

India eases foreign investment norms: Key amendments to the Non-debt Instruments Rules, 2019

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This update covers:

1	Cross border swap of equity instruments is now permitted	1
2	Government approval for transfer of equity instruments between persons resident outside India	2
3	Foreign direct investment in White Label ATM operations permitted	2
4	Downstream investments by Overseas Citizens of India-owned entities not considered as indirect foreign investment	3
5	No government approval for foreign portfolio investment up to the sectoral cap	3
6	Standardisation of the definition of 'control'	3
7	Harmonisation of the definition of 'start-up'	4

The central government has recently amended the Foreign Exchange Management (Non-debt Instruments) Rules, 2019 (**NDI Rules**) to create a more favourable environment for foreign investors in India through the notification of the Foreign Exchange Management (Non-debt Instruments) (Fourth Amendment) Rules, 2024 (**Amendment Rules**) on 16 August 2024.

Key highlights of the Amendment Rules are set out below.

1 Cross border swap of equity instruments is now permitted

The Amendment Rules now permit the transfer of equity instruments of an Indian company between a person resident in India (**R**) and a person resident outside India (**NR**) by way of swap of:

- a. equity instruments; or
- b. equity capital of a foreign company,

The Indian government has relaxed foreign investment rules allowing cross border share swaps and foreign direct investment in White Label ATM operations, mandating the procurement of government approval for transfer of equity instruments between persons resident outside India, and harmonising the definitions of 'control' and 'start-up', among others.



in compliance with the rules and regulations prescribed by the central government and the Reserve Bank of India (RBI).

Such swaps are also permitted in cases where government approval is applicable provided such prior government approval is obtained.

This amendment aims to simplify cross-border share swaps and permits the issuance or transfer of equity instruments of an Indian company in exchange for equity instruments of a foreign company. This will facilitate the expansion of Indian companies through mergers, acquisitions, and other strategic initiatives, enabling them to reach new markets and grow their international presence.

2 Government approval for transfer of equity instruments between persons resident outside India

Prior to the Amendment Rules, government approval was required to be obtained for transfer of equity instruments of an Indian company from an NR to another NR, *if the Indian company was engaged in a sector requiring government approval*.

The Amendment Rules now prescribe that *'prior government approval shall be required to be obtained for transfer of equity instruments of an Indian company from NR to another NR in all cases, wherever government approval is applicable'*.

While this amendment seems to have been made to include acquisitions under Press Note 3 (PN3), the wording and objective of the amendment is unclear. The amendment appears to cover transfer of equity instruments of an Indian company from NR to another NR in all cases where the original transaction was under government approval route (i.e., due to sector or PN3). However, it is unclear whether divestments proposed to be made in relation to investments by investors from restricted countries under PN3 (including those that were made prior to PN3 coming into force), would be captured under this amendment and consequently would necessitate a prior government approval.

This amendment is not applicable in case of transfers from: (i) NR to R; or (ii) R to NR.

3 Foreign direct investment in White Label ATM operations permitted

White Label ATMs (WLA) are ATMs that are set up, owned and operated by non-banking companies in India, and are authorised under the Payment and Settlement Systems Act, 2007 (PSS Act) by the RBI. With the objective of promoting financial inclusion across India, the Amendment Rules now permit 100% foreign direct investment (FDI) in White Label ATM operations (WLAO) through the automatic route, subject to the following conditions:

- a. any non-bank entity intending to set up WLAs should have a minimum net worth of INR 1,000,000,000 (~USD 12,000,000) as per the latest financial year's audited balance sheet, which is to be maintained at all times;
- b. in case the entity is also engaged in any *'Other Financial Services'*, then the foreign investment in the company setting up WLA must also comply with the minimum capitalisation norms, if any, for foreign investments in such *'Other Financial Services'*; and
- c. FDI in the WLAO will be subject to the specific criteria and guidelines issued by the RBI under the PSS Act.

