



OFFSHORE MANIPULATION AND CROSS-BORDER INVESTMENTS: GAPS IN SEBI-FEMA OVERSIGHT OF INDIAN CAPITAL MARKETS

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ABSTRACT

India's integration into global financial systems has led to a sharp increase in cross-border investment activity, generating both economic opportunities and complex regulatory challenges. Oversight of such flows primarily rests with the Securities and Exchange Board of India (SEBI) and the Reserve Bank of India, acting under the Foreign Exchange Management Act (FEMA). Yet, the rise of multi-layered offshore vehicles, participatory notes, and indirect investment channels has revealed critical regulatory blind spots. These gaps can enable concealment of beneficial ownership, evasion of disclosure norms, and avenues for potential market abuse. This paper undertakes a detailed examination of the interaction between SEBI's market governance role and FEMA's foreign investment framework, pinpointing areas where jurisdictional boundaries blur and enforcement becomes fragmented. Drawing on recent cases and policy developments, the analysis evaluates the present regime's capacity to address offshore complexities. The study recommends a coordinated, supervisory approach, supported by stronger inter-agency cooperation, stricter transparency requirements, and targeted statutory reforms. Such measures, it is argued, are essential for protecting market integrity while ensuring that legitimate foreign investment continues to find a stable and transparent entry into India's capital markets.

Keywords: Offshore Investments, Market Manipulation, Cross-Border Capital Flows, Regulatory Framework.

INTRODUCTION

Cross-border investments are a central feature of the global economy, facilitating the transfer of capital, technology, and expertise across nations. In the Indian context, these investments

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occur primarily in two forms: Foreign Direct Investment (FDI), where the investor acquires a lasting interest and a measure of control in a business entity, and Foreign Portfolio Investment (FPI), which refers to passive holdings in securities without managerial influence. While both FDI and FPI contribute to economic development, they differ in terms of investment horizon, risk exposure, and regulatory treatment.

India regulates these inflows through a dual framework. The Foreign Exchange Management Act 1999 (FEMA) provides the legal basis for the Reserve Bank of India to manage cross-border capital transactions and foreign exchange, ensuring they align with national economic policy and balance-of-payments stability. Alongside this, the Securities and Exchange Board of India Act 1992 establishes SEBI as the principal authority overseeing securities markets, tasked with investor protection, market development, and the prevention of unfair trade practices. Together, these statutes form the backbone of India's capital market governance.

In recent decades, India's attractiveness to global investors has grown significantly, driven by its large domestic market, sustained GDP growth, and liberalisation of investment norms. FDI inflows have financed infrastructure, manufacturing, and sector expansion in the service industry, while FPI has enhanced market liquidity and broadened the investor base. However, with increased openness comes heightened vulnerability to complex financial manoeuvres. Offshore investment routes, such as layered corporate structures and participatory instruments, have in some cases been used to mask beneficial ownership, bypass disclosure requirements, and manipulate market dynamics.

These developments highlight the regulatory challenge of striking a balance between investment promotion and market integrity. Jurisdictional overlaps between FEMA and SEBI regulations can lead to enforcement delays and gaps, especially in cases involving overseas entities and multi-jurisdictional transactions. Strengthening coordination between the RBI and SEBI, improving transparency requirements, and developing risk-based monitoring mechanisms are therefore essential to sustaining India's credibility as a safe yet attractive investment destination.

The Adani–Hindenburg case of 2023 highlighted the risks of these loopholes. Allegations of undisclosed offshore shareholdings and regulatory arbitrage led SEBI to investigate Mauritius-based funds holding significant Adani stakes. In 2025, SEBI threatened penalties, including cancellation of licenses, for non-compliant offshore funds that failed to disclose beneficial

ownership.¹ These events highlight the persistent flaws in India's dual supervision system, where the efficiency of enforcement is constrained by a lack of cooperation between SEBI and FEMA authorities.

OFFSHORE INVESTMENT STRUCTURES: RISKS OF MARKET MANIPULATION AND TRANSPARENCY ISSUES

For India's capital markets, offshore investment arrangements have always been a double-edged sword. Although they make it easier for foreign capital to enter the country, they can also be abused to hide investors' true identities and manipulate market behaviour in ways that undermine transparency.

