FOREIGN DIRECT INVESTMENT - RECENT REGULATORY CHANGES UNDER FEMA

N. RAJA SUJITH
Partner

MAJMUDAR & PARTNERS
INTERNATIONAL LAWYERS

202, Pride Elite, 10 Museum Road, Bangalore - 560001
Tel: +91 80 41470000, Fax: +91 80 41470010
Other offices: Mumbai, New Delhi, Chennai and Hyderabad
E-mail: mailbox@majmudarindia.com
Website: www.majmudarindia.com
What is FDI?

IMF and OECD says
- Cross border investment
- Objective – ‘establishing lasting interest’

Indian context
- investment by non-resident entity/person resident outside India in the capital of the Indian company as per the prescribed sectoral policies

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Indian Economy – FDI inflow

- India- third largest economy in Purchasing Power Parity
- Projected GDP growth rate for 2012-13 – 7.6%
- FDI inflow
  - April-Jan 2011-12 is USD 26.19 billion
  - April-Jan 2010-11 is USD 17.08 billion
- 53% growth compared to the previous year
FDI and the legal framework

Sector specific
- 100% FDI allowed in almost all sectors. FDI in certain sectors is subject to certain conditions and limitations.

Entry Routes
- Automatic route – no government approval required
- Approval route – approval of the FIPB required in specified sectors

Investment Routes
- By subscription of fresh shares
- By acquisition of existing shares through transfer
Prohibited in certain sectors

- Retail Trading (except single brand retail)
- Atomic Energy and Railway transport (other than mass rapid transport system)
- Manufacturing of any form of tobacco or tobacco substitutes
- Chit Funds
- Nidhi Company
- Certain kinds of agriculture (except those expressly allowed)
- Lottery business, gambling and betting
- Real estate business/construction of farm houses
## Certain key sectors

<table>
<thead>
<tr>
<th>Sectors</th>
<th>Permitted FDI</th>
</tr>
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<tbody>
<tr>
<td>Cash and carry wholesale trading</td>
<td>100 %</td>
</tr>
<tr>
<td>Single brand retail trading (after FIPB approval)</td>
<td>51% &gt; 100%</td>
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<tr>
<td>FM Radio</td>
<td>20% &gt; 26%</td>
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<tr>
<td>Information Technology and BPO</td>
<td>100 %</td>
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<tr>
<td>Development of Townships, Housing, Built up Infrastructure and Construction- development projects</td>
<td>100 %</td>
</tr>
<tr>
<td>Telecommunications (after FIPB approval)</td>
<td>74 %</td>
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<tr>
<td>Power</td>
<td>100 %</td>
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<tr>
<td>Biotechnology</td>
<td>100 %</td>
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<tr>
<td>SEZ and Free Trade Warehousing Zones</td>
<td>100 %</td>
</tr>
<tr>
<td>Drugs and Pharmaceuticals</td>
<td>100 %</td>
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<tr>
<td>Insurance</td>
<td>26 %</td>
</tr>
<tr>
<td>Limited Liability partnership</td>
<td>100%</td>
</tr>
<tr>
<td>Agriculture (specified) and animal husbandry</td>
<td>100 %</td>
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Sectoral Changes

- 100% FDI allowed in Single Brand product retail trading under the Government route
- 100% FDI allowed for Brownfield investment (i.e., investment in existing companies), in the pharmaceutical sector, under the Government approval route
- 26% FDI allowed in FM Radio
- 100% FDI allowed in Limited Liability Partnerships (LLPs)
FDI – LLPs

Sectors:

- FDI in LLPs will be allowed only in ‘open’ sectors, subject to Government approval.
- No FDI in a LLP would be allowed where there are FDI-linked performance related conditions.
- No FDI would be allowed in sectors such as:
  - NBFCs or
  - Development of Townships / Housing or
  - Built-up infrastructure and Construction-development projects etc.
FDI – LLPs (contd.)

Funding Restrictions:

- Foreign capital participation in the capital structure of the LLPs will be allowed only by way of cash received by inward remittance through normal banking channels or by debit to NRE/FCNR account of the person concerned.
- Foreign Institutional Investors and Foreign Venture Capital Investors will not be permitted to invest in LLPs.
- LLPs will not be permitted to avail ECBs.

