

Foreign Investments in India

Changes in FDI policy





Revised FDI guidelines

Revised position (1/2)

Rationale

Revised FDI guidelines issued to curb the opportunistic takeovers / acquisitions of Indian companies due to the current COVID-19 pandemic

Eligible investors²

Any non-resident entity can invest in India subject to the FDI Policy, except in prohibited sectors

Prior GoI approval required for any investment made by:

- ✓ Entity of a country which shares land border with India ('Specified Country')
- ✓ Beneficial owner of investment is either situated in / citizen of a Specified Country
- ✓ Citizen of Pakistan or an entity incorporated in Pakistan - only in sectors other than defence, space, atomic energy and FDI prohibited sectors



2. Press Note No. 3 (2020 Series) dated 17 April 2020 and amended Rule 6(a) of Foreign Exchange Management (Non-debt Instruments) Rules, 2019 ("NDI Rules")

Revised position (2/2)

Transfer of existing shareholding

- ✓ GOI approval required if transfer of ownership in Indian entity, results in beneficial ownership , directly or indirectly, falling within the above restrictions

Scenarios covered

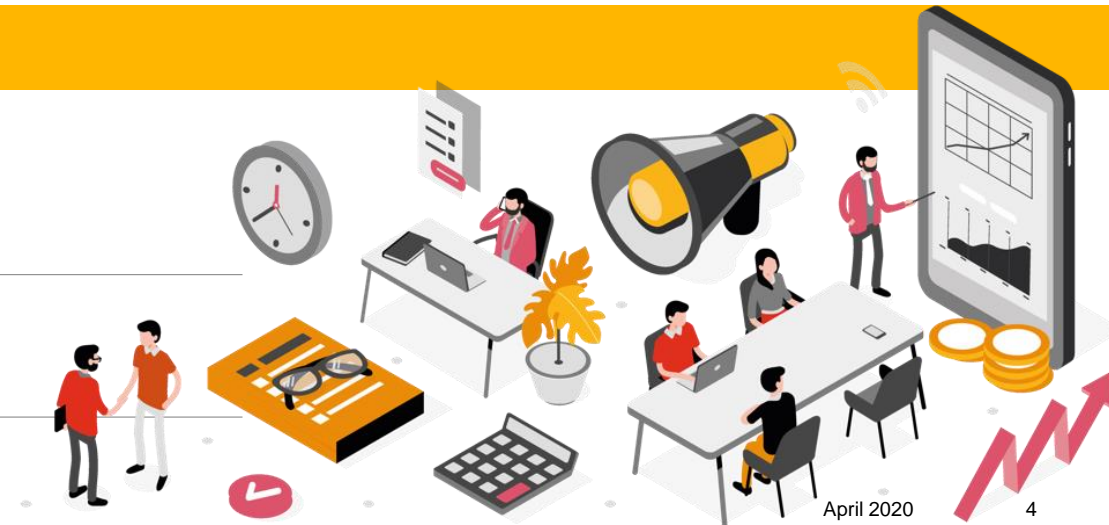
- ✓ Direct investments by an entity of a Specified Country;
- ✓ Indirect investments where beneficial owner of such investment is situated in or is a citizen of a Specified Country;
- ✓ Transfer of ownership from existing shareholders to above - under global transactions



Revised guidelines effective from 22 April 2020

Effective Date

- ✓ Date of release of notification under Foreign Exchange Management Act, 1999 ("**FEMA**"), i.e. 22 April 2020
- ✓ Investments completed upto 21 April 2020 are grandfathered





Key issues / challenges

Jurisdictions covered

India shares its land borders with the following countries³:

✓ Bangladesh, China, Pakistan, Nepal, Myanmar, Bhutan and Afghanistan

Whether Hong Kong covered ?

✓ Hong Kong is officially known as Hong Kong Special Administrative Region of the People's Republic of China



3. As per Ministry of Home Affairs website - <https://www.mha.gov.in/sites/default/files/BMIntro-1011.pdf>

Beneficial owner

Who is a Beneficial Owner?

✓ Press Note 3 does not define the term Beneficial Owner ('BO')

✓ BO not defined under FEMA and / or NDI Rules

✓ Meaning of BO from other regulations:

- Prevention of Money-laundering (Maintenance of Records) Rules, 2005 ('PMLA Rules') read with Master Direction - Know Your Customer (KYC) Direction, 2016
- Companies Act, 2013 ('CA 2013') read with Companies (Significant Beneficial Owners) Rules 2018 ('SBO Rules')



Under PMLA (1/2)

Rule 9 of PMLA Rules:

- ✓ In case of a company- the BO is the natural person(s), who, whether acting alone or together, or through one or more juridical person, has:
 - a controlling ownership interest; or
 - who exercises control through other means.
- ✓ "Controlling ownership interest" - ownership of or **entitlement to >25% of shares** or capital or profits;
- ✓ "Control" shall include the **right to appoint majority of the directors** or to control the management or policy decisions including by virtue of their shareholding or management rights or shareholders agreements or voting agreements;

- ✓ In case of a partnership firm - the BO is the natural person(s), who, whether acting alone or together, or through one or more juridical person, has ownership of/entitlement to >15% of capital or profits of the partnership



Under PMLA (2/2)

Rule 9 of PMLA Rules:

- ✓ In case of an unincorporated association or body of individuals - the BO is the natural person(s), who, whether acting alone or together, or through one or more juridical person, has ownership of or entitlement to >15% of the property or capital or profits of such association or body of individuals;
- ✓ In case of a trust - the identification of BO shall include identification of the author of the trust, the trustee, the beneficiaries with >15% interest in the trust and any other natural person exercising ultimate effective control over the trust through a chain of control or ownership; and
- ✓ Residual clause - Relevant natural person who holds the position of **senior managing official**
- ✓ In case of an entity listed on a stock exchange in India, or an entity resident in jurisdictions notified by the GoI and listed on stock exchanges in such jurisdictions notified by the GoI, or a subsidiary of such listed entity, it is not necessary to identify and verify the identity of any shareholder or beneficial owner of such entities

Under PMLA - Beneficial owner **of an entity**

vs.