Two Mauritius-based investors with close relations to the Adani family allegedly channelled huge funds into Adani Group shares, according to a 2023 BBC article based on the Organised Crime and Corruption Reporting Project OCCRP investigation. This raised worries that they used as fronts to evade disclosure regulations and conceal beneficial ownership.² The case demonstrates how offshore structures can be used to conceal promoter control and erode market transparency, even though Adani refuted the accusations.

Participatory Notes (P-Notes) exemplify how offshore investment instruments can facilitate market manipulation while evading effective regulatory scrutiny. As observed in the Joint Parliamentary Committee (JPC) report, “P-Notes are derivative instruments issued against underlying security of investments in shares,” and serve as a mechanism for pooling funds from multiple investors to mirror equity returns.³ These instruments operate entirely outside Indian jurisdiction: their issuance occurs offshore, as “transactions between two non-residents,” placing them beyond SEBI’s regulatory purview. This extraterritorial nature not only limits SEBI’s oversight but also enables anonymous, high-volume foreign inflows, raising serious concerns around opacity, round-tripping, and potential abuse of market mechanisms.

¹ ‘India threatens two offshore funds holding Adani shares with penalties’, document shows Reuters (19 May 2025) <https://www.reuters.com/sustainability/boards-policy-regulation/india-threatens-two-offshore-funds-holding-adani-shares-with-penalties-document-2025-05-19/> accessed 18 August 2025.

² BBC news, ‘India’s Adani group stung by fresh controversy’, (31 August 2023) <https://www.bbc.com/news/world-asia-india-66643833> accessed 18 August 2025.

³ TaxIndiaInternational, ‘Participatory Notes are derivative instruments issued against underlying security of investments in shares. PNs are extra territorial instruments and SEBI has no regulatory jurisdiction over them’ (para 8.67 of the JPC report) <https://taxindiainternational.com/printContent.php?qwer43fcxzt=MjI3&flag=2> accessed 18 August 2025.

Who is a Beneficial Owner?

A beneficial owner is the natural person who ultimately owns, controls, or benefits from an investment, even if the investment is held in another person's name (like a nominee, trust, or layered corporate structure). In the Indian context, SEBI defines a BO under the Foreign Portfolio Investor (FPI) Regulations, 2019.⁴ By reference to the Prevention of Money Laundering (Maintenance of Records) Rules 2005, which set thresholds (10% ownership for companies, 15% for trusts, etc.).⁵ The aim is to “look through” multi-layered structures to identify the real human being who controls the investment.

What are Participatory Notes (P-Notes)?

Participatory Notes (P-Notes) are financial instruments issued by registered Foreign Portfolio Investors (FPIs) to overseas investors who are not themselves registered with SEBI, thereby allowing them indirect exposure to Indian securities.⁶ Functionally, they operate as derivative contracts: the FPI directly holds the underlying Indian securities, while issuing a note to the foreign client that mirrors the return on those securities. P-Notes rose in popularity because they provided an easy entry route into Indian markets without requiring regulatory registration. However, both SEBI and the Reserve Bank of India (RBI) have repeatedly flagged concerns over their opacity, since the ultimate investor behind the P-Note may remain undisclosed, creating risks of round-tripping, money laundering, and tax evasion.

What are Offshore Derivative Investments (ODI)?

ODIs are a broader category of derivative contracts issued by FPIs to overseas investors, and P-Notes are the most common type of ODI. They allow foreign investors to take positions in Indian stocks, indices, or debt instruments without being directly registered in India. ODIs can be structured to mimic not only equities but also derivatives, such as futures, swaps, or options. SEBI has repeatedly revised ODI rules, e.g., banning ODIs with derivative underlying unless

⁴ Securities and Exchange Board of India, *SEBI (Foreign Portfolio Investors) Regulations, 2019* r 22 (as published in Gazette) <https://www.pwc.com/mu/SEBI-FPI-Regulations.pdf> accessed 18 August 2025.

⁵ ‘Clients Due Diligence’ Rule 9 PMLA (Maintenance of Records) Rules, 2005 https://indiankanoon.org/doc/120437008/?utm_source accessed 18 August 2025.