Investment Restrictions:

- LLPs with FDI will not be eligible to make any downstream investments.
- LLPs with FDI will not be allowed to operate in agricultural/plantation activity, print media or real estate business.
- Conversion of a company with FDI into an LLP will be allowed only with the prior approval of government.
SEBI - FII Investment in units of Domestic Mutual Funds

- Qualified Foreign investors (QFIs): Non resident investors (other than SEBI registered FII s and FVCIs) who meet KYC requirements of SEBI

- QFIs allowed to purchase on repatriation basis rupee denominated units of Domestic Mutual Funds under 2 routes:
  - Direct Route – SEBI registered Depository Participant route
  - Indirect Route – Unit Confirmation Receipt route

- Ceiling of USD 10 billion under both the routes

- No secondary market purchases allowed
SEBI - FIIIs

FDI by SEBI registered FIIIs in other securities

- Foreign Institutional Investors (FIIIs) allowed to invest in non-convertible debentures/bonds issued by Infrastructure Finance Companies (IFCs) enhanced from USD 5 billion > 25 billion subject to:
  
  - Residual maturity of 5 years
  - Lock-in period of 3 years

- Lock-in-period of 3 years for FII investment stands reduced to 1 year up to USD 5 billion

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SEBI – FII

FDI in Infrastructure Debt Funds

- On a repatriation basis, eligible non-resident investors can invest in:
  - rupee and foreign currency denominated bonds issued by the Infrastructure Debt Funds (IDFs) set up as NBFCs; and
  - rupee denominated bonds issued by IDFs which are set up as domestic mutual funds (MFs)
- Original Maturity period: 5 years
- Lock in period: 3 years
- Foreign Currency denominated Bonds to comply by the ECB norms
- All non-resident investment in IDFs (other than NRIs) (in both Rupee and Foreign Currency denominated securities) would be within an overall cap of USD 10 billion only
- No cap / limit for NRI investment in IDFs by way of Rupee denominated bonds / units
SEBI - FVCIs

Investment in domestic VCFs by SEBI registered FVCIs

Earlier, SEBI registered FVCIs were only allowed to invest either through

- initial public offerings or
- private placements or
- units of schemes / funds by VCF

Currently FVCIs are allowed to

- acquire shares in the secondary markets from existing shareholders
- invest in securities on a recognized stock exchange subject to the provisions of the SEBI (FVCI) Regulations, 2000
Process Simplification

Regularization of Liaison / Branch Offices of Foreign Entities established during the pre-FEMA period without RBI approval

- The foreign entities who have established LO or BO in India (during pre-FEMA period) and continuing to function without obtaining permission from RBI to approach the RBI within a period of 90 days from the date of issue of the Circular (15 July 2011) for regularization of establishment of such offices in India

- The foreign entities who have established LO or BO with the permission from the Government of India are also required to approach the RBI along with a copy of the said approval for allotment of a Unique Identification Number (UIN) by the RBI.
Process Simplification

Foreign Investments in India – Transfer of security by way of gift – Liberalization

- Person resident in India who proposes to transfer any security, by way of gift, to a person resident outside India is required to obtain prior approval of RBI.

- The value of security to be transferred together with any security transferred by the transferor, as gift, to any person residing outside India which was not to exceed the rupee equivalent of USD 25,000 during a calendar year has been enhanced to USD 50,000 per financial year.
Process Simplification

Issue of Equity shares under the FDI scheme allowed under the Government route

- Equity / preference shares can be issued under the government route by conversion of:
  - Import of capital goods / machineries / equipments
  - Pre-operative / pre-incorporation expenses

- Applications for conversion of import payable into FDI to be completed within a period of 180 days from the date of shipment of capital goods/machinery

- Applications for capitalization being made to be completed within a period of 180 days from the date of incorporation of the company

- Payments made through third parties would not be allowed
Pledge of Shares for Business purposes

Powers delegated to AD Category – I banks to allow pledge of shares of an Indian company held by non-resident investor/s in accordance with the FDI policy in the following cases subject to compliance with certain conditions:

- Pledge of shares of an Indian company in favour of an Indian bank in India to secure the credit facilities being extended to the resident investee company for bonafide business purposes.

