

Change in Rules – A Sign of Change

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Govt on Changes Under NDI Rules - Introduces Much Sought After Changes Under NDI Rules

The Government of India ("GOI") has been constantly striving to make India an investment hub and in its endeavour to do so, has been introducing timely changes to its foreign investment regime. On 17th October, 2019 the GOI notified the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019[1] ("NDI Rules"). Subsequently, on 27th April, 2020 the Ministry of Finance, under the GOI, brought in the second amendment to the NDI Rules, the Foreign Exchange Management (Non-debt Instruments) (Second Amendment) Rules, 2020[2] ("Amended Rules") (the NDI Rules and the Amended Rules are collectively referred to as the "Rules".) The Amended Rules have brought in some long anticipated changes.

Background

The Foreign Exchange Management Act, 1999 ("Act") and the rules and regulations thereunder govern Foreign Direct Investments ("FDI") in India. An Indian company looking to receive any foreign investment must comply with the sectoral caps, entry routes and such other ancillary regulations related to the business of the company. The Indian foreign investment regime categorises various sectors / industries into which FDI is permitted in India either through the automatic or approval route.

Further, non-debt instruments have been brought under the purview of the newly introduced NDI Rules. The NDI Rules supersede the Foreign Exchange Management (Transfer of Issue of Security by a Person Resident outside India) Regulations, 2017 ("TISPRO") and the Foreign Exchange Management (Acquisition and Transfer of Immovable Property in India) Regulations, 2018, thus consolidating the entire non-debt instrument regulations under a single umbrella.

Significant Changes

Some of the significant changes brought in by the Amended Rules are as mentioned hereinbelow:

- Acquisition subsequent to renunciation of rights: The Amended Rules deleted the explanation to Rule 7 of the NDI Rules, which stated that the conditions stipulated under the said Rule 7 shall be applicable with respect to an investment made by a non-resident person in the equity instruments (other than share warrants) issued by an Indian company as a rights issue that are

renounced by the person to whom it was offered. Also, a new Rule 7A has been inserted which stipulates that a non-resident person may subscribe to equity instruments (other than share warrants), in the event a person resident in India has specifically renounced the shares offered in a rights issue in favour of such non-resident and the same shall be subject to the pricing guidelines as prescribed in Rule 21 of the NDI Rules. However, it is to be noted that the current language in the Amended Rules does not consider a situation where an existing foreign investor renounces a rights issue entitlement in favour of another foreign investor. Hence, clarification to this effect is required to understand whether the NDI pricing guidelines would apply or acquisition can be effectuated at the prevailing price for rights issue.

- Relaxation of sourcing norms: The NDI Rules prescribe the sourcing norms for entities having more than 51% of FDI and engaged in Single Brand Retail Trading ("SBRT"). Foreign investment in an entity engaged in SBRT is permitted under the automatic route up to 100%. Currently, the sourcing norms mandate entities having more than 51% of FDI and undertaking SBRT to source 30% of the value of the goods domestically, which can be met, in the first instance, as an average of 5 years' total value of goods procured, beginning from 1st April of the year of commencement of the business and shall thereafter be met on an annual basis. In this regard, the government has also clarified that goods procured from units in special economic zones ("SEZs") by single brand retailers, owned by foreign companies, would qualify for the mandatory 30% local sourcing conditions, subject to SEZ Act, 2005. However, the NDI Rules now provides exemption from the aforesaid sourcing norms to entities with more than 51% FDI and undertaking SBRT of products having state of art, and cutting edge technology and where local sourcing is not possible, for a tenure of up to 3 years from the date of commencement of business (i.e., from opening of the first store, or the start of online retail activities, whichever is earlier). The Amended Rules, by incorporating the phrase "*or start of online retail, whichever is earlier*" in the relevant part of the table set out in the NDI Rules[3], have brought about much required clarity with respect to the above stated exemption pertaining to the sourcing norm for entities engaged in SBRT through e-commerce in India.
- 100% FDI for Insurance Intermediaries: The Amended Rules have further liberalised the FDI norms in the insurance sector by permitting 100% FDI under the automatic route in intermediaries or insurance intermediaries including insurance brokers, reinsurance brokers, insurance consultants, corporate agents, third party administrators, surveyors, loss assessors, and such other entities as may be notified by the Insurance Regulatory and Development Authority of India ("IRDAI"). It is pertinent to mention here that FDI limit for Insurance Companies remains unaltered at up to 49% under the automatic route, thereby bifurcating insurance companies from the insurance intermediaries.
- Divestment by Foreign Portfolio Investors: The NDI Rules stipulate the threshold limit for the maximum investment permitted by a Foreign Portfolio Investor ("FPI"). Also, the NDI Rules stipulate conditions in the event an FPI exceeds the prescribed threshold limit in an entity. The FPI has the option to divest excess investment within the prescribed time limit, failing which such excess investment shall convert into FDI. The Amended Rules have now made such divestment and/or reclassification subject to further

regulations that may be issued by the Securities and Exchange Board of India and the Reserve Bank of India.

Conclusion

In light of the economic and financial crisis looming in the horizon, the amendments introduced would be able to further regularise and attract foreign investment into the country. Opening up of sectors, especially in the insurance field may enable to usher a new change in the insurance industry. While the stakeholders are optimistic about the steps taken by the Government of India, it would be interesting to see what further measures are introduced in order to disburse the dark clouds of economic distress.

- In the principal rules, in Schedule 1, in the Table, against serial number 15.3.1, in the entries under column (2), under sub-heading "Note", in serial number (3), after the words "first store", the words "or start of online retail, whichever is earlier" shall be inserted. The same shall now be read as: (3) *Sourcing norms shall not be applicable up to three years from commencement of the business i.e. opening of the first store or start of online retail, whichever is earlier, for entities undertaking single brand retail trading of products having 'state-of-art' and 'cutting-edge' technology and where local sourcing is not possible. Thereafter, condition mentioned at 15.3.1(e) above shall be applicable. A Committee under the Chairmanship of Secretary, DPIIT, with representatives from NITI Aayog, concerned Administrative Ministry and independent technical expert(s) on the subject shall examine the claim of applicants on the issue of the products being in the nature of 'state-of-art' and 'cutting-edge' technology where local sourcing is not possible and give recommendations for such relaxation.*

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