Debt Funding in India

February 2019
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## Glossary

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1. Introduction

Investment into companies are generally in the form of equity investment or debt investment. Equity instruments provide the investor direct upside from the operations of the investee company, along with substantial control rights. On the other hand, debt investments provide investors downside protection, guaranteed returns and security against the sums advanced. In the last couple of decades alternative means to bank lending also emerged to cover for the debt needs of Indian companies. Another paradigm shift that investments into Indian companies that was noticed was the use of hybrid instruments, merging the benefits of debt instruments (such as downside protection and guaranteed returns) as well as of equity instruments (such as upside sharing and controlling rights).

The Indian central bank, the Reserve Bank of India has undertaken stern measures in the last 2 years to clean up the non-performing assets in India. In the backdrop of these measures, banking institutions in India have been more cautious in lending to companies. Further, a few banks have been put under RBI’s Prompt Corrective Action (PCA) plan, thereby restricting the ability of these banks to lend.

With banks facing constraints on lending, Indian companies have been looking at alternative modes of funding. Private debt funds have seen a substantial rise in the Indian debt scenario due to increasing opportunities. The emergence of these debt platforms can also be attributed to the enactment of the Insolvency and Bankruptcy Code, 2016 in India, which provided creditors with substantial powers enabling them to ensure that the promoters of the Indian companies do not go rogue.

The changing dynamics of the Indian regulatory framework has also resulted in debt funds / investors being compelled to look at various structures for debt investments into India. Some of these regulatory requirements include minimum residual maturity for corporate bonds issued to foreign portfolio investors, concentration norms for foreign portfolio investors investing into Indian corporate bonds, thin capitalization norms for Indian corporates, applicability of the International Financial Reporting Standards (IFRS) for Indian companies and enactment of the General Anti-Avoidance Rules under the Indian tax regime. (Refer Annexure I for comparative analysis of debt vs equity). This paper discusses structures and strategies for offshore debt investors to invest in India.
2. Debt funding options

The Indian regulatory framework provides options for both onshore and offshore debt funding for Indian companies. The offshore funding routes are generally highly regulated and need to comply with a number of conditions provided under Foreign Exchange Management Act, 1999 ("FEMA"). Onshore lending generally does not require compliance with FEMA, and is generally less regulated.

I. Investment Instruments

Debt Investment in India can be made by way of various instruments, such as:

i. Non-Convertible Debentures ("NCDs") are debt instruments which cannot be converted into equity shares of a company. Return on NCDs is by way of interest that is payable on them and upside on sale or extinguishment. They are regarded as corporate debt and will accordingly be subjected to the overall corporate debt auction limits of India. Investment in NCDs can be made under the FPI Route or by an FVCI.

ii. Compulsorily Convertible Debentures ("CCDs") or Compulsorily Convertible Preference Shares ("CCPS") are instruments which mandatorily convert into equity shares of the issuing company on the conditions decided mutually at the time of issuance of the instruments. CCDs generally have a lower rate of interest than NCDs. CCDs are considered as capital instruments and investment in CCDs may be made under the FDI route. (Refer Annexure II for comparative analysis of CCD (under FDI) vs NCD (under FPI))

iii. Optionally Convertible Debentures ("OCDs") are instruments that may be converted to equity shares of a company but such conversion is not mandatory. Investment in OCDs may be made under the FVCI route.

iv. Rupee Denominated Bonds ("RDBs") or Masala Bonds are bonds issued by corporates outside India but are denominated in Indian Rupees. These bonds are generally priced at 450 basis points over the prevailing government security rate. These bonds are governed by the directions issued by Reserve Bank of India ("RBI") from time to time.

v. Security Receipts ("SRs") are instruments issued by ARCs (defined below) in exchange for non-performing assets acquired by them.

II. Investment Routes

Foreign debt could be infused in one of the following ways:

i. Foreign Direct Investment ("FDI") is investment through capital instruments such as equity, CCD and CCPS.

ii. Foreign Portfolio Investment is (i) investment by a person registered with the Securities and Exchange Board of India ("SEBI") as a Foreign Portfolio Investor ("FPI") and is investing in instruments such as NCDs of an Indian company, units of domestic mutual funds, SRs issued by asset reconstruction companies etc.; or (ii) investment by a person resident outside India through less than 10% of capital instruments of listed Indian company.

iii. Investment by Foreign Venture Capital Investor ("FVCI") through securities of an Indian company engaged in a few limited sectors or units of a Category I Alternative Investment Vehicle or Venture Capital Fund and / or OCDs of an Indian venture capital undertaking or a venture capital fund.