Press Note 3 – Beneficial Owner **of investment**

Under Companies Act (1/2)

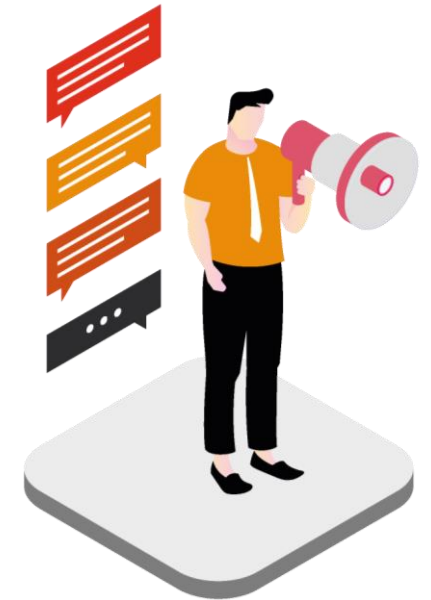
Beneficial Interest: Defined under Section 89 (10) of CA 2013

Significant Beneficial Owner: Defined under Section 90 of CA 2013 r.w. Companies (Significant Beneficial Owners) Rules

Section 89 (10) of CA 2013:

Beneficial interest in a share includes, directly or indirectly, through any contract, arrangement or otherwise, the right or entitlement of a person alone or together with any other person to –

- ✓ exercise or cause to be exercised any or all of the rights attached to such share; or
- ✓ receive or participate in any dividend or other distribution in respect of such share.



Under Companies Act (2/2)

"**significant beneficial owner**" in relation to a reporting company means an individual who, acting alone or together, or through one or more persons or trust, possesses one or more of the following rights or entitlements in such reporting company, namely:-

- ✓ holds indirectly, or together with any direct holdings, not less than **10% of the shares**;
- ✓ holds indirectly, or together with any direct holdings, not less than **10% of the voting rights** in the shares;
- ✓ has right to receive or participate in not less than **10% of the total distributable dividend**, or any other distribution, in a financial year through indirect holdings alone, or together with any direct holdings;
- ✓ has right to exercise, or actually exercises, significant influence or control, in any manner other than through direct holdings alone:



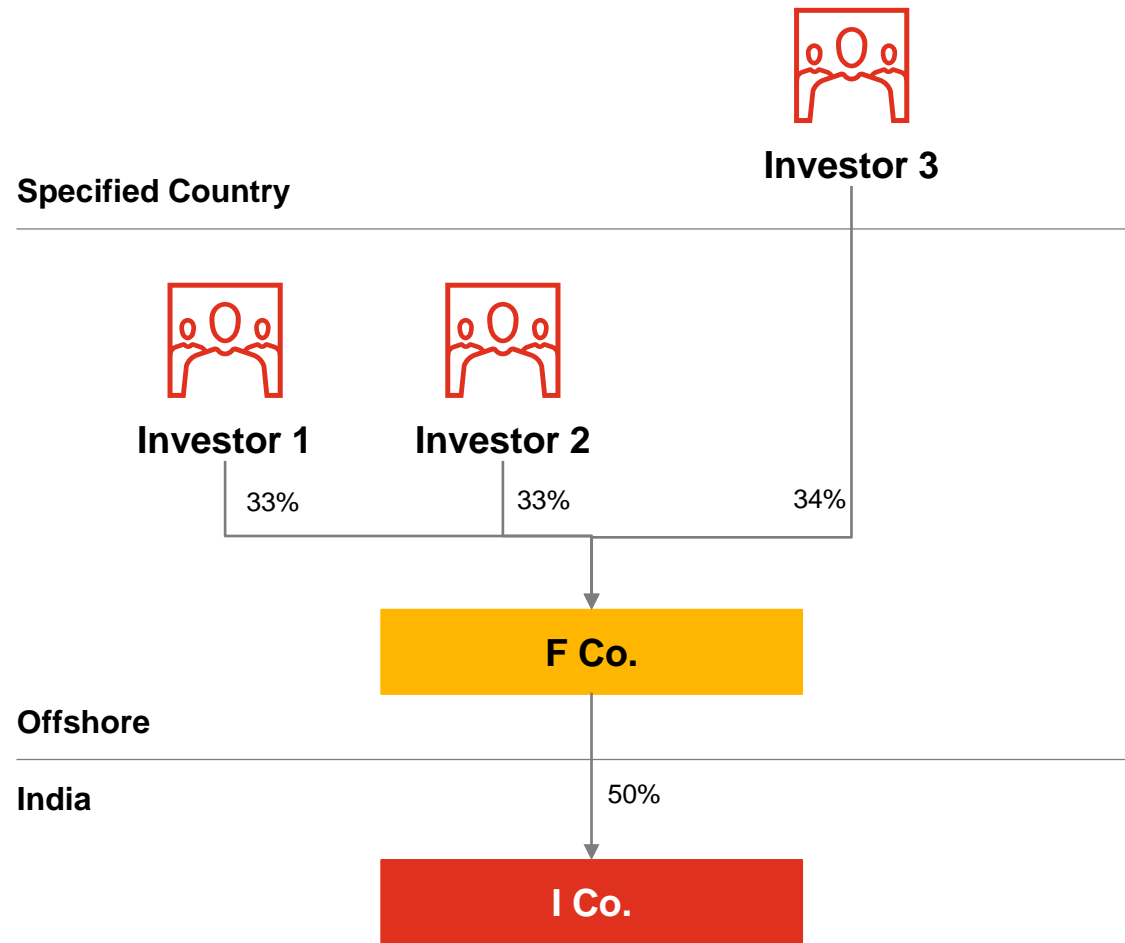
An individual shall be considered to hold a **right or entitlement indirectly in the reporting company**, if he satisfies any of the following criteria, in respect of a member of the reporting company:-

