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Changes introduced by the Foreign Direct Investment Policy

The Department of Industrial Policy and Promotion ("**DIPP**") issues a consolidated policy on foreign direct investment ("**FDI**") in India ("**Consolidated FDI Policy**") on an annual basis. The DIPP has issued the latest edition of the Consolidated FDI Policy vide Circular no. 1 of 2013 ("**New FDI Policy**"). The New FDI Policy (effective from 5 April 2013) introduces several changes to the erstwhile Consolidated FDI Policy; some of which have been set out below.

A. Amendments in FDI policy pursuant to Press Notes issued by DIPP

1. As per Press Note 2 of 2012, issued by DIPP, while computing downstream investments in a banking company (incorporated as an Indian company and not owned by resident entities) investment vide corporate debt restructuring, loan restructuring mechanism, trading books or for acquisition of shares due to defaults in loan shall not be considered towards indirect foreign investment.
2. As per Press Note 3 of 2012, citizens of Pakistan or an entity incorporated in Pakistan are permitted to invest in India, under the Government approval route.
3. As per Press Note 5 of 2012, FDI in Multi Brand Retail Trading shall be allowed upto 51% FDI under government route in branded products, subject to the specified conditions.
4. As per Press Note 6 of 2012, FDI in Civil Aviation Sector by foreign airlines has been permitted upto 49% (cumulative of investment vide FDI and foreign institutional investors) of the paid up capital of such private airline companies, subject to the conditions stipulated in the note.
5. The DIPP has vide Press Note 7 of 2012, amended FDI limits in the Broadcasting sector. Foreign investment for companies engaged in broadcasting sector shall include foreign investments by foreign institutional investors ("**FIIs**"), NRIs and through issuance of foreign currency convertible bonds, American depository receipts, global depository receipts and convertible preference shares. The revised limits are as stated below:

Sector / Activity	**Existing sectoral cap**	**Sectoral cap as per New FDI policy**
Teleports (setting up of up-linking HUBs / Teleports), Direct to home, Cable networks (Multi System operators operating at National / State / District level and undertaking upgradation of networks towards digitalization and addressability); Head-end in the sky Broadcasting services	49%- under Government approval route	Upto 49% - automatic route; Beyond 49% and upto 74% - Government approval route
Mobile TV	-	

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6. As per Press Note 8 of 2012, foreign investment upto 49% cumulative of FDI and FII investment in Power Trading Exchanges is allowed. The FDI limit being 26% and FII limit being 23%.
7. As per Press Note 9 of 2012, Non Banking Financial Companies (‘**NBFC**’) having foreign investments above 75% and below 100% and a minimum capitalization of US$ 50 million, have been permitted to set up step down subsidiaries for specific NBFC activities, without any restriction on the number of operating subsidiaries and without bringing in additional capital.
8. FDI limits in Single Brand product retail trading (“**SBT**”) had been relaxed upto 100%. Further, to address the concerns of foreign investors the two key conditions pertaining to ownership of brand and mandatory local sourcing have been liberalised as under:
    - Earlier, a foreign investor was required to be the owner of brand. Currently this condition has been liberalized and now only one non-resident entity, whether owner of the brand or otherwise, shall be permitted to undertake SBT in India. SBT shall be allowed through a legally tenable agreement, with the brand owner. The onus for ensuring compliance shall rest with the Indian entity carrying out SBT in India.
    - Earlier, in case of proposals involving FDI beyond 51%, mandatory sourcing of at least 30% of the value of goods was required from Indian villages, cottage industries, artisans and craftsmen. The New FDI Policy has relaxed this condition by providing that such sourcing should preferably be from Micro, Small and Medium Enterprises, village and cottage industries, artisans and craftsmen.

B. Other Amendments in FDI policy

1. In case of investment by a FII an additional compliance is required to be undertaken by the custodian bank by uploading daily statements on the Reserve Bank of India (“**RBI**”) website in addition to submission of requisite details in floppy /soft copy to the RBI.
2. Dividend payments on equity shares to Qualified Foreign Investors (“**QFIs**”) have to be credited directly to designated overseas bank accounts of the QFIs or single non-interest bearing rupee account. Under the Consolidated FDI Policy, dividends were required to be directly credited to the single rupee pool bank account.
3. FDI in LLPs is permitted only on compliance with the stipulated conditions as laid down in Clause 3.2.5 (a) to (j) of the policy. As per the New FDI Policy, in cases of conversion of a company with FDI into an LLP, compliance with clause 3.2.5(e) has been made optional. Clause 3.2.5(e) and (j) reads as under:

    …“(e) Foreign capital participation in LLPs will be allowed only by way of cash consideration, received by way of inward remittance, through normal banking channels or by debit to NRE /FCNR account of person concerned, maintained with authorized dealer / bank”.

    …“(j) Conversion of a company with FDI into LLP, will be allowed only if the above stipulations (except clause 3.2.5(e) which would be optional in case of a company) are met and with prior approval of FIPB / Government”.

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Although compliance with clause (e) has been relaxed, from the above it is not clear whether such compliance has been made optional in case of companies prior to their conversion into an LLP or post such conversion into an LLP.

4. As per the Consolidated Policy the value of shares at the time of subscription by foreign investors was required to be determined as per the discounted cash flow method by SEBI registered Category – I Merchant Banker or a Chartered Accountant. The New FDI Policy permits non-residents to subscribe to the memorandum of association of an Indian company at face value, subject to their eligibility to invest under the FDI scheme.
5. The New FDI Policy permits foreign investments in Asset Reconstruction Companies ("**ARC**") upto 74% of paid up capital of ARC under the Government approval route (cumulative of FDI and FII investment) subject to the following conditions:
   - No single sponsor to hold more than 50% of shareholding in ARC;
   - Total shareholding of individual FII shall not exceed 10% of total paid-up-capital; and
   - All investments will be subject to provisions of Section 3(3)(f) of Securitization & Reconstruction of Financial Assets & Enforcement of Security Interest Act, 2002 (i.e. sponsor should neither be a holding company nor holding any controlling interest in such securtisation or reconstruction company).
6. As per the New FDI Policy, 100% FDI under the Government approval would be permitted for brownfield investments (i.e. investments in existing companies), in the pharmaceutical sector subject to fulfillment of appropriate conditions at the time of granting approval.

Although the relaxation in sectoral caps and other initiatives outlined above are a welcome initiative, there has been no clarification on the aspect of valuation requirements in case of issue of shares to a non-resident pursuant to a right issue. The question whether a valuation as per the DCF method is required to be done by a Chartered Accountant when right issue is to be made in case there are only foreign shareholders remains a grey area with differing views being taken.

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