iv. External Commercial Borrowing ("ECB"): is infusion of capital by direct lending or lending in exchange of rupee denominated bonds.
III. Onshore Investment Vehicles

i. **Non-Banking Finance Companies (“NBFC”)** means a company incorporated under the Companies Act, 2013, engaged in the business of loans and advances, acquisition of bonds and marketable securities issued in relation to leasing, hire-purchase, insurance business, chit business but does not include any institution whose principal business is that of agriculture activity, industrial activity, purchase or sale of any goods (other than securities) or providing any services and transfer of immovable property.

ii. **Alternative Investment Fund (“AIF”)** means any fund established or incorporated in India which is a privately pooled investment vehicle which collects funds from sophisticated investors, whether Indian or foreign and invests it for the benefit of its investors.

iii. **Asset Reconstruction Companies (“ARC”)** means a company which purchases bad assets or Non-Performing Assets (“NPAs”) from banks or financial institutions in exchange for SRs. Thus, helps banks clean up their balance sheets and helps revive the stressed company.
3. Investment Routes

I. Foreign Direct Investment

A. Introduction

Foreign Direct Investment is governed by the Foreign Exchange Management Act (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2017 (“TISPRO Regulations”). FDI investment is by way of investment:

(i) through capital instruments by a person resident outside India in an unlisted Indian company; or

(ii) in 10% or more of the post issue paid-up equity share capital on a fully diluted basis of a listed Indian company.

Investment by way of FDI is subject to entry route restrictions and sectoral caps. The TISPRO Regulations provide for the following two entry routes, and specify the sectors pertaining to each:

a. **Automatic Route:** no prior approval from either the RBI or the Government is required for investment by non-resident investors

b. **Government Route:** prior approval is required from the Government for investment made by nonresident investors, and such investment shall be subject to the conditions stipulated in the approval.

B. Instruments and Modes of Investment

FDI Investment is investment in capital instruments which include equity shares, compulsorily and fully convertible debentures, compulsorily and fully convertible preference shares and share warrants issued by an Indian company. A debt investor can invest by way of CCDs. There are a few sectors in which FDI is prohibited. The investment and conversion into equity shares may be subject to pricing guidelines, and other FDI-linked requirements such as:

a. **Optionality:** Instruments subscribed to by foreign investors may contain an optionality clause (such as a put/call option), subject to a minimum lock-in of 1 year, or the prescribed lock-in for the relevant sector, as applicable.

b. **No assured returns:** While interest payments on CCDs is permissible, due to RBI guidelines on pricing, the price/conversion formula has to be determined upfront at the time of issuance, and the price at the time of conversion cannot be lower than fair market value. Further, instruments issued with optionality clauses will not considered to be FDI compliant, unless they comply with RBI guidelines in this regard, including, inter alia, minimum lock-in of 1 year, and obtaining exit only according to the prevailing market price. The prevailing intent is that foreign investors subscribing to instruments with optionality clauses should not be guaranteed an exit price.

c. **Pricing guidelines:** FEMA also regulates the entry and exit price of investments made under the FDI regime. The pricing requirements are different for companies having their shares listed and unlisted. The price of capital instruments of an Indian company issued by it to a person resident outside India should not be less than:

- Listed company - the price worked out in accordance with the relevant SEBI guidelines.
- Unlisted company - the valuation of capital instruments done as per any internationally accepted pricing methodology for valuation on an arm’s length basis duly certified by a Chartered Accountant, a SEBI registered Merchant Banker or a practicing Cost Accountant.
II. Foreign Venture Capital Investors

A. Introduction
The FVCI regime is regulated by the SEBI (Foreign Venture Capital Investors) Regulations, 2000 ("FVCI Regulations"). The regulations were enacted to incentivize foreign investment into venture capital undertakings and startups in India, by providing certain incentives to FVCIs who registered themselves with SEBI. They are permitted to invest in far fewer sectors.

B. Permitted Sectors
Investment by an FVCI is only permitted in entities in certain sectors, VCFs, Category I AIF and start-ups:

List of Sectors in which an FVCI can invest:

a. Biotechnology
b. IT related to hardware and software development
c. Nanotechnology
d. Seed research and development
e. Research and development of new chemical entities in pharmaceutical sectors
f. Dairy industry
g. Poultry industry
h. Production of bio-fuels
i. Hotel-cum-convention centres with seating capacity of more than three thousand
j. Infrastructure sector. The term ‘Infrastructure Sector’ has the same meaning as given in the Harmonised Master List of Infrastructure sub-sectors approved by Government of India vide Notification F. No. 13/06/2009-INF dated March 27, 2012 as amended/updated.

C. Instruments and Modes of Investment
FVCIs can invest in the following instruments:

a. equity or equity linked instruments (including optionally convertible debentures), or debt instruments issued by an Indian company engaged in any of the permitted sectors, whose shares are not listed on any recognized stock exchange at the time of issue of the said securities;

b. equity or equity linked instruments, or debt instruments issued by a start-up, irrespective of the sector in which the startup is engaged; and

c. units of a Venture Capital Fund ("VCF"), or of a Category I AIF, or of a scheme or fund set up by such VCF or by a Category I AIF.

