

Reforms in FPI Investment and G-Sec Market, Need, Key Details

June 8, 2026 • vajiramandravi.com



Why in the News? : The Government has introduced a series of reforms to increase Foreign Portfolio Investor (FPI) participation in Government Securities (G-Secs), including tax exemptions, expansion of the Fully Accessible Route (FAR), and simplification of investment norms. These measures aim to deepen India's bond market and attract stable long-term foreign capital.

Need of the Reforms in FPI Investment and G-Sec Market

With India aspiring to become a major global investment destination, reforms in **FPI investment** and the **Government Securities (G-Sec)** market are essential to deepen **capital markets**, attract stable foreign capital, and support the country's long-term development requirements.

- **Attracting Stable Foreign Capital:** Reforms are needed to encourage long-term and predictable foreign investments rather than short-term speculative capital flows.
- **Deepening the Government Securities Market:** Greater FPI participation is required to increase the depth, size, and efficiency of the G-Sec market.

- **Diversifying the Investor Base:** A broader mix of domestic and foreign investors reduces excessive dependence on traditional institutional investors and strengthens market stability.
- **Improving Market Liquidity:** Higher participation by foreign investors increases trading activity and liquidity in Government Securities across different maturities.
- **Enhancing Price Discovery:** A larger and more diverse investor base leads to more efficient market-based pricing of sovereign debt instruments.
- **Reducing Government Borrowing Costs:** Increased demand for Government Securities can lower borrowing costs and improve fiscal efficiency.
- **Strengthening Debt Market Development:** Reforms are necessary to build a mature bond market capable of supporting India's growing financing needs.
- **Attracting Long-Term Institutional Investors:** India needs to attract pension funds, insurance companies, and sovereign wealth funds that typically provide stable and sustained capital inflows.
- **Boosting Foreign Exchange Inflows:** Higher foreign investment in **sovereign debt** contributes to stronger external sector stability and foreign exchange reserves.
- **Enhancing Financial Market Resilience:** A diversified investor base strengthens the ability of financial markets to absorb shocks and withstand volatility.
- **Facilitating Global Market Integration:** Reforms are required to align India's debt market framework with global standards and improve integration with international financial markets.
- **Supporting Inclusion in Global Bond Indices:** Simplified investment norms and improved market access can increase the representation of Indian bonds in major global bond indices, attracting additional foreign capital.
- **Providing a Seamless Investment Experience:** Rationalised regulations and simplified procedures reduce operational complexities and make India a more attractive destination for global investors.

Tax Reforms for FPIs Investing in Government Securities

Recognising that taxation plays a crucial role in investment decisions, the Government has introduced a favourable tax regime for FPIs investing in Government Securities.

Earlier Tax Regime: Prior to the latest reform, Foreign Institutional Investors (FIIs), including SEBI-registered Foreign Portfolio Investors (FPIs), were taxed under Section 210 of the Income-tax Act, 2025 on income earned from investments in Government Securities.

- Interest income earned by FIIs and FPIs from Government Securities was taxed at 20%, reducing the effective returns available to investors.
- Short-Term Capital Gains (STCG) arising from the sale of Government Securities were taxed at 30%, depending upon the nature of the transaction.
- Long-Term Capital Gains (LTCG) earned from Government Securities were taxed at 12.5%.

Consequently, a portion of the returns generated from holding or trading Government Securities was payable as tax in India, reducing the overall attractiveness of Indian sovereign debt.

New Tax Regime: To create a more competitive tax framework and attract greater foreign investment into the debt market, the Government has introduced a comprehensive tax exemption for FIIs and FPIs investing in Government Securities.

- **Interest income earned by FIIs and FPIs from Government Securities** has been **fully exempted from taxation**.
- **Capital gains** arising from the sale, transfer, exchange, or redemption of Government Securities **have also been fully exempted from taxation**.
- The exemption will apply to income arising **on or after 1 April 2026**.
- The Income-tax (Amendment) Ordinance, 2026 has inserted specific provisions granting these exemptions to foreign investors investing in Government Securities.

Classification of Capital Gains

The tax treatment of capital gains depends upon the holding period of the Government Security.

