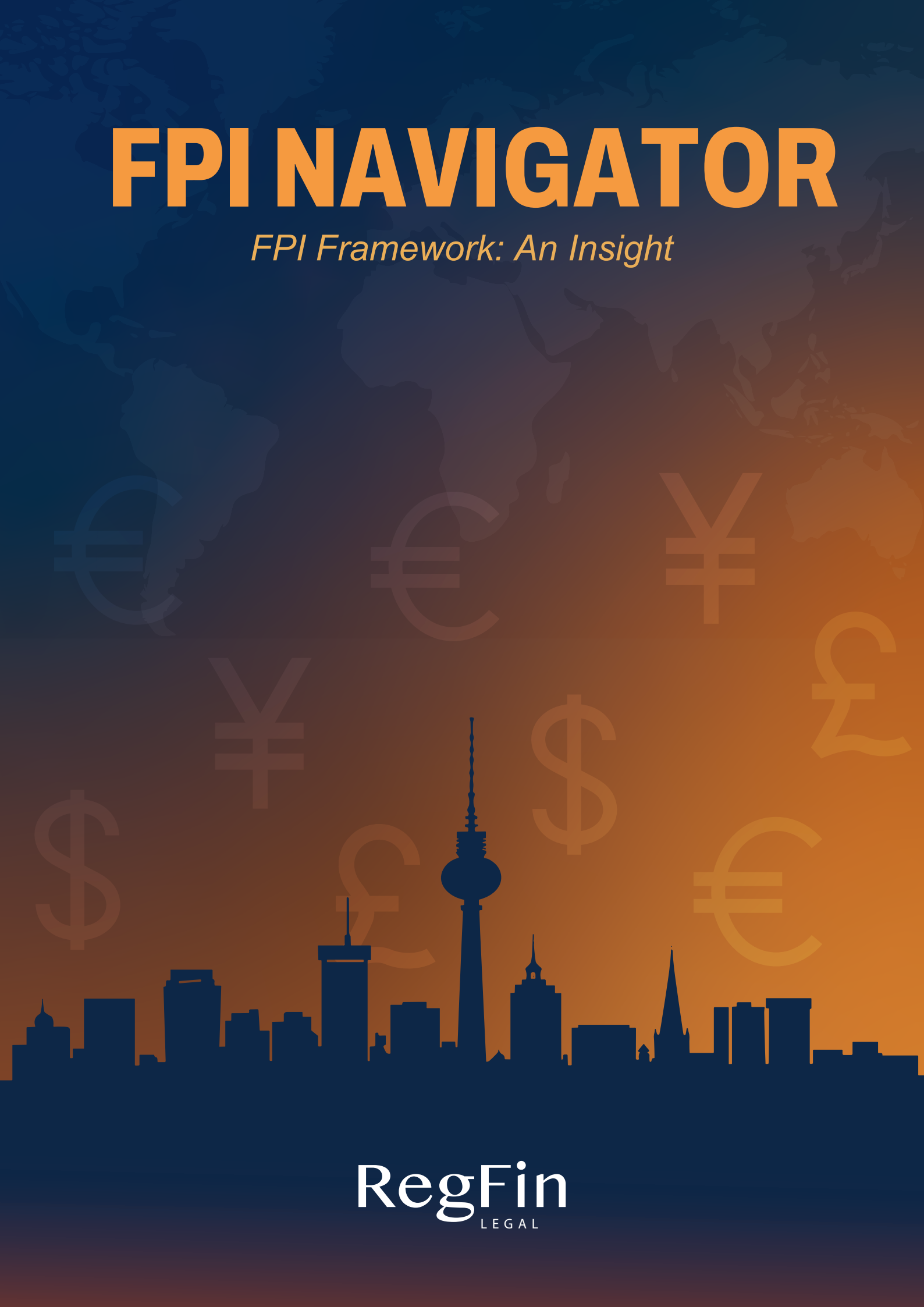


FPI NAVIGATOR

FPI Framework: An Insight



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ODIS UNPACKED: EVOLUTION OF A DYNAMIC GATEWAY TO INDIAN MARKETS

The economic liberalization reforms of 1992 marked India's transition from a tightly controlled, protectionist regime to a more open, market-oriented economy. This evolution, nudged by the balance of payments crisis of 1991, made way for the foreign capital to flow into Indian companies, including investments by Foreign Institutional Investors (“**FII**s”) (now, Foreign Portfolio Investors (“**FPI**s”)) into Indian listed securities. The mid to latter part of the 1990s saw the emergence of Offshore Derivative Instruments (“**ODIs**”), a convenient and synthetic method to become a part of India’s listed ecosystem.