D. Considerations
The FVCI Regulations provide for risk diversification norms for FVCI entities:

a. The FVCI can invest its total funds committed in one VCF or Category I AIF;

b. The investment shall be made in the following manner:

i. at least 66.67% of the investible funds shall be invested in unlisted equity shares or equity linked instruments of venture capital undertakings or investee company;

ii. up to 33.33% of the investible funds may be invested by way of:

2. Venture capital undertaking means a domestic company: (i) which is not listed on a recognized stock exchange in India at the time of making investment; and (ii) which is engaged in the business for providing services, production or manufacture of article or things, and does not include the following activities or sectors: (1) non-banking financial companies, other than Core Investment Companies (CICs) in the infrastructure sector, Asset Finance Companies (AFCs), and Infrastructure Finance Companies (IFCs) registered with Reserve Bank of India; (2) gold financing; (3) activities not permitted under industrial policy of the Government of India; and (4) any other activity which may be specified by the Board in consultation with the Government of India from time to time.
- subscription to an initial public offer of a venture capital undertaking or investee company whose shares are proposed to be listed;
- debt or debt instrument of a venture capital undertaking or investee company in which the FVCI entity has already invested by way of equity; or
- preferential allotment of equity shares of a listed company, subject to a lock-in period of one year; and

iii. the life cycle of the fund shall be disclosed by the FVCI entity.

F. Benefits of an FVCI entity

i. Broad range of Instruments

As per the FVCI Regulations, FVCI entities can invest instruments such as CCDs and OCDs as well as equity shares and other equity linked instruments. Equity linked instruments include instruments convertible into equity shares, including instruments optionally convertible into equity shares.

ii. Pricing Exemption

Where the FVCI entity acquires securities from, by purchase or otherwise, or transfers securities, by sale or otherwise, to a non-resident, the pricing norms do not apply, and the purchase/sale may be carried out at a price mutually acceptable to the seller and the buyer. The FVCI entity may also receive proceeds of liquidation of VCFs or Cat-I AIFs, or of schemes/funds set up by them.

Thus, there are no price floors/ceilings applicable to FVCI entities, and the investment in capital instruments will only be subject to sectoral caps, reporting and related requirements.

iii. Lock-in Exemption

Under the SEBI (Issue of Capital and Disclosure) Regulations 2009 (“ICDR Regulations”), the entire pre-issue share capital (other than certain promoter contributions which are locked in for a longer period) of a company conducting an IPO is locked for a period of 1 year from the date of allotment in the public issue. However, an exemption from this requirement has been granted to registered FVCIs, provided that the shares shall be locked in for at least 1 year from the date of purchase by the FVCI. This exemption permits FVCIs to exit from investments immediately post-listing.

iv. Exemptions under the Takeover Code

Regulation 10 of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (“Takeover Code”) provides an exemption from open offer obligations to promoters of a listed company, acquiring shares of the listed target company, from an FVCI entity, pursuant to an agreement between the FVCI entity and the promoters.

v. QIB Status

FVCIs registered with SEBI have been accorded qualified institutional buyer (“QIB”) status under the ICDR Regulations, and are eligible to subscribe to securities at an IPO through the book building route.

III. Foreign Portfolio Investments

A. Introduction

The FPI regime in India is governed by the SEBI (Foreign Portfolio Investors) Regulations, 2014 (“FPI Regulations”), which was enacted by merging the erstwhile foreign institutional investor route and the qualified foreign investor route. Erstwhile FIIs and QFIs were deemed to be Foreign Portfolio Investors (“FPIs”) after payment of a conversion fees, and new foreign investors were required to register separately under these regulations.
B. Limitations

a. Individual Limit: The total holding of one single FPI or an investor group shall not exceed: (i) 10 percent of the total paid-up equity share capital issued by an Indian company, on a fully diluted basis; or (ii) 10 percent of the paid-up value of each series of debentures, or preference shares, or share warrants issued by an Indian company.

b. Aggregate Limit: The total holdings of all FPIs put together shall not exceed 24% of the Indian company's paid-up equity share capital on a fully diluted basis, or the paid-up value of each series of debentures, or preference shares, or share warrants issued by the Indian company.

In case the investment made by an FPI is in excess of the prescribe Individual Limit, such investment shall be re-classified as an FDI investment, subject to further compliances by SEBI and RBI Regulations framed in this regard.

