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REGULATORY UPDATES

KEY AMENDMENTS UNDER THE FOREIGN EXCHANGE MANAGEMENT (NON-DEBT INSTRUMENTS) RULES, 2019

Earlier in the Union Budget 2024-25 the Union Minister for Finance and Corporate Affairs, announced the government's intention to streamline the regulatory framework governing Foreign Direct Investments (FDI) and Overseas Investments (OI). Consequently, the Ministry of Finance issued a notification on August 16, 2024, amending the Foreign Exchange Management (Non-debt Instruments) Rules, 2019, through the Foreign Exchange Management (Non-debt Instruments) (Fourth Amendment) Rules, 2024.

The salient features of these amendments are detailed below:

1. Harmonization of Definitions

To ensure consistency, the definitions have been removed from the Rule 23 dealing with downstream investment and in Schedule II for the purpose of determining common control in relation to investment by FPI including foreign governments, and a unified definition has been added to Rule 2.

Furthermore, the definition has been aligned with the Companies Act, 2013, which now includes 'control exercised by a person or persons acting individually or in concert, directly or indirectly.'

However, the definition of 'control' with respect to a limited liability partnership remains unaltered i.e.,

"the right to appoint the majority of designated partners, who, with specific exclusion of others, have authority over all policies of the LLP."

Additionally, the definition of 'startup company' has been brought in line with the Department for Promotion of Industry and Internal Trade notification G.S.R. 127 (E), dated February 19, 2019.

2. <u>Prior approval of Government for transfer of Equity instrument</u>

Earlier, the transfer of equity instruments of an Indian Company by a Person Resident Outside India required government approval only if the Indian entity was involved in a sector needing such approval. However, with the amended NDI Rules of 2024, government approval is now required for all applicable transfers wherein government approval is required in case of fresh issuance of equity shares, regardless of the sector in which the Indian Company operates.

3. <u>Facilitation of Equity Instrument and Capital Exchange</u>

Earlier as per the schedule I of NDI rules, the issuance of Equity Instrument by an Indian Company to a Person Resident Outside India through swap of equity instrument of another Indian Company were permitted. However, it does not cover the transfer of equity instrument of an Indian between the Person Resident in India and Person Resident Outside India against swap of equity instruments of another Indian company.

The new Rule 9A introduced by this amendment allows the transfer of Equity instruments of an Indian Company between a Person Resident in India and a Person Resident outside India by way of:-

(i) Swap of equity instruments of an Indian Company between a Person Resident in India and a Person Resident outside India in compliance with the rules prescribed by the Central Government and the Reserve Bank of India ("**RBI** ").

(ii) Swap of Equity capital of a foreign capital in compliance with the Foreign Exchange Management (Overseas Investment) Rules, 2022.

However, the prior approval of government is required before making any transfers if it is required.

Further, similar amendments have been made under the schedule I of the NDI Rules permitting the swap of equity capital of foreign Company and equity instrument by way of transfer subject to the compliance of provisions with the provisions of both the NDI Rules and the Foreign Exchange Management (Overseas Investment) Rules 2022 (OI Rules).

4. Investments Exempt from Downstream Investment Classification

Earlier, the investment made by an Indian Entity which is owned and controlled by the Non-Resident Indians (NRIs) on a non-repartition basis were exempted from the calculation of indirect foreign investment and resultant compliances relating to downstream investment.

Now this exemption has been extended to the investment made by an Overseas Citizen of India (OCIs) including a company, a trust and a partnership firm incorporated outside India and owned and controlled by NRI or an OCI on non-repatriation basis in compliance with Schedule IV of FEMA NDI Rules.

5. Permissible Foreign Portfolio Investment without Government Approval

Earlier, the government approval was not required, and sectoral conditions were not applied if the aggregate foreign portfolio investment by Foreign Portfolio Investor was upto 49% of the paid-up capital or the sectoral cap, whichever was lower.

Now, the recent amendment to the NDI Rules has permitted the aggregate foreign portfolio investment upto the sectoral or statutory cap without compliance of sectoral conditions. Provided such investment does not result in transfer of ownership and/or control of the resident Indian company.

6. Sectoral Cap for White Label ATMs

A new entry has been introduced in Schedule I of the NDI Rules under the section 'Other Financial Services', permitting 100% Foreign Direct Investment (FDI) in White Label ATM operations through the automatic route.

Although this was already included in the Consolidated FDI Policy 2020, it has now been formally added to the NDI Rules.

Conclusion: -

The Amendment Rules aim to make cross-border equity share swaps more straightforward by enabling the exchange of equity instruments between

Indian and foreign companies. The rules also update the definitions of 'start-ups' and 'control' to be consistent with other legal frameworks and allow for 100% Foreign Direct Investment (FDI) in white label ATM operations under the automatic route.

For more details, refer to the Ministry of Finance Notification Dated August 16,2024.

DISCLAIMER*: - The summary information herein is based on Ministry of Finance Notification Dated August 16,2024. While the information is believed to be accurate, we make no representations or warranties, express or implied, as to the accuracy or completeness of it. Readers should conduct and rely upon their own examination and analysis and are advised to seek their own professional advice. This note is not an offer, advice or solicitation. We accept no responsibility for any errors it may contain, whether caused by negligence or otherwise or for any loss, howsoever caused or sustained, by the person who relies upon it.*

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