- ✓ where the member of the reporting company is a body corporate (whether incorporated or registered in India or abroad), other than a limited liability partnership, and the individual -
 - (a) holds majority stake in that member; or
 - (b) holds majority stake in the ultimate holding company (whether incorporated or registered in India or abroad) of that member;



Impact on India investments

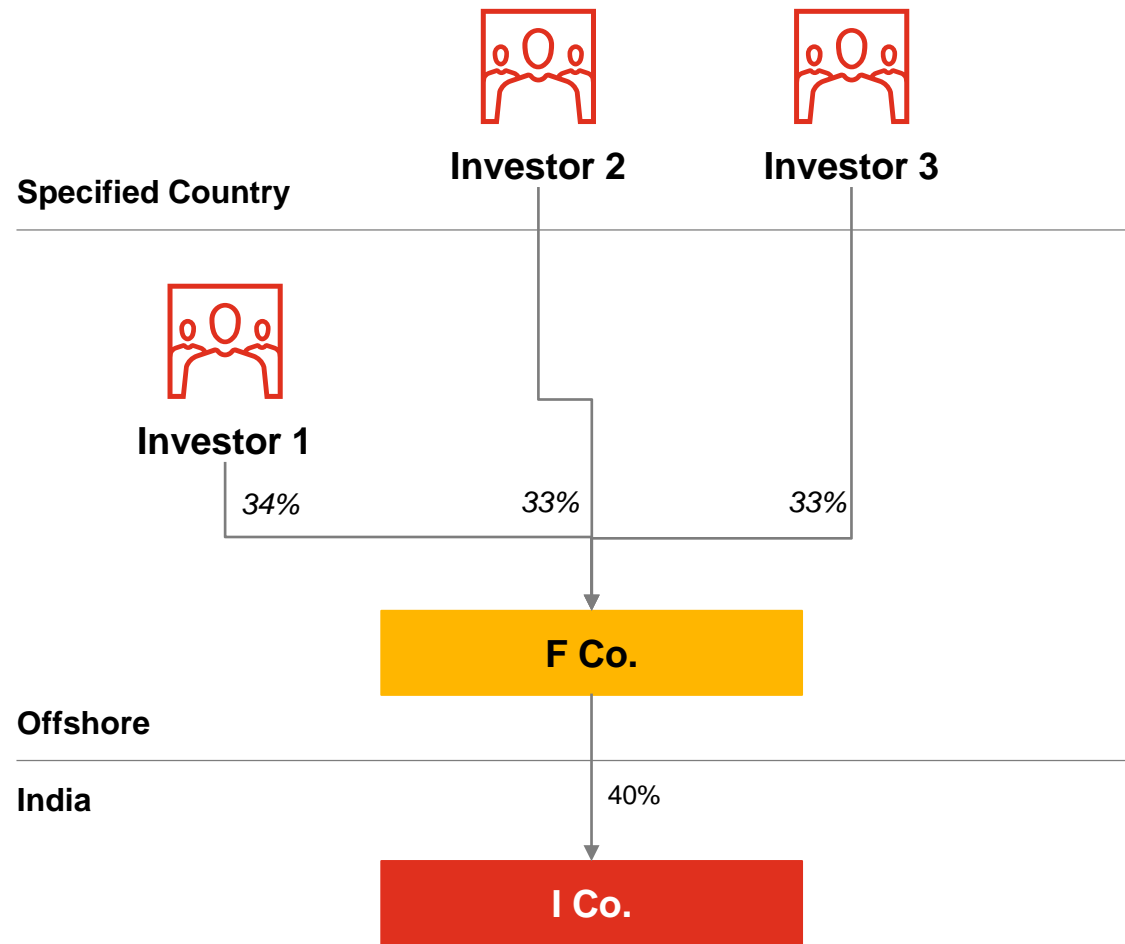
Illustration 1 - Beneficial owner of investment



Facts:

- F Co. proposes to acquire 50% stake in I Co. under FDI route
- 34% shareholding in F Co. is held by entities of Specified Country
- BO threshold to be tested at I Co. level or F Co. level ?
 - No reportable BO at I Co. level under PMLA Rules or CA 2013
 - Intent of Press Note - whether to identify BO sans threshold ?
 - 17% pro-rata shareholding of Investor 3 to trigger GoI approval ?
 - No threshold in case of direct acquisition ?