⁶ Risevestors Team, ‘What is a Participatory Note in the Stock Market? Understanding P-Notes’ (Risevestors Blog, 28 October 2024) <https://www.risevestors.com/blogs/what-is-a-participatory-note-in-the-stock-market-understanding-pnotes> accessed 18 August 2025.

hedged, requiring stricter BO disclosures, and mandating dedicated FPI registration for ODI issuers (2024 reforms).⁷

COMPARATIVE TABLE

Aspect	Participatory Notes	Offshore Derivative Instruments	Layered Corporate Structures
Definition	P-notes are contracts that are issued by registered FPIs to overseas investors, giving exposure to Indian equities (shares) without direct SEBI registration.	Broad class of derivative instruments issued by FPIs to overseas investors; includes P-Notes, swaps, debt-linked notes, and other synthetic instruments.	Multi-jurisdictional ownership chains (companies, trusts, LLPs) are used to hold investments indirectly, often through offshore tax havens.
Purpose	Quick entry for foreign investors who are not SEBI-registered.	Provide synthetic exposure to the Indian equity, debt, or derivatives segment. Useful for risk management (hedging).	Useful for Tax optimisation (DTAA benefits), Asset protection, and Cross-border structuring for MNCs.
Risks	Potential risk for round-tripping, money laundering, or tax evasion.	It includes derivative exposures, leading to risk of leverage and synthetic	Undisclosed ownership can be used to bypass disclosure thresholds under SEBI

⁷ Securities and Exchange Board of India, 'Measures to address regulatory arbitrage with respect to Offshore Derivative Instruments (ODIs) and FPIs with segregated portfolios vis-à-vis FPIs' (Circular, 17 December 2024) https://www.sebi.gov.in/legal/circulars/dec-2024/measures-to-address-regulatory-arbitrage-with-respect-to-offshore-derivative-instruments-odis-and-fpis-with-segregated-portfolios-vis-vis-fpis_89986.html accessed 18 August 2025.

		positions. Also, it can bypass FPI norms	takeover and insider trading rules. It can also favour market manipulations through hidden holdings.
Regulatory Response	SEBI tightened rules since 2007, and now requires detailed disclosure by issuers and subscribers.	Dec 2024 SEBI circular banned ODIs backed by derivatives (except for hedged exposures) and now requires separate FPI registration for ODI issuers.	SEBI requires BO disclosures under FPI Regulations 2019. RBI & FEMA rules monitor capital inflows
Instances	Heavy use in the early 2000s until the SEBI crackdown; volumes reduced but not eliminated.	Target of SEBI's 2024 reforms to curb arbitrage and opacity.	Prominent in the Adani–Hindenburg case , Mauritius-based funds with complex layers allegedly obscured true investors. ⁸

GAPS BETWEEN SEBI AND FEMA REGULATIONS

Absence of Consistent Beneficial Ownership Standards: SEBI's FPI regulations require that ultimate beneficial owners (UBOs) be disclosed in detail for compliance and anti-money laundering (AML) purposes, particularly for big FPIs. But FEMA (via PMLA Rule 9) employs distinct definitions and standards, enabling multilayer offshore buildings to mask true ownership.⁹ Regulatory arbitrage is made easier by the mismatch.

Inadequate Enforcement and Fragmented Authority: SEBI keeps an eye on secondary market activity but does not have access to information on foreign ownership. While offshore

⁸ 'Business partners of India's Adani family used offshore funds to invest in its stocks, report says' Reuters (31 August 2023) <https://www.reuters.com/world/india/business-partners-indias-adani-family-used-opaque-funds-invest-its-stocks-media-2023-08-30/> accessed 18 August 2025.

⁹ PMLA Rules 2005, r 9 (n 5).

commerce is unregulated by FEMA, inbound capital is. Due to multilayer offshore interests that were beyond its direct reach, SEBI investigations stagnated in cases like Adani–Hindenburg (2023).¹⁰

Policy disconnects: FEMA's regulations have not always kept up with SEBI's stricter ODI and P-Note standards (see below), which has resulted in inconsistent enforcement and compliance difficulties for FPIs.