C. Categories of FPIs

The FPI Regulations classify FPIs into three categories based on the basis of risk-based approach of the customer. The following table describes the eligibility criteria and registration fee for each category:

i. Category I FPI includes Government and government-related investors such as central banks, Governmental agencies, sovereign wealth funds or international and multilateral organizations or agencies.

ii. Category II FPI includes the following: i. Appropriately regulated broad based funds; ii. Appropriately regulated persons; iii. Broad-based funds that are not appropriately regulated but their managers are regulated; iv. University funds and pension funds; and v. University related endowments already registered with SEBI as FIIs or sub-accounts. The FPI Regulations provide for the broad-based criteria. To satisfy the broad-based criteria two conditions should be satisfied. Firstly, fund should have 20 investors even if there is an institutional investor. Secondly, both direct and underlying investors i.e. investors of entities that are set up for the sole purpose of pooling funds and making investments shall be counted for computing the number of investors in a fund.

iii. Category III FPI includes all FPIs who are not eligible under Category I and II, such as endowments, charitable societies, charitable trusts, foundations, corporate bodies, trusts, individuals and family offices.

D. Instruments

FPI entities are permitted to invest in Indian companies by way of the following instruments:

a. Listed or to-be listed shares, debentures and warrants of a company

b. Listed/unlisted units of schemes floated by a recognized mutual fund

c. Units of schemes floated by a collective investment scheme

d. Derivatives traded on a recognized stock exchange

e. Treasury bills and dated government securities;

f. Commercial papers issued by an Indian company

g. Rupee denominated credit enhanced bonds

h. SRs issued by ARCs (to this extent, FPIs are allowed to invest up to 100% of each tranche in SRs issued by ARCs, subject to RBI guidelines and within the applicable regulatory cap)

i. Perpetual debt instruments and debt capital instruments

j. Listed and unlisted NCDs/ bonds issued by an Indian company in the infrastructure sector (where infrastructure has the same meaning as under ECB Guidelines)

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2. As per Regulation 23(3) of the FPI Regulations, “In case the same set of ultimate beneficial owner(s) invest through multiple entities, such entities shall be treated as part of same investor group and the investment limits of all such entities shall be clubbed at the investment limit as applicable to a single foreign portfolio investor.”
k. Non-convertible debentures or bonds issued by NBFC-IFCs
l. Rupee denominated bonds or units issued by Infrastructure Debt Funds
m. Indian depository receipts
n. Unlisted NCDs/ bonds issued by an Indian company, subject to MCA guidelines
o. Securitized debt instruments (such as mortgage-backed securities and asset-backed securities)

E. Considerations

FPIs are allowed to purchase instruments of an Indian company through public offer or private placement, subject to the individual/aggregate limits, and the following conditions:

a. In case of subscription by way of public offer, the price of the shares issued to FPIs shall not be less than the price at which shares are issued to resident investors.

b. In case of subscription by way of private placement, the price shall not be less than: (i) the price arrived at in terms of the Pricing Guidelines (as applicable to FDI investment) issued by SEBI; or (ii) the fair price worked out as per any internationally accepted pricing methodology for valuation of shares, on an arm's length basis. Such fair price arrived at shall be certified by a SEBI registered Merchant Banker or CA, or a practicing Cost Accountant.

c. Minimum maturity period of the NCDs shall be one year. The minimum residual maturity has been reduced from 3 years to 1 year vide a recent circular dated April 27, 2018. This change is prospective in nature, and does not impact NCDs issued before the date of the circular.

d. If foreign investment by an FPI is made up to an aggregate limit of 49% of the paid-up equity share capital of the Indian company, or the applicable statutory/sectoral cap, whichever is lower, no government approval or compliance with sectoral conditions is required. However, it must be ensured that such an investment does not result in transfer of ownership and control of the resident Indian company to non-resident investors.

e. The FPI Regulations further prescribe that the transaction of business in securities by an FPI shall be carried out only through SEBI registered stock brokers. However, an exemption is provided to Category I and Category III FPIs while transacting in corporate bonds.

F. Diversification: (50/20)

Foreign exchange control regulations currently permit foreign investments into India by way of unlisted or listed NCDs. Subscribing to NCDs was the most preferred route of foreign investment by FPIs due to substantial regulatory flexibility with respect to structuring returns from investment, as well as tax planning. FPIs were earlier permitted to hold 100% of the NCDs issued by a borrower, whereas investment by FPIs into equity was restricted. RBI and SEBI recently issued circulars which introduced limits on exposure a single FPI could take into a single borrower group to 20% of the debt portfolio, as well as the maximum extent to which a single investor could subscribe in a single bond issuance which was set at 50% of the relevant issue. Such test has to analyzed on a group basis and hence related FPI entities and investment by FPI into related companies, will have to kept in mind while calculating the limits and setting up investment structures. (Refer Annexure VII for our hotline on the 50/20 diversification)

IV. External Commercial Borrowing

A. Introduction

ECBs are commercial loans that are raised by certain eligible Indian companies from eligible non-residents. ECBs can be raised as plain vanilla loans, capital market instruments (such as floating rate notes, fixed rate bonds, non-convertible debentures, non-convertible, optionally convertible, or partially
convertible preference shares and debentures), foreign currency convertible bonds, foreign currency exchangeable bonds, buyers’ credit, suppliers’ credit and financial lease. RBI regulates the ECB route very closely. Hence, Indian entities can undertake the borrowings by confirming to various parameters such as minimum maturity, permitted and non-permitted end-uses, maximum all-in-cost ceiling, etc. These parameters apply in totality and not on a standalone basis. The ECB route comprises of the following three tracks:

- Track I: Medium term foreign currency denominated ECB with minimum average maturity of 3/5 years.
- Track II: Long term foreign currency denominated ECB with minimum average maturity of 10 years.
- Track III: Indian Rupee (INR) denominated ECB with minimum average maturity of 3/5 years.