Long-Term Capital Gains (LTCG):

- Long-Term Capital Gains arise when a listed Government Security is held for **more than 12 months** before its transfer or sale.
- Long-Term Capital Gains arise when an unlisted Government Security is held for **more than 24 months** before its transfer or sale.

Short-Term Capital Gains (STCG):

- Short-Term Capital Gains arise when a listed Government Security is held for **up to 12 months** before its transfer or sale.
- Short-Term Capital Gains arise when an unlisted Government Security is held for **up to 24 months** before its transfer or sale.

Significance of the Tax Reform

- The exemption significantly improves post-tax returns for foreign investors and enhances the attractiveness of Indian Government Securities.
- The reform is expected to attract long-term institutional investors such as pension funds, insurance companies, and sovereign wealth funds that seek stable and tax-efficient investment opportunities.
- Higher foreign participation can deepen the Government Securities market, improve liquidity, strengthen price discovery, and support the development of a robust sovereign bond market.
- The measure aligns India's tax framework more closely with global best practices and strengthens its position as a preferred destination for international capital.

G-Sec Market Reforms

Foreign Portfolio Investors (FPIs) can invest in Indian Government Securities (G-Secs) through two routes:

- The **General Route**, which permits investment subject to specified limits and restrictions.

- The **Fully Accessible Route (FAR)**, which allows investment in designated securities without the restrictions applicable under the General Route.

As of 12 May 2026, FPIs held Government Securities worth ₹3.75 lakh crore, accounting for 3.34% of the total outstanding G-Sec stock of ₹112.42 lakh crore. The majority of these investments were made through the FAR, where FPI holdings stood at ₹3.21 lakh crore, representing 6.74% of the ₹47.63 lakh crore outstanding FAR-eligible stock. In contrast, investments through the General Route amounted to only ₹54,091 crore, accounting for 0.83% of the eligible stock, highlighting the greater attractiveness of the FAR framework.

Expansion of the Fully Accessible Route (FAR)

Recognising strong investor preference for the FAR framework, the **Government has expanded the list of securities eligible for investment under this route.**

- The **FAR framework has been extended to include new issuances of 15-year Government Securities**, thereby expanding investment opportunities in medium- and long-term sovereign debt instruments.
- The **FAR framework now includes new issuances of 30-year Government Securities**, thereby attracting long-term institutional investors seeking stable returns.
- The FAR framework has **also been expanded to include new issuances of 40-year Government Securities**, thereby broadening investment opportunities across the maturity spectrum.
- **Sovereign Green Bonds (SGrBs)** issued in FAR-eligible tenors have been brought under the **FAR framework**, thereby encouraging participation from ESG-focused and climate-conscious investors.

The expansion of FAR is expected to increase foreign participation in long-duration sovereign debt instruments and deepen the Government Securities market.

Relaxation of Investment Restrictions under the General Route

To facilitate greater participation by foreign investors, the Government has simplified the investment framework under the General Route.

- The **short-term investment limit has been removed**, thereby providing greater flexibility in portfolio allocation and investment decisions.
- The **concentration limit has been removed**, thereby allowing investors to allocate capital more efficiently across Government Securities.
- The **security-wise investment limit has been removed**, thereby reducing regulatory restrictions and improving ease of investment.
- The **existing 'General' and 'Long-Term' categories for FPI investments have been merged into a single investment limit** structure for Government Securities and State Government Securities, thereby simplifying compliance requirements.
- The **overall investment ceiling for Central Government Securities remains unchanged at 6% of the outstanding stock**, ensuring prudent management of foreign participation.

- The **overall investment ceiling for State Government Securities (SGSs) remains unchanged at 2% of the outstanding stock**, balancing market access with financial stability considerations.

Significance of the Reforms

- The expansion of FAR and relaxation of investment restrictions will make **India's sovereign debt market more accessible and attractive to global investors.**
- The reforms will **broaden the investor base** by attracting pension funds, insurance companies, sovereign wealth funds, and other long-term institutional investors.
- Greater foreign participation will **improve market liquidity, strengthen price discovery, and contribute to the development of a smoother sovereign yield curve.**
- The measures will support **deeper integration of India's bond market with global financial markets** and enhance prospects for greater inclusion in international bond indices.

Source: <https://vajiramandravi.com/current-affairs/reforms-in-fpi-investment-and-g-sec-market/>

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