India's economy suffered from these variations in several ways:

- **Market opacity:** Investor trust and market transparency are undermined by secretive promoters and offshore fund arrangements.
- **Regulatory arbitrage:** Skilled operators undermine domestic regulation by taking advantage of dual-jurisdictional loopholes.
- **Macropprudential risk:** As demonstrated by past P-Note cycles, unanticipated inflows and abrupt outflows have the potential to destabilise capital markets and the whole economy.

RISKS ASSOCIATED WITH GAPS IN SEBI-FEMA REGULATIONS

India's capital markets are at serious risk due to the lack of smooth coordination between the Reserve Bank of India (RBI) under the Foreign Exchange Management Act (FEMA), 1999, and the Securities and Exchange Board of India (SEBI) under the Foreign Portfolio Investors (FPI) Regulations, 2019. Round-tripping of funds, in which Indian monies are illegally transferred through offshore jurisdictions like Singapore, Mauritius, or the Cayman Islands and then reinvested in India under the pretence of foreign portfolio investment, is one of the most urgent issues. In contrast to FEMA, which oversees cross-border flows but lacks procedures to identify the ultimate beneficial owner (UBO), SEBI supervises FPIs and mandates disclosures, but it mostly depends on statements made by intermediaries. Contrarily, FEMA regulates cross-border flows but does not have any systems in place to determine who the ultimate beneficial owner (UBO) is. Under the pretence of legal inflows, promoters might recycle unexplained riches or boost share prices thanks to this regulatory vacuum.¹¹

¹⁰ Reuters (n 1).

¹¹ SEBI (Foreign Portfolio Investors) Regulations 2019 (n 4).

The risk of money laundering is closely related to this. Illegal funds can enter Indian markets through presumably legal channels because of offshore derivative instruments (ODIs) and multi-layer corporate structures. Although beneficial ownership disclosure is required by SEBI (Regulation 22 of the FPI Regulations, 2019), custodians and intermediaries must self-report for this requirement to be enforced.¹² The FEMA notifications issued by the RBI keep an eye on foreign exchange transactions, but they don't offer a standardised system for tracking opaque fund structures. Because of this, financial crime organisations or politically exposed persons (PEPs) can use these loopholes to "clean" dirty money through offshore investment vehicles, compromising the integrity of Indian markets and putting India under scrutiny from international organisations like the Financial Action Task Force (FATF).¹³

Treaty shopping and tax avoidance are further dimensions. In the past, investors have taken advantage of favourable terms in Double Taxation Avoidance Agreements (DTAs) with nations like Singapore and Mauritius, costing India money. While FEMA regulations allow inflows through the automatic method without examining whether the structuring is purely for tax minimisation, SEBI controls access into securities markets but lacks jurisdiction over tax treaties. As a result, international investors might avoid paying capital gains tax, which would level the playing field and weaken India's tax base.¹⁴

Price rigging and market manipulation are also made easier by the regulatory disjunction. In order to dodge the disclosure thresholds required by SEBI under the takeover and insider trading legislation, offshore funds frequently divide their interests across many jurisdictions.¹⁵ Consolidated ownership across companies is not monitored by FEMA at this time. Unchecked market volatility and artificial stock price inflation are made possible by this lack of integration. The story with Adani and Hindenburg serves as a clear reminder: There are concerns regarding unreported beneficial ownership and market concentration when it was alleged that funds

¹² Ibid reg 22.

¹³ Financial Action Task Force (FATF), *Mutual Evaluation Report of India* (2023) <https://www.fatf-gafi.org/content/dam/fatf-gafi/mer/Executive-Summary-MER%20India%202024.pdf.coredownload.inline.pdf> accessed 18 August 2025.

¹⁴ Foreign Exchange Management Act 1999 (Act No. 42 of 1999, India), https://www.indiacode.nic.in/bitstream/123456789/1988/1/A1999_42.pdf accessed 18 August 2025.

¹⁵ Securities and Exchange Board of India, *SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011* (as amended 17 May 2024) <https://www.sebi.gov.in/legal/regulations/may-2024/securities-and-exchange-board-of-india-substantial-acquisition-of-shares-and-takeovers-regulations-2011-last-amended-on-may-17-2024-69218.html> accessed 18 August 2025.

domiciled in Mauritius concealed genuine ownership while amassing sizeable shares in Adani group companies.¹⁶

Lastly, there is a significant reputational risk for India. If oversight shortcomings persist, India would be seen as a financial manipulation-prone nation, which could draw closer FATF inspection and turn off legitimate investors. The government's objective of making India a global financial centre may be jeopardised if this view results in capital outflows, higher borrowing costs, and sovereign rating downgrades.