However, it may be noted that NCDs issued to FPIs shall not be construed to be investments routed through the ECB Route. Investments made by FPIs into NCDs in India shall not fall under the ECB Route.

All circulars, instructions, etc. in respect of ECB transactions have been now compiled in the RBI Master Direction No. 5 dated January 1, 2016 ‘External Commercial Borrowings, Trade Credit, Borrowing and Lending in Foreign Currency by Authorised Dealers and Persons other than Authorised Dealers’ (which is amended from time to time) (“ECB Master Directions”).

B. Routes and Instruments

ECBs can be raised under either:

- The automatic route; or
- The approval route (i.e. where the terms of the ECB would require a prior approval from the RBI before the loan can be availed).

With respect to the automatic route, each specific case is examined by an Authorized Dealer Category-I banks (“AD Banks”). For the approval route, the prospective borrowers are required to send their requests to the RBI through their AD Banks for examination.

Individual Limits: The following limits apply to the amount of ECB which can be raised in a financial year under the automatic route, and are further applicable to all three tracks:

a. Up to USD 750 million or equivalent for the companies in infrastructure and manufacturing sectors, NBFC-IFCs, NBFCs-AFCs, Holding Companies and CICs
b. Up to USD 200 million or equivalent for companies in software development sector
c. Up to USD 100 million or equivalent for entities engaged in micro finance activities
d. Up to USD 500 million or equivalent for remaining entities

Beyond these aforesaid limits, investments through the ECB routes would fall under the approval route. Further, when the ECB is raised from direct equity holder, these individual limits will also be subject to the ECB liability: equity ratio requirement (i.e. the ECB liability of the borrower should not be more than seven times of the equity contributed by the Foreign Equity Holder). However, an exemption is provided for this requirement where the total of ECBs raised by an entity does not exceed USD 5 million or equivalent.

C. Considerations

a. Hedging requirement

Eligible borrowers of ECBs and RDBs (as outlined above) are required to have a board-approved risk management policy, including the policy of keeping their ECB exposure hedged at 100% at all times. Entities raising ECBs under Tracks I and II are required to follow the hedging guidelines issued by the concerned sectoral or prudential regulator.

Further, the ECB borrower is required to hedge the principal as well as coupon payments. The minimum tenor of financial hedge is one year,
with a periodic rollover such that the exposure is not unhedged at any time during the currency of the ECB.

b. **End use restrictions**

The end-use restriction prescribed for each ECB Track as well as RDBs is very high. Thus, the sectors for while ECBS can be employed are limited, to which extent, foreign investors may prefer going through the FPI Sector which has opened up maximum sectors for investment, and prescribes very few sector linked conditions, subject to certain compliances.

c. **Eligibility Requirements:**

The biggest hit to the RDB regime has been the restriction placed on related parties of the issuer. Since the definition of a “related party” under the Indian Accounting Standards is quite broad, issuing companies will be restricted from raising loans in RDBs from their holding, parent or group companies.

d. **Prescribed All-in-cost Ceiling:**

For Tracks I and II the prescribed ceiling is 450 basis points over 6-month LIBOR of applicable currency. If the current rate of USD LIBOR for a 6-month maturity is around 2.5%, the maximum possible return the foreign investor will be able to make is limited to ~7%. These returns are significantly less as compared to returns which may be available through other debt or debt-linked instruments through the FPI/FVCI routes.

Further, for Track III ECBS and RDBs, the prescribed ceiling is 450 BPS over prevailing rate of G-secs of corresponding maturity. Assuming the maturity period to be 5 years, maximum interest would be approximately 12.5%. However, given the current status of the emerging markets currency, and the high cost of hedging, the risks might not be worth the interest payments available.

- **Eligible borrowers and lenders:** Each track specifies the persons who can be eligible borrowers of lenders. Foreign equity owners holding at least 25% shareholding in the Indian entity directly are recognized as eligible lenders (“Foreign Equity Holder”)

- **Security:** Borrowers are free to provide any security, as it may agree with the lender as a security for ECB, provided the agreement for the ECB contains a clause requiring the creating of such security and a no objection certificate from existing lenders in India has been obtained. However, in case of immovable property being provided as security, at the time of enforcement, the sale of the property must necessarily be to an Indian resident, and the proceeds used to repay the ECB.

