Vide Circular dated January 01, 2013, it was announced that those FIIs/ sub-accounts which did not hold debt investments limits as on January 03, 2012 and purchased debt limits thereafter, it was decided that they shall be allowed a cumulative re-investment facility to the extent of 50% of their maximum debt holding at any point of time during the calendar year 2013.

D.FII Debt limits: Increase in limits and relaxation in lock-in and residual maturity:

An additional limit of USD 5 billion each was made available under the Government – Long Term category and Corporate Bond – Old (non infra) category respectively.
The requirement of 3 years residual maturity under the Government – Long Term category was done away with. However, FIIs cannot invest in short term papers such as treasury bills under this category.
The requirement of initial maturity of 5 years and lock-in period of 12 months under Corporate – Long Term Infra category was done away with.

E.Reporting of ODIs/ PN Activity: For streamlining the reporting of PNs/ ODIs, it was decided that the FIIs issuing ODIs/PNs shall submit details of ODI/PN transaction report along with the monthly summary report by 10th of every month for previous month's ODI transactions.

CONCLUSION

Government, SEBI and RBI have initiated several measures to attract FII. Despite global gloom, FIIs have retained their faith in Indian economy, thanks to India's robust financial structure and favourable business ecosystem. India has witnessed a surge in FII inflows in 2013 wherein foreign investors deployed USD 11.3 billion in the first four months of 2013, an increase of 31% year-on-year. Industry analysts believe that the trend would sustain for as India seems to be benefitting from the reallocation of global flows. Foreign funds drive Indian capital markets in a big way. Sensex had gained 26% on FII inflows of USD 24 billion in 2012. Foreign investors have immense faith in Indian financial markets. The fact is substantiated through statistics which shows that they pumped massive USD 10 billion in Indian markets in January-March 2013 quarter. Moreover, FIIs ownership in top 500 companies is highest at 21.2% for the January-March 2013 quarter. It increased by 1.28% in the January-March quarter alone and 2.87% in 2012-13. Moreover, value of FII inflows stood at USD 25.8 billion for the financial year ending March 2013, the second best ever. The number of registered FIIs in India stood at 1,757 in FY 2012-13 while the number of FII sub-accounts rose to 6,335, from 6,322 at the end of 2011-12. The market is likely to hit new highs in 2014, but it may not necessarily be a smooth ride getting there as India is still grappling with multiple problems as it tries to get its once red hot economy back on track. Inflation remains high, corporate investment stagnant, economic growth tepid and the Rupee vulnerable. Interest rates are likely to remain elevated as long as consumer price inflation, hovering in the double digits, isn't under control. Market regulator SEBI in the year 2013 cleared the decks for a new, simpler investment regime for foreign portfolio investment in the country. The SEBI board approved the draft SEBI Foreign Portfolio Investors (FPI) Regulations, 2013, to replace the existing two-decade-old SEBI FIIs Regulations. However, the sentiment will improve when there will be a revival in economic growth and corporate earnings improve. Experts have said though the new rules have been made simpler for foreign investors yet their sentiment may not change until the economic conditions improve. “Some thorns have been taken out but we are not offering any flowers”.

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