ILLUSTRATIVE CASES AND SEBI'S REGULATORY RESPONSE

Adani–Hindenburg Offshore Shareholdings: According to the investigative report in the Hindenburg Research and Adani Group incident from 2023–2025, offshore funds, more especially, the Vespera Fund and the Elara India Opportunities Fund, both based in Mauritius, may have contributed to the inflated stock prices of Adani by means of structured offshore holdings. Because of their concentrated holdings in Adani companies, SEBI requested that these investors, who are registered as Foreign Portfolio Investors (FPIs), submit detailed shareholder reports. Despite repeated requests since 2023, they failed to comply, impeding SEBI's probe into the Adani Group's adherence to minimum public shareholding norms. In May 2025, SEBI warned these funds of possible penalties and license cancellation.¹⁷

Jane Street Derivatives Market Manipulation: SEBI acted against Jane Street, a U.S. trading company, between 2023 and 2025 for allegedly manipulating the Bank Nifty index using expiry day trading techniques. The regulator froze over USD 567 million, termed "illegal gains," and prohibited Jane Street from trading in India. After collecting a lot of information from exchanges, SEBI finally allowed them to start trading again after an escrow deposit, but with restrictions, such as not trading index options until their justification was approved. Subsequent reform proposals include algorithmic trading integration into broker rules and restructuring equity indices to deter index-level manipulation.¹⁸

¹⁶ *Reuters* (n 8).

¹⁷ *Reuters* (n 1).

¹⁸ 'How India struggled to regulate Jane Street's money-spinning machine' *Reuters* (14 August 2025) <https://www.reuters.com/sustainability/boards-policy-regulation/how-india-struggled-regulate-jane-streets-money-spinning-machine-2025-08-14/> accessed 18 August 2025.

SUGGESTIONS

Bring the RBI and SEBI Together: The fact that SEBI and the RBI frequently operate independently is one of the main issues. While the RBI examines foreign exchange and capital inflows under FEMA, SEBI is primarily focused on investor protection, market fairness, and disclosure regulations. This division causes offshore monies to occasionally fall between the cracks. Consider the Adani-Hindenburg incident. Large stakes were held by a number of Mauritius-based funds, although it was difficult to identify who owned them. FEMA permitted inflows without thoroughly investigating the final source of the cash, despite SEBI's disclosure regulations. Manipulation was possible because of this "regulatory loophole." SEBI and RBI need to collaborate as a single unit. A joint supervision cell with access to the same data ought to be established. To ensure that no one can take advantage of gaps by pitting one regulator against another, all foreign portfolio investors (FPIs) entering India should be subject to scrutiny from both the market and forex regulations.

Transparency in Beneficial Ownership: Beneficial owners, the actual people who hold an investment, must currently disclose their information to SEBI. However, the 25% ownership barrier is predetermined, making it simple to go around. By distributing ownership among several shell corporations, the same interests hold significant holdings, but no one ever crosses that line. As advised by global watchdogs such as the Financial Action Task Force (FATF), the threshold should be lowered to 10%. More significantly, SEBI ought to implement a "look-through" rule, which requires investors to identify the ultimate owner regardless of the number of offshore layers. To put it briefly, regulators need to know whose money is coming into Indian markets. SEBI should have the authority to suspend an FPI's trading license if it refuses to cooperate.

Close the Gaps Regarding ODIs and P-Notes: Foreign investors can wager on Indian markets using Participatory Notes (P-Notes) and Offshore Derivative Instruments (ODIs) without having to register with SEBI directly. They increase liquidity, but they also make it possible for money to enter anonymously. Although SEBI has previously attempted to crack down, these tools continue to reappear in various forms. Some investors still use them for round-tripping, which is the practice of moving Indian money overseas and returning it under the guise of foreign investment, even after limitations have been put in place.