- **Currency:** ECB can be raised in any freely convertible foreign currency as well as in INR.

- **Proceeds:** ECB proceeds meant for INR expenditure should be repatriated immediately for credit to the borrower’s INR accounts with the AD Banks in India. ECB borrowers are also allowed to park ECB proceeds in term deposits with AD Banks in India up to a maximum period of 12 months. These term deposits should be kept in unencumbered position.

ECB proceeds meant for only foreign currency expenditure can be parked abroad until they are utilized. Prior to utilization, they can be invested in the certain specified liquid assets.

V. **Rupee Denominated Bonds (Masala Bonds)**

Indian companies and body corporates have also been permitted to issue RDBs (privately placed or listed as per host country regulations), also known as masala bonds, to certain eligible lenders. The two frameworks, on ECBS and RDBs, run separately. For example, limit of borrowing under the ECB framework would be separate from the borrowing under the framework for issuance of Rupee Denominated bonds overseas.
Some of the features of the route for availing ECB by way of issuance of RDBs are provided below:

a. **Eligible Borrowers**: Any corporate or body corporate is eligible to issue RDBs, including SEBI regulated Real Estate Investment Trusts (REITs) and Infrastructure Investment Trusts (InvITs). Further, Indian banks are also eligible to issue RDBs by way of Perpetual Debt Instruments (PDI) which qualify for inclusion as additional Tier 1 capital, and debt capital instruments which qualify for inclusion as additional Tier 2 capital, as well as issuing long term RDBs for financing infrastructure and affordable housing.

b. **Recognized Investors**: RDBs can be issued in, and subscribed by a resident of a country:

- which is a member of the Financial Action Task Force ("FATF") or its regional equivalent;
- whose securities market regulator is a part of the Appendix A signatory to the International Organization of Securities Commission’s (IOSCO’s) Multilateral Memorandum of Understanding or is a signatory to the bilateral Memorandum of Understanding with SEBI for appropriate information sharing arrangements; and
- is not a country identified in the public statement of the FATF as: (i) a jurisdiction which has strategic deficiencies in anti-money laundering or in combating the financing of terrorism (activities to which FATF has suggested counter measures); or (ii) a jurisdiction that has not made progress in addressing the aforementioned deficiencies or has not committed to an action plan developed in consultation with the FATF to address these deficiencies.

Related party within the meaning as given in Ind-AS 24 cannot subscribe or invest in or purchase such bonds.

Further, Multilateral and Regional Financial Institutions of which India is a member country are also considered as recognized investors. *Investment by recognized investors is subject to the condition that the eligible Indian entities cannot issue RDBs to related parties as classified under Indian Accounting Standards.*

Under Indian Accounting Standards, the definition of related party is quite broad and includes, *inter alia*: parent entities, holding companies, majority shareholders, persons having significant influence over the entity, persons who are employed in key managerial positions of the entity, entities which are engaged in a joint venture, and sister concerns.

c. **Minimum Maturity**: Minimum original maturity period for Rupee denominated bonds raised up to USD 50 million equivalent in INR per financial year should be 3 years and for bonds raised above USD 50 million equivalent in INR per financial year should be 5 years. The call and put option, if any, shall not be exercisable prior to completion of minimum maturity. Transfer to eligible parties is permitted within the minimum maturity. In genuine cases the authority may permit early redemption.

d. **All-in-cost ceiling**: Interest rate offered and paid will be governed by the all-in-cost ceiling. The all-in-costs ceiling has been capped at 450 basis points over the prevailing yield for government securities for corresponding maturity period. The term ‘All-in-Cost’ includes rate of interest, other fees, expenses, charges, guarantee fees whether paid in foreign currency or Indian Rupees (INR) but will not include commitment fees, pre-payment fees / charges, withholding tax payable in INR. In the case of fixed rate loans, the swap cost plus spread should be equivalent of the floating rate plus the applicable spread.

e. **End-use restrictions**: The proceeds from the issuance of the RDBs can be used for any purpose, except (i) real estate activities (not being development of integrated townships/affordable housing projects), (ii) investment into capital markets and equity investments domestically; (iii) on-lending activities; (iv) purchase of land; and (v) activities prohibited under the foreign direct investment guidelines;
f. **Security**: The ECB Master Direction permits creation of security for the purpose of securing the RDBs. The security creation must be required in accordance with the terms of the lending/facility agreement. Practically it has been more favorable to have the security to be created in a debenture trustee in India on the behalf of the lender, as it reduces the costs at the time of transfer of RDBs in the future.

g. **Hedging**: Under the ECB Master Directions, the investors are permitted to hedge currency risk through AD Banks in India. Additionally, the investors are also permitted to hedge the risk offshore through foreign branches or subsidiaries of Indian banks or foreign banks which have a presence in India. For all purposes, the exchange rate applicable on the date of the settlement of the transaction would be considered as the exchange rate for the purpose of the RDBs.
4. Investment Vehicles

I. Non-Banking Financial Companies

A. Introduction

A non-banking financial company ("NBFC") is a company engaged in the business of loans and advances, acquisition of shares and other identified financial activities. An NBFC needs to be registered with the RBI.