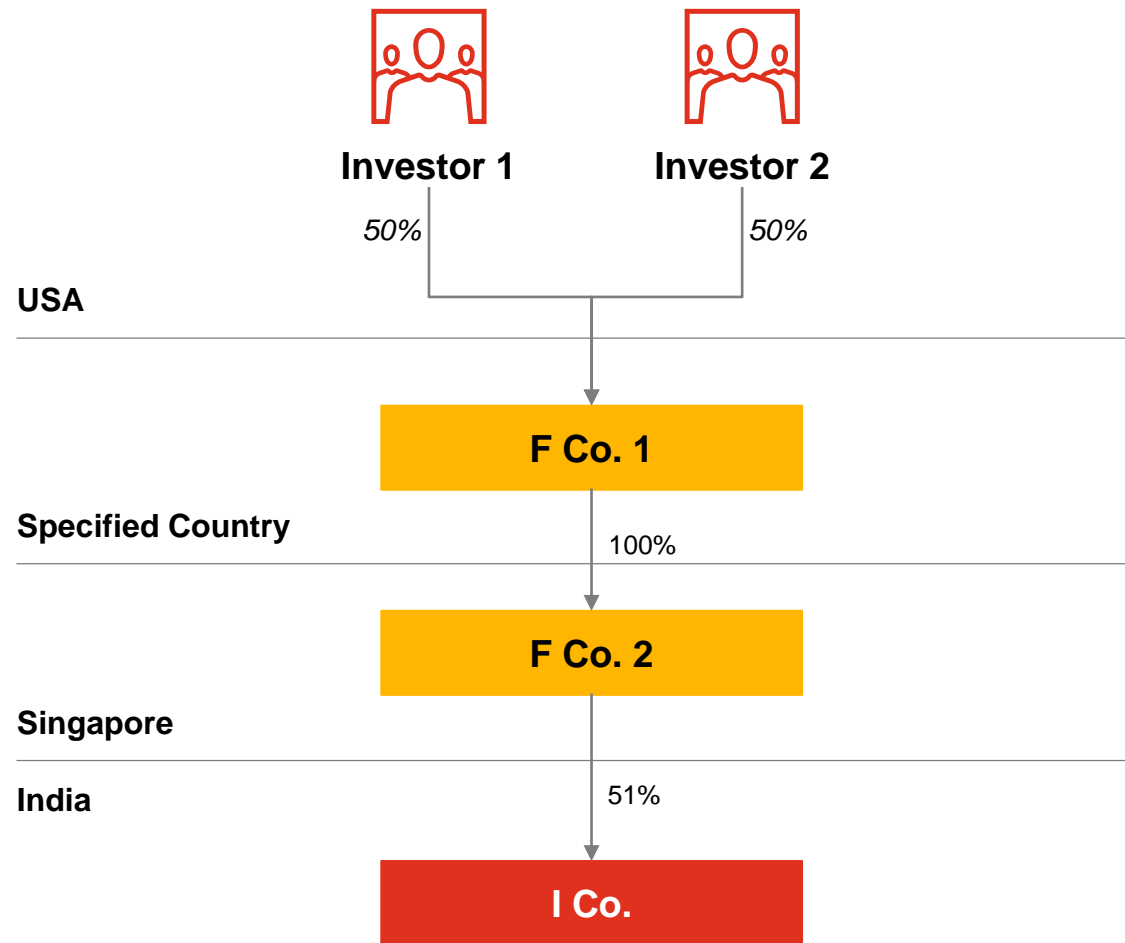
Illustration 2 - Beneficial owner of investment



Facts:

- Offshore Fund proposes to acquire 40% stake in I Co.
- 66% shareholding in F Co. is held by entities of Specified Country
- No individual reportable BO under PMLA Rules or CA 2013
- Aggregation of Investor 2 and Investor 3 holdings for BO threshold ?
- Whether Investor 2 & Investor 3 are acting individually / collectively ?

Illustration 3 - Beneficial owner of investment



Facts:

- F Co. 2 proposes to acquire 51% stake in I Co.
- No direct shareholding in I Co. by shareholders from Specified Country
- Indirect shareholding - BO not situated in Specified Country
- Impact of Press Note 3 ?

Illustration 4 - Differential voting rights



Investor 2

Specified Country



Investor 1

92% Economics

8% Economics
+
Differential voting rights

F Co. 1

100%

F Co. 2

Offshore

India

50%

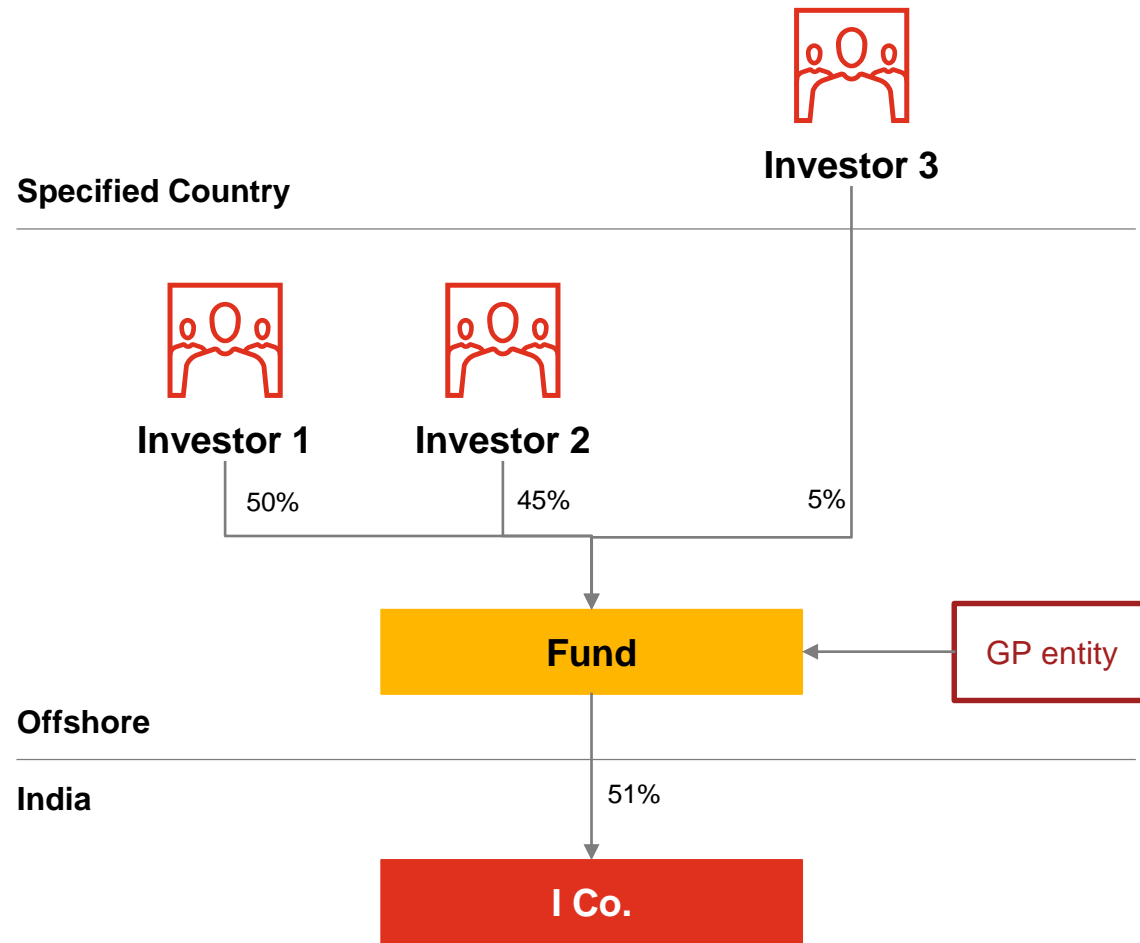
I Co.



