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REGULATORY UPDATES

RESERVE BANK OF INDIA PERMITS FOREIGN-OWNED OR CONTROLLED COMPANIES (FOCCs) TO BUY AND SWAP SHARES WITH INDIAN BUSINESSES AND DEFERRED PAYMENT ARRANGEMENT

The Master Direction now unequivocally provides that, in line with the principles governing downstream investments, mechanisms permitted for direct investments under the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 ("NDI Rules"), such as equity instrument swaps and deferred payment arrangements, are also applicable to downstream investments, subject to compliance with the relevant provisions of the NDI Rules.

Previously, under Rule 23 of the NDI Rules, downstream investments by Foreign Owned or Controlled Companies (FOCCs) were restricted to utilizing foreign funds or the internal accruals of the Indian entity. In contrast, non-resident investors making Foreign Direct Investments (FDI) in Indian entities enjoyed greater flexibility, including the ability to invest through share swaps and deferred payment arrangements.

This created a regulatory imbalance, where indirect foreign investments by FOCCs faced stricter compliance requirements compared to direct foreign investments by non-residents.

In a progressive and much-welcomed move, the Reserve Bank of India (RBI) has now addressed this disparity by allowing FOCCs engaged in downstream investments to utilize deferred payment arrangements and share swaps. This clarification not only resolves long-standing uncertainties but also aligns the regulatory framework for downstream investments with broader FDI norms. By eliminating these constraints, the RBI has fostered a more balanced and investor-friendly environment, enabling smoother and more flexible investment structures for FOCCs.

INTRODUCTION OF SWAP MECHANISM FOR DOWNSTREAM INVESTMENT

According to Rule 23(4) of the NDI Rules, a downstream investment by an Indian entity must be made using funds received from abroad or from the internal accruals of the entity (internal accruals refer to profits transferred to reserve accounts after tax payments). This means that the Indian entity cannot make a downstream investment using funds borrowed from domestic markets.

However, the Reserve Bank of India (RBI), through an updated Master Direction on Foreign Investment dated 20th January, 2025 has now permitted downstream investments through share swaps.

With the new guidelines, Indian entities that have received foreign investment can now also make downstream investments by acquiring shares in the local market through the share swap mechanism.

This change allows both listed and unlisted companies with more than 50% foreign shareholding to quickly pursue peer acquisitions through stock or stock-and-cash deals, without needing RBI approval.

As a result, stock acquisitions by Foreign Owned or Controlled Companies (FOCC), whether through cash transactions or share swaps, are now classified as downstream investments under Foreign Direct Investment (FDI) regulations. This is because the FOCC was originally established with foreign currency inflows via the conventional FDI route. Therefore, any investment made by the FOCC in Indian entities, regardless of the method used, is considered an extension of FDI and aligns with the principles and conditions outlined in FDI regulations.

DEFERRED PAYMENT ARRANGEMENTS

As per Rule 9(6) of the NDI Rules, deferred payment arrangements are permissible only for cross-border transactions (i.e., transactions between residents and non-residents), subject to certain conditions:

1. The deferred payment, which may include post-closing escrow, indemnity or price adjustment must not exceed 25% of the total transaction value.
2. The deferred amount must be settled within 18 months from the date of the transfer agreement.

Further, the said deferred payment terms are not allowed in case of downstream investment. However, with the amended direction issued by the Reserve Bank of India deferred payment terms are now clarified to have been permitted under downstream investments.

For more details, refer to the RBI Master Direction No. FED Master Direction No.11/2017-18 dated 20th January, 2025

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