This amendment now aligns the NDI Rules with Paragraph 5.2.25 (*White Label ATM Operations*) of the Consolidated Foreign Direct Investment Policy (effective from 15 October 2020).

4 Downstream investments by Overseas Citizens of India-owned entities not considered as indirect foreign investment

Another key change brought to the NDI Rules through the Amendment Rules is that investments made by Indian entities owned and controlled by an Overseas Citizen of India (OCI) (including a company, a trust and a partnership firm incorporated outside India and owned and controlled by such OCI) on a non-repatriation basis will not be considered for calculation of indirect foreign investment, a benefit that was previously available only for Non-Resident Indian (NRI)-owned entities.

This amendment provides greater clarity on the treatment of downstream investments by OCI-owned entities on a non-repatriation basis, aligning it with the treatment of investments by NRI-owned entities. This is expected to encourage more OCIs to invest in India through the entities owned and controlled by them.

5 No government approval for foreign portfolio investment up to the sectoral cap

The Amendment Rules prescribe that the aggregate foreign portfolio investment (FPI) up to the sectoral or statutory cap will not require government approval or compliance with sectoral conditions, if such investment does not result in transfer of ownership and/or control of the resident Indian company from resident Indian citizens to NRs. This replaces the previous requirement under the NDI Rules, which mandated compliance with the cap of 49% of the paid-up capital of the resident Indian company on a fully diluted basis or the sectoral or statutory cap, whichever is lower.

The Amendment Rules streamline FPI by removing the need for government approval up to sectoral or statutory caps, provided ownership and/or control remains with resident Indians.

6 Standardisation of the definition of ‘control’

The Amendment Rules have aligned the definition of ‘control’ under the NDI Rules with the definition set out in the Companies Act, 2013 (**Companies Act**).

Under the Companies Act and Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011, ‘control’ has been defined to include the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner.

The Amendment Rules standardise the definition of ‘control’ to ensure clarity and consistency in the legal frameworks, which aids the structuring of mergers, acquisitions, and private equity transactions.

In the context of a Limited Liability Partnerships (LLP), the definition of ‘control’ remains unchanged, i.e., the right to appoint majority of the designated partners, where such designated partners, with specific exclusion to others, have control over all the policies of an LLP.

7 Harmonisation of the definition of ‘start-up’

The Amendment Rules bring the definition of “*start-up company*” up to date with the notification issued by the Department for Promotion of Industry and Internal Trade (DPIIT), Ministry of Commerce and Industry, in 2019 (in place of the 2016 notification) which prescribes that an entity will be considered as a ‘*start-up*’:

- a. up to a period of 10 years from the date of its incorporation/registration, if it is incorporated as a private limited company or registered as a partnership firm or an LLP in India;
- b. if the turnover of the entity for any of the financial years since incorporation/registration has not exceeded INR 1,000,000,000 (~USD 12,000,000); and
- c. if the entity is working towards innovation, development or improvement of products or processes or services, or if it is a scalable business model with a high potential for employment generation or wealth creation.

Aligning the definition of ‘*start-up*’ with the DPIIT’s wider framework clarifies the status of startups for FDI and enhances their appeal to international investors.

The Amendment Rules underscore the government's commitment to enhance the attractiveness of India as a global investment destination and clarify various grey areas impacting deal structuring such as share swaps for secondary transactions. The amendments offer Indian companies greater flexibility in structuring mergers, acquisitions, and other deals through a combination of cash and non-cash considerations. Further, streamlining of the NDI Rules with other relevant legislations promotes consistency in legal and regulatory interpretations, thereby enhancing investor confidence in the Indian deal market.

However, some clarity is required on whether divestments proposed to be made in relation to investments by investors from restricted countries under PN3 (including those that were made prior to implementation of PN3), would be captured under the Amendment Rules and consequently necessitate a prior government approval. This might create complexities for investors from restricted countries seeking exits.

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