Facts:

- F Co. 2 proposes to acquire 50% stake in I Co. under FDI route
- 8% shareholding in F Co. 2 is indirectly held by resident of Specified Country
- Investor 2 has differential voting rights
- Whether BO threshold breached due to differential voting rights ?

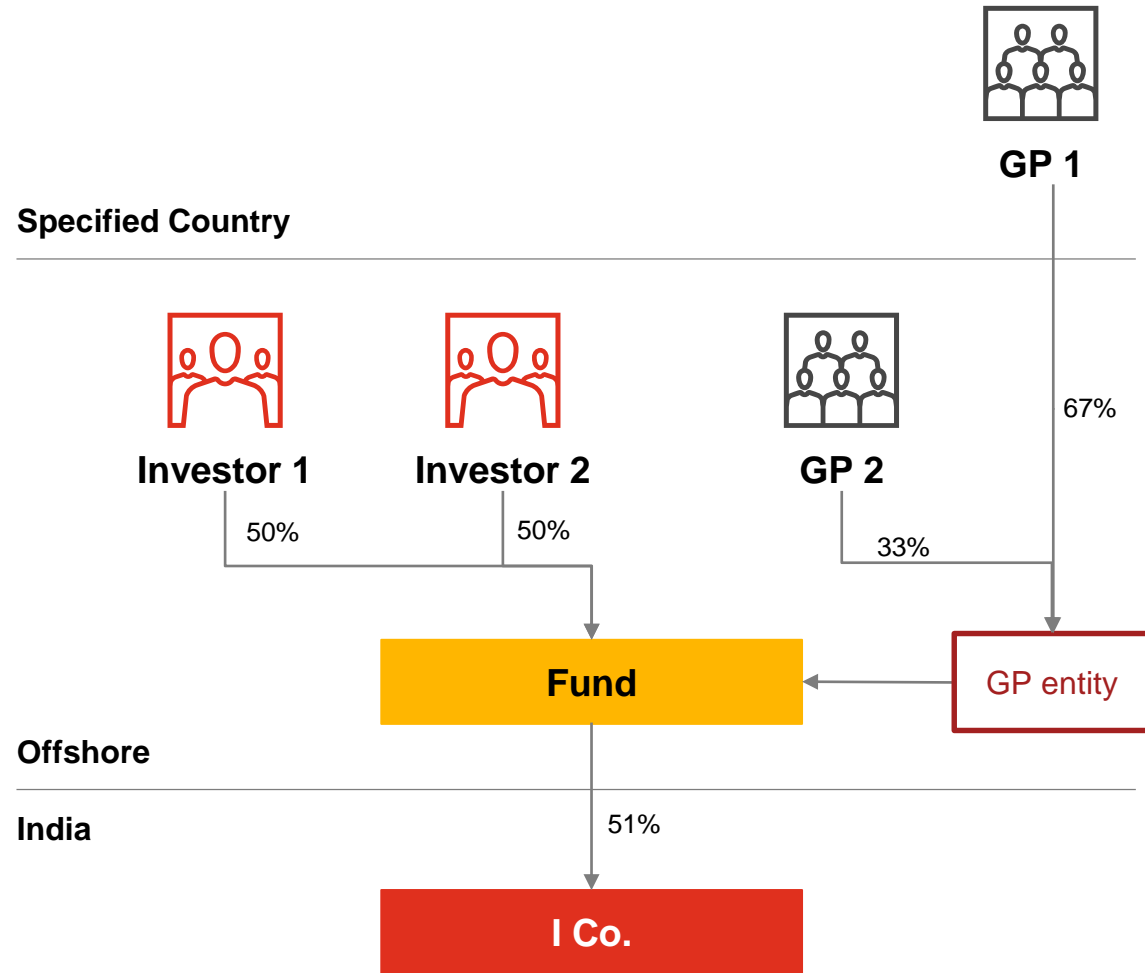
Illustration 5 - Fund structure



Facts:

- Offshore Fund proposes to acquire 51% stake in I Co.
- Offshore Fund has raised capital from investors based in Specified Country as well as other jurisdictions
 - 5% LP interest from Specified Country
- General Partner of Offshore Fund not situated in Specified Country
- Beneficial ownership of Offshore Fund to be tested for GoI approval ?

