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NEW FOREIGN INVESTMENT REGIME – ADDITIONAL CLARIFICATIONS

6 December 2019

The Central Government, vide notification dated 17 October 2019 had notified the Foreign Exchange Management (Non-debt Instruments) Rules, 2019 (NDI Rules) in supersession of the Foreign Exchange Management (Transfer and Issue of Security by a Person Resident outside India) Regulations, 2017 (Old FEMA 20) and the Foreign Exchange Management (Acquisition and Transfer of Immovable Property in India) Regulations, 2018. Our earlier update on the NDI Rules is available here.

Now, the Ministry of Finance, Department of Economic Affairs, vide its notification dated 5 December 2019 has further amended the NDI Rules (NDI Amendment Rules). As expected, majority of the revisions brought in the NDI Amendment Rules are of clarificatory nature and have been implemented retrospectively from 17 October 2019 (i.e. the date of implementation of the NDI Rules). Certain amendments however have been implemented prospectively from 5 December 2019 (i.e. the date of notification of the NDI Amendment Rules).

A Summary of the amendments notified with 'retrospective effect' is set out below:

Amendments in definitions

NDI Amendment Rules now bring expected clarity on key definitions of sectoral cap and investment vehicle. Now the word 'debt' included in the ambit and definition of sectoral cap has been removed. Moreover, mutual funds regulated by SEBI have now been excluded from the definition of investment vehicle. The key changes to definitions are:

- Definition of "Investment Vehicle": Mutual funds that invest more than 50% in equity and are governed by the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996 (Mutual Funds Regulations) have now been excluded from the definition of "Investment Vehicle".

- Definition of "Sectoral Cap": The term "sectoral cap' now means the maximum investment including both foreign investment on a repatriation basis by persons resident outside India in equity instruments of a company or the capital of a LLP, as the case may be and the term "debt" has again been omitted from the definition of "Sectoral Cap".

Amendments related to gift of shares

- The scope of gift by person resident in India has now been widened. A person resident in India holding equity instruments or units of an Indian company (whether on non-repatriation basis or even on repatriation basis) is permitted to gift the shares to person resident outside India. The conditions prescribed under the NDI Rules for gift (including the requirement of prior approval of the Reserve Bank of India) shall continue to apply.

Clarification on conversion price / formula

Going back to the original position of Old FEMA 20, it has now been clarified that the price / conversion formula of convertible equity instruments need to be determined upfront at the time of issue of convertible equity instruments. Further, the price at the time of conversion should not be lower than the fair value worked out at the time of issuance of the convertible equity instruments.

A Summary of the amendments notified with 'prospective effect' is set out below:

Sectoral Changes

- The NDI Rules had not taken into account the changes brought about in the FDI policy by press note no. 4 of 2019 released by Department for Promotion of Industry and Internal Trade on 18 September 2019 (Press Note 4) in relation to FDI in coal mining, single brand retail, contract manufacturing and digital media. Now, pursuant to the NDI Amendment Rules the changes brought about in the FDI policy by Press Note 4 have been incorporated in the NDI Rules.

Comment

Since the NDI Rules did not incorporate amendments implemented through Press Note 4, there was confusion on the regulators' position. Therefore, NDI Amendment Rules are indeed welcome as they provide much needed clarity on the discrepancies between the NDI Rules and the existing position under the extant regulations.

On the other hand, however, the questions like what constitutes 'digital media' still remain unanswered. Complete clarity on these aspects would have been a welcome step.

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