In this edition, we explore the history and evolution of ODIs, examine their regulatory reception over time, and analyze the current legal framework.

HISTORY AND RECEPTION OF ODIs

The first instance of SEBI taking note of ODIs and enhancing its visibility on these instruments can be traced back to 2001 when it first mandated reporting requirements for the issuance, renewal, cancellation, and redemption of ODIs by FIIs.¹ Thereafter, in 2003, the extant SEBI (Foreign Institutional Investors) Regulations, 1995 (“**FII Regulations**”) were amended prescribing the disclosure of information concerning ODIs issued by FIIs and their sub-accounts.² In 2004, the FII Regulations were amended to add two key restrictions: first, the ODIs could only be issued/ transferred to regulated entities; and second, ODIs could only be issued/ transferred subject to compliance with KYC requirements.³

While these measures enhanced transparency, ODI route was not being perceived as a desirable mechanism for accessing India's capital markets owing to lack of anti-money laundering checks, opaque dealings, anonymity of ultimate investors and leveraged nature of exposures. Hence, in 2007, partial ban was imposed on further issuance of ODIs and a 40% cap was mandated on total assets held by FIIs under P-notes.⁴ These restrictions were, however, reversed in 2008 in the wake of the global financial crisis.⁵

Following some market stabilization, SEBI decided to revamp the reporting requirements in 2011.⁶ These changes ushered towards moving away from allowing unchecked inflows with a renewed focus on transparency and accountability.

The next major changes came in 2017, when SEBI prohibited ODIs from being issued against derivatives for speculative purposes. An exception was made for those derivative positions that were taken for hedging the equity shares held by the ODI issuers on a one-to-one basis.⁷

¹ SEBI Circular No. FITTC/CUST/14/2001, dated October 31, 2001, available at

<https://www.sebi.gov.in/legal/circulars/oct-2001/issuance-of-derivative-instruments-by-registered-foreign-institutional-investors-fii-17948.html>

² SEBI Circular No. IMD/CUST/9/2003, dated November 20, 2003, available at

<https://www.sebi.gov.in/legal/circulars/nov-2003/issuance-of-offshore-derivative-instruments-by-registered-foreign-institutional-investors-fii-15974.html>

³ SEBI Circular No. IMD/CUST/13/2004, dated February 19, 2004, available at

<https://www.sebi.gov.in/legal/circulars/feb-2004/issuance-of-offshore-derivative-instruments-by-registered-foreign-institutional-investors-fii-9575.html>

⁴ SEBI PR No. 286/2007, dated Oct 25, 2007, available at https://www.sebi.gov.in/media/press-releases/oct-2007/sebi-board-meeting_8297.html.

This came about in light of the almost “anonymous” inflows to India touching 51.6% of the total assets under custody of all FII inflows.

⁵ SEBI PR No. 202/2008, dated October 06, 2008, available at

https://www.sebi.gov.in/media/press-releases/oct-2008/pr-sebi-board-meeting_7561.html

⁶ SEBI Circular No. CIR/IMD/FIIC/1/2011, dated January 17, 2011, available at

https://www.sebi.gov.in/legal/circulars/jan-2011/reporting-of-offshore-derivative-instruments-odis-participatory-notes-pns-activity_14397.html

⁷ SEBI Circular No. CIR/IMD/FPI&C/76/2017, dated July 07, 2017, available at

https://www.sebi.gov.in/legal/circulars/jul-2017/guidelines-for-issuance-of-odis-with-derivative-as-underlying-by-the-odi-issuing-fpis_35266.html

In 2019, SEBI overhauled the FPI regime by issuance of the SEBI (Foreign Portfolio Investors) Regulations, 2019 (“**FPI Regulations**”), along with the Operational Guidelines for FPIs, DDPs and EFIs (“**Operational Guidelines**”). The Operational Guidelines, *inter alia*, reiterated the above-mentioned position by permitting FPIs to issue ODIs referencing derivatives and hedge such exposure with derivatives position, subject to them (i) having a separate FPI registration, (ii) retaining cash equity for the life of ODI, and (iii) having a short future position in the same scrip, i.e., on a one-to-one basis.