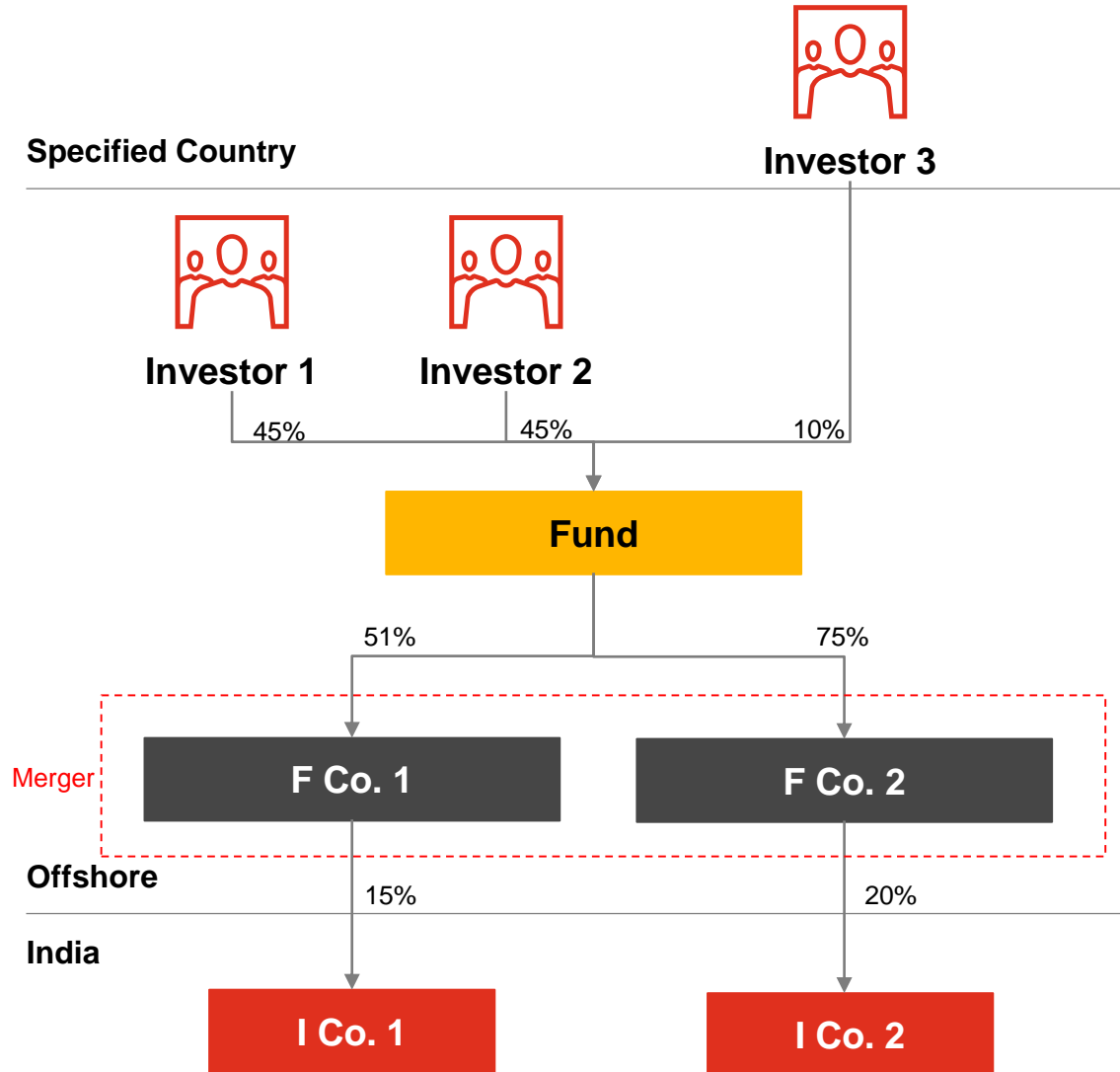
Illustration 6 - Fund structure



Facts:

- Same as above, except no investors are from Specified Country
- However, one of the General Partner (GP) is a citizen of Specified Country
- Beneficial ownership of investment to be tested in light of GP being a citizen of Specified Country?
- What if GP-2 is not a citizen of a Specified Country but a permanent resident of a Specified Country - Meaning of the term "situated in" ?

Illustration 7 - Offshore merger



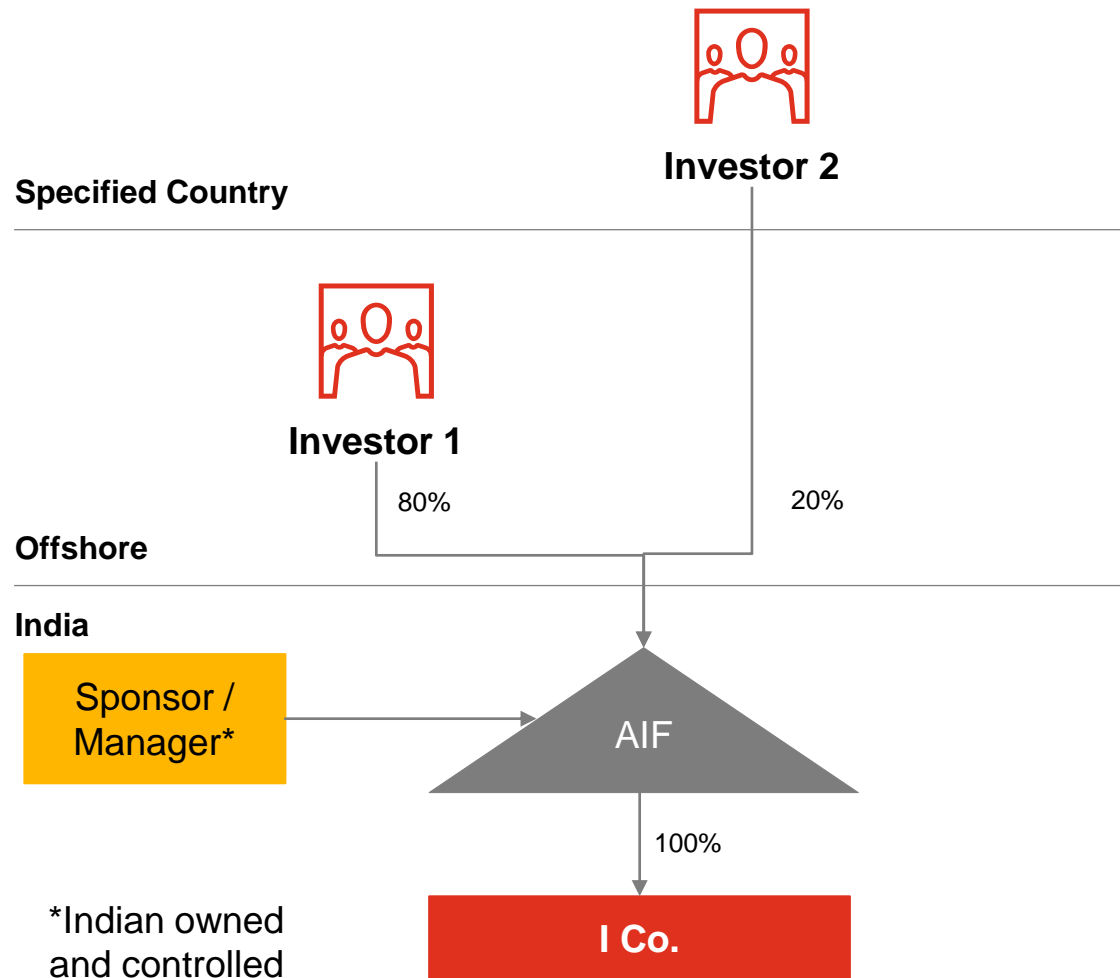
Facts:

- Offshore Fund holds investment in I Co. 1 and I Co. 2 through F Co. 1 and F Co. 2
- Proposed merger of F Co. 1 and F Co. 2
- Post merger, I Co. 1 and I Co. 2 to issue shares to Merged Co.

Issue:

- Whether issue of shares by I Co. 1 and I Co. 2 pursuant to an offshore merger requires GoI approval ?
- Similarly, if I Co. 1 to merge with I Co. 2 - GoI approval required ?

Illustration 8 - AIF structure



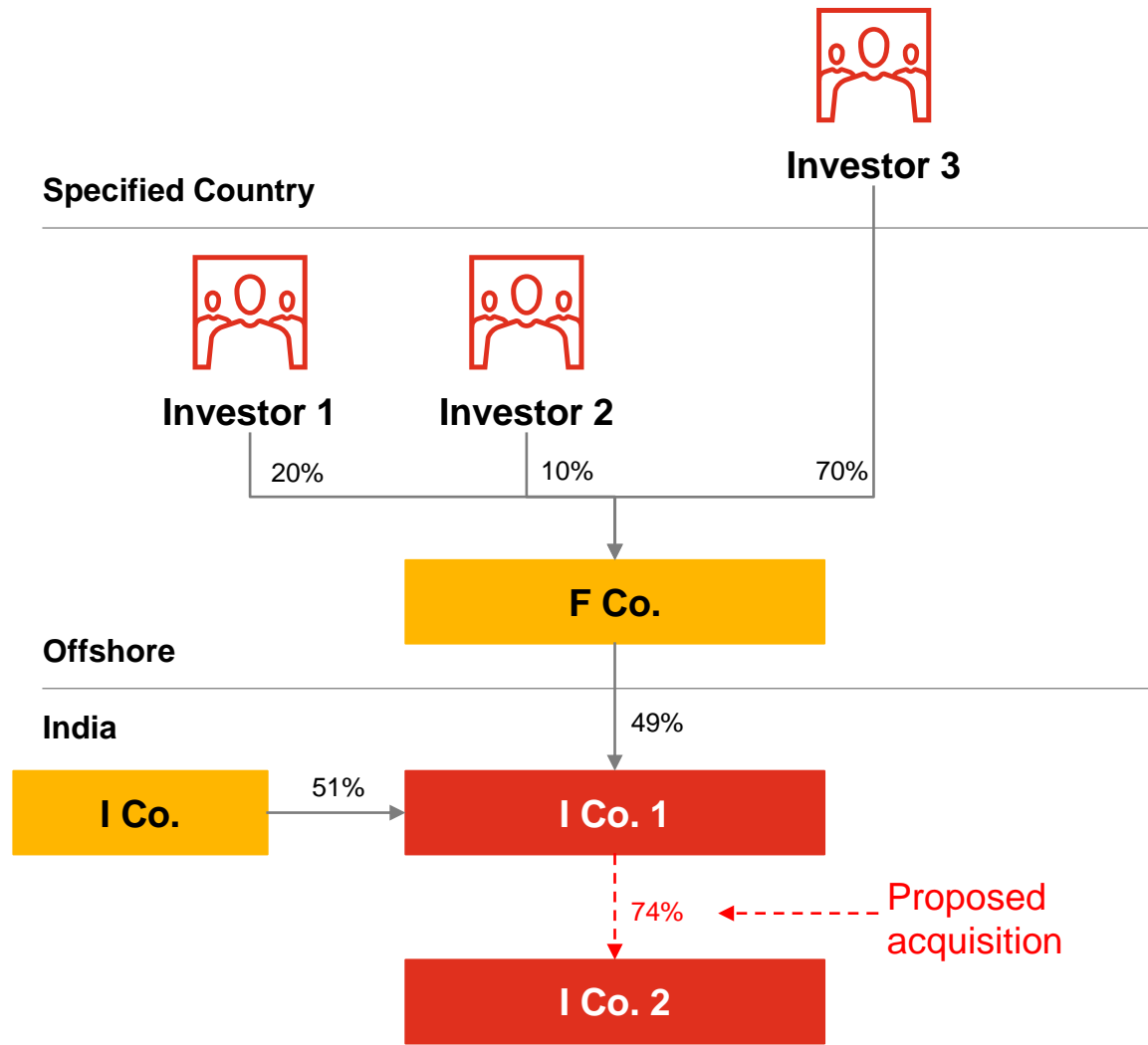
Facts:

- Offshore Fund to acquire units of an Alternative Investment Fund (AIF) in India
- Sponsor and manager of the AIF are Indian owned and controlled
- AIF to acquire 100% stake in I Co.
- Offshore Fund has raised capital from investors based in Specified Country as well as other jurisdictions
 - 20% LP interest from Specified Country

Issues:

- A. GoI approval on investment in units of AIF?
- B. GoI approval on AIF's acquisition of I Co.?
- C. What if Sponsor and manager are not Indian owned and controlled?