- Pledge of shares of the Indian company in favour of an overseas bank to secure the credit facilities being extended to the non-resident investor / non-resident promoter of the Indian company or its overseas group company.
Process Simplification

RBI liberalized opening of Escrow Accounts for FDI transactions

- All Category – I Authorised Dealer Banks (in India) to open and maintain Non-Interest Bearing Escrow Accounts in Indian Rupees on behalf of Residents and / or Non-Residents towards payment of Share Purchase Consideration
- SEBI Authorised Depository Participants to open and maintain Escrow Account for the Securities
- These facilities applicable for both issue of fresh shares to the non-residents as well as transfer of shares from / to the non-residents
- Conditions are attached for opening of Escrow Accounts
FDI – Transfer of Shares from R to NR

Previously, prior approval of the RBI was required if:

- transfers not compliant with RBI’s pricing norms;
- transfers that required prior approval of the FIPB; and
- where the investee company was in the financial services sector.

Current position: So long as the transfer is otherwise in accordance with the FDI policy, prior approval of RBI is not required.
Process Simplification

FDI – Reporting of Issue / Transfer of ‘Participating Interest/Right’ in Oil Fields to a Non-Resident as an FDI Transaction

- All transfer of stake or interest in an oil and gas field to non-residents will be treated as FDI
- Transactions involving the issue or transfer of participating rights or interests in oil fields to a non-resident will have to be reported to the RBI as FDI transactions.
Process Simplification

Compounding:

- Compounding powers delegated to the regional offices of the RBI, Foreign Exchange Department

<table>
<thead>
<tr>
<th>Contraventions</th>
<th>Regional offices</th>
<th>Amount of contravention</th>
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<tbody>
<tr>
<td>Delay in reporting of inward remittance;</td>
<td>Bhopal, Bhubaneshwar, Chandigarh, Guwahati, Jaipur, Jammu, Kanpur, Kochi, Patna and Panaji</td>
<td>Below Rs. 1,00,00,000 (Rupees One Crore only)</td>
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<tr>
<td>Delay in filing of form FC-GPR after allotment of shares; and</td>
<td></td>
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<tr>
<td>Delay in issue of shares beyond 180 days</td>
<td>Ahmedabad, Bangalore, Chennai, Hyderabad, Kolkata, Mumbai and New Delhi</td>
<td>Without any limit</td>
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External Commercial Borrowings

- Corporate other than hotel, hospital and software company can avail USD 750 million per year

- Eligible Borrowers under the automatic route can raise Foreign Currency Convertible Bonds (FCCB) up to USD 750 million or equivalent per financial year for permissible end-uses

- FCCB availed for the purpose of refinancing the existing outstanding FCCB will be reckoned as part of the limit of USD 750 million
ECB (contd.)

- Corporates in specified sectors viz. hotels, hospital and software can avail ECB up to USD 200 million during the financial year which cannot be used for acquisition of land.

- The rupee funds raised abroad will not be permitted to be used for investment in capital markets, real estate or for inter-corporate lending.

- ECB proceeds meant only for foreign currency expenditure can be retained aboard pending utilization.
Infrastructure debt Funds

- **Automatic route**: Infrastructure Finance Companies (IFCs) permitted to avail of ECBs, including the outstanding ECBs, up to 50% of their owned funds.

- **Approval route**: above 50% of owned funds.

- **End-use**: on-lending to the infrastructure sector.

- **AD Category – I** banks to certify the leverage ratio (i.e. outside liabilities/owned funds) of IFCs desirous of availing ECBs under the approval route.
Equity v. Debt

Amendment (withdrawn):

- Eligible instruments for FDI: Equity with no in-built options of any type
- Debt / ECB: Equity with in-built options – debt and requires to comply ECB regulations

Current position:

- The above position has been withdrawn
- Consequently, equity with in-built options also qualify for eligible instruments for FDI

Challenges continued:

SEBI/RBI/Judiciary views
Changes in the recent Budget

- Airlines allowed to raise ECB up to USD 1 billion
- ECB for low cost affordable housing projects
- Lower withholding rate of 5% for the next 3 years on ECB for power, airlines, roads, bridges, affordable houses and fertilizer sectors
- Sectoral restrictions on VCF/VCC under the Income Tax Act, 1966 would be removed and governed by conditions imposed by SEBI and RBI
Thank You