Prevent Money Laundering and Round-Tripping: Round-tripping is another serious problem. To take advantage of tax treaties or to make black money appear legitimate, Indian businesses and individuals have been reinvesting their money in India after moving it abroad and storing it in tax havens for years. Establishing a Central Beneficial Ownership Registry, a public database that reveals who owns what, akin to the UK's Persons with Significant Control register, would be a wise first move in this regard. In order to trace suspicious funds internationally, India should also collaborate more with international authorities and organisations such as the International Organisation of Securities Commissions (IOSCO). Since the majority of these shell corporations are headquartered in Singapore, Mauritius, and the Cayman Islands, international collaboration is essential.

Enhance SEBI's Enforcement Capabilities and Technology: The Jane Street case, in which high-frequency transactions and expiry-day trading tactics caused concerns, demonstrated that SEBI's surveillance capabilities are still lagging behind international standards. Today, buying and selling stocks in bulk is not the only technique to manipulate the market. It is frequently concealed in milliseconds of trade, derivatives, and algorithms. Regulators have already made significant investments in tech-driven monitoring in the US (SEC) and the UK (FCA). AI-based monitoring systems that can quickly identify anomalous trends must be implemented by SEBI. At the same time, SEBI should have a specific Market Integrity Division that handles algorithmic trading and offshore manipulations, supported by a team of data scientists and legal professionals.

CONCLUSION

India stands at a critical juncture in its journey to become a truly globalised capital market. Foreign investments are crucial for growth and liquidity, but they also present a number of difficulties when control is dispersed, as demonstrated by the Adani–Hindenburg and Jane Street cases. Opportunities for market manipulation, money laundering, and round-tripping have been created by the disclosure of discrepancies between FEMA's foreign exchange regulations and SEBI's regulatory mission due to offshore structures, stacked ownerships, and opaque derivative products. Risks are complex. First, there is systemic financial risk: if big positions are suddenly liquidated, secretive offshore movements have the potential to cause market shocks by manipulating prices and causing volatility. Second, there is a risk to investor confidence. Trust in India's financial system may be damaged if domestic institutional players and retail investors are reluctant to enter markets they believe are controlled by unseen foreign

firms. Third, there is a compromise in budgetary integrity. Tax evasion can be facilitated by round-tripping and multilayer business structures, which deny the government funds that are essential for development.

The SEBI FPI Regulations 2019, FEMA reforms, and recent ODI restrictions of 2024, however, show that India is working in the right direction. Crackdowns on P-Notes and stricter surveillance rules signal a commitment to enhancing transparency and preventing abusive practices. SEBI's use of advanced surveillance technologies, algorithmic trading monitoring, and penalties for non-disclosure shows that India can respond decisively when offshore manipulations are detected. These challenges also present an opportunity for India to modernise and strengthen its regulatory framework.

India needs to take a comprehensive approach going forward. Mandatory beneficial ownership declaration, improved SEBI-RBI joint oversight, the phase-out of anonymous instruments like P-Notes and unhedged ODIs, and standardising surveillance procedures are important steps. A sustainable market is built on a foundation of openness, prompt reporting, and strong enforcement, according to lessons learned from the US and the UK. To create a system that is both fraud-resistant and investor-friendly, India should integrate these international best practices with its unique circumstances.

Crucially, regulatory measures aim to rebuild confidence rather than only address technical issues. Investors, both domestic and foreign, are more inclined to make confident investments in India if they believe that the market is transparent, accountable, and controlled. On the other hand, inaction or mediocre actions run the risk of sustaining grey areas that could be used for money laundering, tax evasion, or market manipulation, which would hinder long-term economic expansion. The capital markets in India have enormous potential, but they will only flourish if the flow of foreign investment is both restricted and encouraged. India can establish a transparent, egalitarian, and resilient market environment by bridging the supervisory gaps between SEBI and FEMA, implementing stringent disclosure regulations, utilising technology for surveillance, and taking inspiration from its international counterparts.

Ultimately, the goal is clear: embrace global capital while ensuring domestic stability. India must continue to welcome foreign investors, but based on clarity, compliance, and fairness. A transparent, well-regulated market will not only attract genuine long-term investments but also

strengthen domestic investor confidence, protect national economic interests, and secure India's place as a credible global financial hub.