JUDICIAL JURISPRUDENCE

ODIs, traditionally, have not been able to strike a chord with the Indian regulators mainly on account of the anonymity surrounding them, and hence, much of the regulatory reforms outlined above have focussed on refining disclosure requirements for the ODI subscribers. In addition to the Parliament discussing and taking note of the steps taken by SEBI in this regard⁸, SEBI in the matter of *Societe Generale*⁹ had summarised the core compliance principles to be adhered to by ODI issuing FIIs/FPIs, viz.,

- (i) FIIs/FPIs to provide complete and correct picture of their activities, including ODI issuances, to SEBI;
- (ii) FIIs/FPIs to issue ODIs only to regulated entities; and
- (iii) FIIs/FPIs to diligently undertake KYC of the ODI subscribers.

SEBI, in its order, had noted that if an ODI is structured as a back-to-back instrument, the issuing FII/FPI must disclose the identity of the ultimate investor, with the responsibility of identifying and reporting the end beneficial owner resting entirely on the ODI issuer. SEBI also highlighted that, by their very design, ODIs limit the regulator’s ability to verify the source and nature of funds or to detect whether they are being misused for market abuse or fraudulent activities. This makes it critical that ODI issuers ensure full and transparent disclosure.

A recent SEBI settlement order further underscored the importance of strict adherence to ODI reporting standards and protocols by issuing FPIs.¹⁰

CURRENT REGIME

The FPI Regulations define an ODI to mean ‘any instrument, by whatever name called, which is issued overseas by a foreign portfolio investor against securities held by it in India, as its underlying’.¹¹ The regulations, further, prescribe eligibility criteria for ODI issuers and subscribers as follows:

- (i) ODIs to be issued only by Category I FPIs¹²; and

⁸ Lok Sabha Unstarred Question No. 1242, 22/12/2017 - <https://sansad.in/getFile/loksabhaquestions/annex/13/AU1242.pdf?source=pgals>.

Also see - Press Information Bureau, ‘Agreement with other Countries on Money Laundering Information’ dated 06/03/2018

<https://www.pib.gov.in/Pressreleaseshare.aspx?PRID=1522771>

⁹ SEBI Order - WTM/KMA/IMD/207/01/2010, available at https://www.sebi.gov.in/web/?file=/sebi_data/attachdocs/1288609309042.pdf

¹⁰ SEBI Settlement Order -SO/AB/EFD2/2022-23/7083, available at

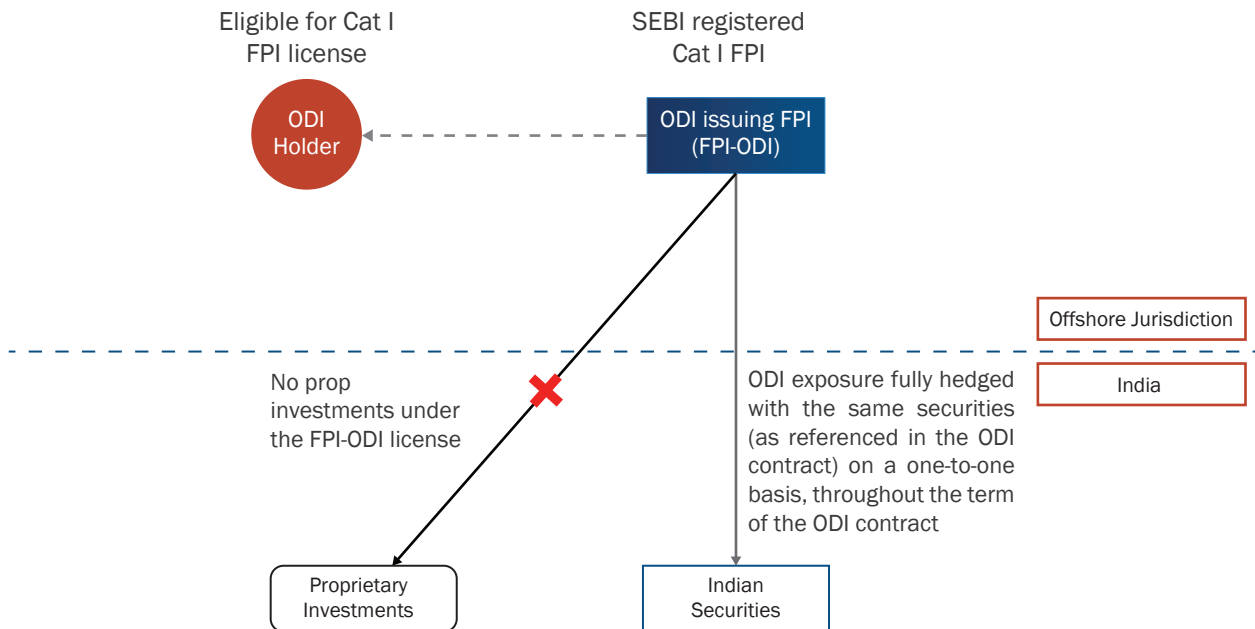
https://www.sebi.gov.in/web/?file=https://www.sebi.gov.in/sebi_data/attachdocs/sep-2023/1695203625045.pdf#page=1&zoom=page-width,-16,850