In light of the challenges that NCDs under the FPI route are subjected to and the restrictions on offshore debt funding, there has been a keen interest in offshore funds to explore the idea of setting up their own NBFC to lend or invest in Indian companies.

As per the Reserve Bank of India Act, 1934 ("RBI Act"), NBFC means: (i) a financial institution which is a company; or (ii) a non-banking institution (company, corporation or cooperative society), and which carries on the Principal Business of receiving deposits, under any scheme/ arrangement or in any other manner, or lending in any manner but does not include any institution which carries on, as its Principal Business and activity in relation to, any agricultural operations, industrial operations, purchase or sale of any goods, (other than securities) or providing services. The Central Government by notification in the Official Gazette may notify any other class of institutions.

<table>
<thead>
<tr>
<th>PROS</th>
<th>CONS</th>
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<tbody>
<tr>
<td>Onshore leverage</td>
<td>Pricing norms, as per TISPRO, will apply</td>
</tr>
<tr>
<td>Listing, repatriation and attendant liquidity</td>
<td>Minimum Net Owned Funds of INR 20 million</td>
</tr>
<tr>
<td>Security creation - SARFAESI benefits</td>
<td>Minimum capital adequacy ratio of 15% to be maintained</td>
</tr>
<tr>
<td>NBFC is a resident entity, and accordingly, all instruments are permitted including loans including loans</td>
<td>Tier I capital shall be minimum 10%</td>
</tr>
<tr>
<td>Double level of taxation – 30% at the NBFC level and tax of approximately 20% on dividend distribution</td>
<td>Concentration Norms</td>
</tr>
</tbody>
</table>
i. Types of NBFCs

NBFCs may be classified into different types, based on certain parameters like liability, activity and size (Refer Annexure V).

i. Based on liability undertaken - NBFCs may be classified as deposit accepting and non-deposit accepting NBFCs. In this regard, only Investment Companies, Asset Finance Companies and Loan Companies are allowed to accept public deposits.

ii. Based on their size - NBFCs may be classified either as Systemically Important ("SI") or Non-Systemically Important (Non-SI) NBFCs; SI NBFCs are those whose asset size is at least INR 500 crore.


Further, RBI has determined prudential norms applicable to NBFCs by classifying them into three main categories: Non-Systemically Important Non-Deposit Accepting or Holding NBFCs (NBFC-ND-NSI), Deposit Accepting or Holding NBFCs (NBFC-D), and Systemically Important Non-Deposit Accepting or Holding NBFCs (NBFC-ND-SI). RBI has issued directions for governance of each kind of NBFC (collectively referred as “NBFC Regulation”).

Please note that the below analysis is in relation to NBFC-ND-SI, refer Annexure VI for comparative analysis.

B. Conditions

In order to carry on the business of a non-banking financial institution, the following requirements must be complied with:

a. The entity should be a company, duly registered under the Companies Act, 2013

b. The entity should have a minimum net owned fund of INR 2 crores. Net owned funds, as further detailed below, is the capital of the company less the investments made and loans given.

c. Minimum capital risk adequacy ratio of 15% of tier 1 capital to tier 2 capital is to be maintained.

d. Minimum Tier I capital to be 10%.

e. Tier II capital shall not exceed Tier I capital

f. NBFCs are subject to concentration and exposure norms. The NBFC Regulations gives a certain percentage over which an NBFC cannot lend.

C. Important Terms

a. **Tier I Capital** - means owned fund as reduced by investment in shares of other non-banking financial companies and in shares, debentures, bonds, outstanding loans and advances including hire purchase and lease finance made to and deposits with subsidiaries and companies in the same group exceeding, in aggregate, ten per cent of the owned fund; and perpetual debt instruments issued by a non-deposit taking non-banking financial company in each year to the extent it does not exceed 15% of the aggregate Tier I Capital of such company as on March 31 of the previous accounting year;

b. **Tier II Capital** - includes the following:

i. (a) preference shares other than those which are compulsorily convertible into equity;

ii. (b) revaluation reserves at discounted rate of fifty-five percent;

iii. (c) General provisions (including that for Standard Assets) and loss reserves to the extent these are not attributable to actual diminution in value or identifiable potential loss in any specific asset and are available to meet unexpected losses, to the extent of one and one fourth percent of risk weighted assets;

iv. (d) hybrid debt capital instruments;

v. (e) subordinated debt; and
vi. (f) perpetual debt instruments issued by a non-deposit taking non-banking financial company which is in excess of what qualifies for Tier I Capital,

c. **Owned Fund** of a company means the aggregate of (i) the paid-up equity share capital; (ii) compulsorily convertible preference shares; (iii) free reserves; (iv) the balance in securities premium account; and (v) capital reserve account, to the extent that it represents the surplus arising out of the proceeds of sale of assets less (i) accumulated balance of loss; (ii) deferred revenue expenditure; and (iii) other intangible assets.