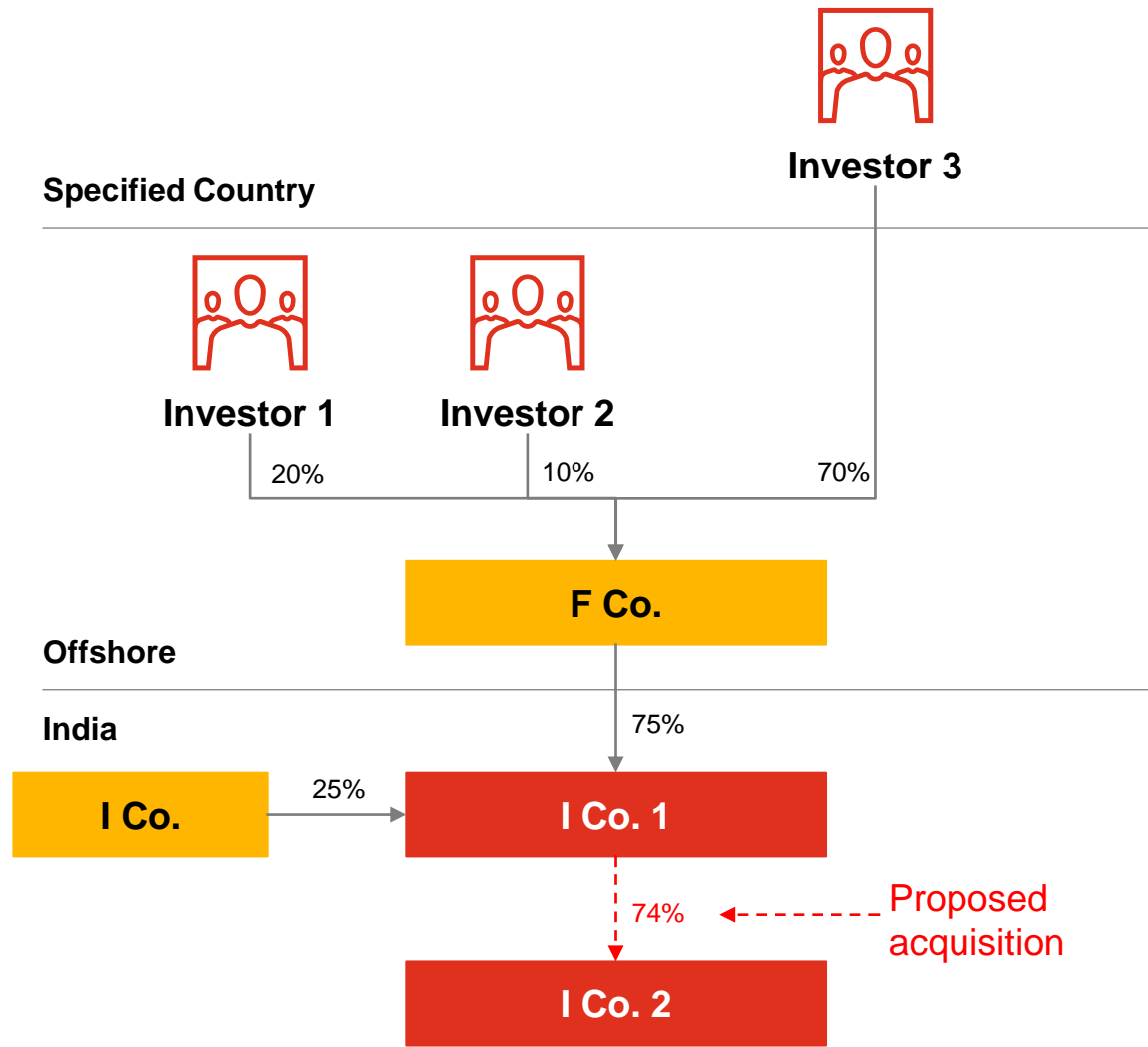
Illustration 9 - Downstream investment (IOCC)



Facts:

- F Co. holds 49% equity in I Co. 1
- 70% stake in F Co. is held by investors based in Specified Country
- I Co. 1 proposes to acquire 74% stake in I Co. 2
- Whether I Co. 1 required to obtain GoI approval for investment in I Co. 2 ?

Illustration 10 - Downstream investment (FOCC)



Facts:

- F Co. holds 75% equity in I Co. 1
- 70% stake in F Co. is held by investors based in Specified Country
- I Co. 1 proposes to acquire 74% stake in I Co. 2
- Whether I Co. 1 required to obtain GoI approval for investment in I Co. 2 ?

Open issues

1

Beneficial owner needs to be appropriately defined for the purpose of Press Note 3 - Whether BO definition to be used as per PMLA / SBO / some other definition ?

2

Foreign investments in AIFs / REITs / InVITs - Covered by Press Note 3 ?

3

Meaning of the term “situated in” used in the Press Note

4

Clarity on bonus issues, rights issues, warrants on existing investments



Thank you

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