¹¹ Regulation 2(o) of the FPI Regulations.

¹² Issuance can be done only post proper KYC check, as prescribed by SEBI under the Master Circular for FPIs, DDPs and EFIs, dated May 30, 2024 (as updated from time to time), conducted on the subscriber.

- (ii) ODIs to be subscribed only by persons eligible for Category I FPI license.¹³

The structure of a standard ODI arrangement can be depicted as follows:



Note: The structure shown above is a simplified illustration for conceptual understanding only and does not reflect a formal structuring position / advice.

In December last year, SEBI issued a circular¹⁴ introducing certain modifications to the ODI framework for addressing existing regulatory arbitrage. The key changes announced were:

- (i) FPIs to have a separate dedicated registration for ODI issuances, with the name of the FPI being in the format “X-ODI”, where ‘X’ is the name of the FPI. Further, proprietary investments to be allowed through a separate registration, with PAN of both the FPIs being the same.

An exception to the above rule is for an FPI which issues ODIs with only G-Secs as underlying securities.

The above position differs from earlier view of requiring the FPIs to maintain their non-derivative proprietary investments / ODI hedge investments and proprietary derivative investments under separate licenses.

- (ii) FPIs neither be permitted to issue ODIs referencing derivatives nor hedging their ODI exposure with derivatives. Moreover, FPI’s ODI exposure should be completely hedged with the same Indian scrip on a one-to-one basis throughout the ODI term.

¹³ An ODI issuing FPI is required to collect SEBI prescribed regulatory fee from every ODI subscriber and deposit the same with SEBI (Regulation 21(4) of the FPI Regulations).

¹⁴ SEBI Circular SEBI/HO/AFD/AFD-POD-3/P/CIR/2024/176, dated December 17, 2024, available at https://www.sebi.gov.in/web/?file=https://www.sebi.gov.in/sebi_data/attachdocs/dec-2024/1734433925581.pdf#page=1&zoom=page-width,-15,842

The above-mentioned amendments were brought into force on the date of the circular, i.e., December 17, 2024. However, a 1-year period was provided to the existing (non-compliant) structures to align themselves with the new regulatory prescriptions.

- (iii) Extending granular disclosure requirements to ODI subscribers, covering both their direct and indirect positions—whether individually or at an investor group level. These requirements were aligned with the triggers, cure periods, disclosure mechanics, and exemptions already laid out under SEBI’s August 24, 2023 circular (and subsequent amendments) for FPIs.

The compliance timeline provided initially was 5 months which was further extended by SEBI in May this year to November 17, 2025¹⁵.

CONCLUSION

With the recent circulars aligning ODI reporting obligations with the broader FPI disclosure regime, it is clear that SEBI’s approach is to gradually reduce regulatory arbitrage while ensuring that ODIs remain an accessible but controlled channel of foreign participation in Indian markets. The comfort level of issuers and subscribers with the December 2024 circular will likely determine the long-term relevance of ODIs as an instrument of choice for foreign investors. Today, their existence appears to hinge less on convenience and more on the compliance frameworks around them.

¹⁵ SEBI Circular SEBI/HO/AFD/AFD-POD-3/P/CIR/2025/71, dated May 16, 2025, available at https://www.sebi.gov.in/web/?file=https://www.sebi.gov.in/sebi_data/attachdocs/may-2025/1747387829929.pdf#page=1&zoom=page-width,-15,842



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