



ERGO

Analysing developments impacting business

THE MANY FACES OF FOREIGN INVESTMENT

28 January 2020

A. [Introduction](#)

- There has been a lot of ambiguity on whether a foreign portfolio investor (FPI) registered under the SEBI (Foreign Portfolio Investor) Regulations 2019 (FPI Regulations) can make investments in unlisted equity shares of an Indian company under the foreign direct investment (FDI) route specified under Foreign Exchange Management (Transfer or Issue of Security in Person Resident outside India) Regulations 2017 (FEMA 20), which have now been superseded by the Foreign Exchange Management (Non-debt instruments) Rules 2019 (FEMA NDI Rules).
- This ambiguity has arisen as the list of permitted instruments in which FPIs can make investments does not include unlisted equity shares but only permits FPIs to invest in equity shares of a body corporate listed or to be listed on a recognized stock exchange in India.
- It may be noted that foreign investors use both the FDI and FPI routes for entirely different purposes. One would argue that investments under the two routes are not mutually exclusive and adopting one route should not preclude a foreign investor from adopting another route. This is even more so because both routes are adopted for different reasons. Often, investments through the FDI route are strategic in nature, and meant for the long term. Many FDI investors may also participate in the management of the investee company by obtaining board representation. On the other hand, investments under the FPI route are typically financial in nature, with investors having the ability to trade in stock on the bourses.
- On 24 January 2020, the Securities and Exchange Board of India (SEBI) issued an informal guidance (Informal Guidance) in response to an application (Application) made by IPFII Singapore 4 Pte Ltd., an entity set up in Singapore (Applicant).
- While the Application pertained to the subject matter of an FPI using the FDI route to make investments in unlisted equity shares, for reasons that may be attributed to incomplete nature of questions and lack of perspicuity in the Application, the Informal Guidance issued by SEBI only clarifies whether an FPI

registered under the FPI Regulations can make investments in the unlisted equity shares of an Indian company strictly under the FPI Route.

- While it would have been helpful for the industry if the Informal Guidance provided clarity on the ability of an FPI investor to make investments simultaneously under the FDI route, SEBI limited its response in the Informal Guidance to the specific question asked by the Applicant i.e. whether the Applicant can make investments in unlisted equity shares under the FPI Regulations.

B. Background

- The Applicant is registered with SEBI as a 'Category II' FPI under the FPI Regulations and had invested in non-convertible debentures (NCDs) issued by Metropolitan Lifespace Real Estate Developers Private Limited (Indian Company).
- In addition to the NCDs, the Applicant in its Application has explained that it proposes to buy 0.01% of the equity share capital of the Company from an existing shareholder of the Indian Company. It may be noted that the equity shares of the Company are not listed on any stock exchange in India nor is there any proposal to list the equity shares. Accordingly, the proposal to buy the equity shares of the Indian Company does not fall within the purview of Regulation 20(8) of the FPI Regulations which *inter alia* permits FPIs to invest in shares issued by a body corporate that are listed or to be listed on a recognized stock exchange in India.
- The Applicant in its Application explained that while Regulation 20(1)(a) of the FPI Regulations specifies that an FPI can invest only in shares which are 'listed or to be listed on a recognized stock exchange in India', Regulation 20(8) of the FPI Regulations lays down that an FPI is permitted to invest in Indian securities as a person resident outside India in accordance with the provisions of FEMA 20. FEMA 20 allows FDI to be made by a person resident outside India in an unlisted Indian company.
- In light of the above, the Applicant sought a clarification as to whether the Applicant can purchase 0.01% of equity share capital of the Indian Company under the FPI Regulations.

C. Interpretation by SEBI

- SEBI while issuing the Informal Guidance relied on Schedule II(1)(a) of the FEMA NDI Rules which has superseded FEMA 20 and which states that an FPI can purchase or sell equity instruments of an Indian company listed or to be listed on a recognized stock exchange.
- SEBI reiterated that the provision under Schedule II(1)(a), which specifies that an investment by an FPI should be in listed or to be listed equity instruments of an Indian company, is in line with the provision laid down under Regulation 20(8) of the FPI Regulations.

- In light of the above reasoning, SEBI in its Informal Guidance has clarified that an FPI is not permitted to make investments in unlisted equity shared under the FPI Regulations.
- Since the Applicant did not pose a direct question to SEBI on whether a foreign investor with an FPI license can also make investments under the FDI route, SEBI did not throw light on whether the Applicant is permitted to make the proposed investment in unlisted equity shares under the FDI route. The Informal Guidance is restricted to the ability of the Applicant to make investments in unlisted equity shares under the FPI Regulations.

D. [Our Analysis](#)

- While we agree that under the FPI Regulations, an FPI can only make investments in equity shares of a body corporate which is listed or to be listed on a recognized stock exchange and a standalone reading of the FPI Regulations does not permit an FPI to make investments in unlisted shares, it is difficult to conclude that an entity which is registered as an FPI cannot adopt the FDI route to make such investments i.e. investments in unlisted equity shares.
- The Indian foreign exchange regime has for long permitted foreign investors to adopt multiple routes to make various types of investments. While there is no explicit clarification issued by the regulators in this regard, there are certain precedents that indicate that a foreign investor may use different routes to make simultaneous investments.
- To further substantiate this position, SEBI vide circular numbered CIR/IMD/FIIC/05/2015 dated 12 June 2015 (SEBI FVCI Circular) has issued a clarification that an FPI can simultaneously hold registration as a foreign venture capital investor (FVCI) and make investments under the FVCI route so long as the funds raised, allocated and invested and the securities held under each route are clearly segregated. SEBI also clarified under the same circular that the reporting of transactions must be done separately under each route according to the conditions applicable under the relevant registration.
- Further, SEBI, under the FAQs published on its website for the FPI Regulations (SEBI FPI FAQs), had in its response to a question of whether an FDI investor holding equity stake in Indian company through the FDI route could make debt investments in the same company simultaneously as an FPI stated that *"The FDI eligible instruments are not only 'equity' but also Compulsorily Convertible Preference Shares (CCPs) and Compulsorily Convertible Debentures (CCDs). Since this does not cover debentures/debt, these can be subscribed to subject to compliance with the respective FEMA/SEBI regulations"*.
- The above position has been further clarified through the consolidated investment limit caps used for determination of FDI and FPI investments. This clearly suggests that irrespective of which route an investor invests through, the status of his investment will be determined by the level of his consolidated ownership.
- In light of the above, it would be safe to assume that while an FPI cannot invest in unlisted shares under the FPI route, there should be no restriction on such entity investing in unlisted shares through the FDI route subject to compliance with FDI conditionalities.

- Further, the above position of allowing foreign investors to adopt multiple routes to make foreign investment is only aligned with efforts of regulators geared towards rationalization and simplification of foreign investment regimes with a view to offer a clean and hassle free investment regime.
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