d. **Net Owned Fund** means Owned Fund less (i) investment made by the company in shares of its subsidiaries, group companies, and all other NBFCs; and (ii) book value of all debentures, bonds, outstanding loans and advances (including hire-purchase and lease finance) made to and deposits with its subsidiaries and group companies, to the extent that it exceeds 10% of the owned fund.

e. **Principal Business**: The Act has remained silent on the definition of 'principal business' and has thereby conferred on the regulator, the discretion to determine what is the principal business of a company for the purposes of regulation. Accordingly, the test applied by RBI to determine what is the principal business of a company was articulated in the Press Release 99/1269 dated April 8, 1999 issued by RBI. A company is regarded as an NBFC if it satisfies the following two requirements: (i) more than 50% of the company's total assets (netted off by intangible assets) are financial assets; and (ii) income from the financial assets is more than 50% of the gross income. The determination of these factors is to be done basis the last audited balance sheet of the company, and these factors will determine the 'principal business' of a company. This test is also referred to as the '50-50 test,' and any company fulfilling both these requirements will have to obtain a certificate of registration as an NBFC from the RBI.

f. **Capital risk adequacy ratio** means the ratio of the aggregate of Tier 1 and Tier 2 capital to the risk weighted assets of the company. Assets are assigned weights as given in the NBFC Regulations.

D. **Prudential Norms**

a. No applicable NBFC shall,

i. (i) lend to - (a) any single borrower exceeding 15% of its owned fund; and (b) any single group of borrowers exceeding 25% of its owned fund

ii. (ii) invest in - (a) the shares of another company exceeding 15% of its owned fund; and (b) the shares of a single group of companies exceeding 25% of its owned fund

iii. (iii) lend and invest (loans/investments taken together) exceeding - (a) 25% of its owned fund to a single party; and (b) 40% of its owned fund to a single group of parties.

b. For calculation of the above concentration limits (i) investments in shares of; or (ii) book value of debentures, bonds, outstanding loans and advances (including hire-purchase and lease finance) made to, and deposits with, subsidiaries and group companies, to the extent of 10% of the owned fund.

E. **Acquisition of NBFC**

For transfer of 26% or more of a paid-up capital of an NBFC, prior approval of the RBI would be required. On a case to case basis in case of intra-group transfers, NBFC shall submit an application, on the company letter head, for obtaining prior approval of the Bank. Based on the application of the NBFC, it would be decided, on a case to case basis, which documents the NBFC requires to submit for processing the application of the company.

Setting up of an NBFC can take anywhere between 6 to 8 months, which is why typically many debt players prefer to acquire an existing NBFC. Acquisition process could take up to 3 months and can be rather simpler. At the time of acquisition diligence of NBFC should be carefully carried out.
F. Advantages of NBFC

a. Onshore leverage - The funding provided through NBFCs is in the form of domestic loans or NCDs, without being subjected to interest rate caps as in the case of CCDs. These NCDs can be structured to provide the requisite distribution waterfall or assured investors’ rate of return to the offshore fund.

b. Repatriation, Liquidity and Listing – Even though repatriation of returns by the NBFC to its offshore shareholders will still be subject to the restrictions imposed by the FDI Policy (such as the pricing restrictions, limits on interest payments etc.), but since the NBFC will be owned by the foreign investor itself, the foreign investor is no longer dependent on the Indian company as would have been the case if the investment was made directly into the Indian entity.

c. Security Creation - Creation of security interest in favour of non-residents on shares and immovable property is not permitted without prior regulatory approval. However, since the NBFC is a domestic entity, security interest could be created in favour of the NBFC. Enforceability of security interests, however, remains a challenge in the Indian context. Enforcement of security interests over immovable property, in the Indian context, is usually a time consuming and court driven process. Unlike banks, NBFCs are not entitled to their security interests under the provisions of the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (“SARFAESI”).

d. No restrictions on instruments – As NBFC is a resident company, there are no restrictions on the instruments it can issue or invest in.

G. Challenges in set up of NBFC

a. Minimum capitalization – Each NBFC should maintain a certain percentage minimum Tier 1 and certain total capital to be eligible for registration and licence.

b. Credit Concentration Norms – Each NBFC should comply with certain credit concentration norms and prudential norms which restricts its investment and lending. Depending on the category of NBFC, the credit concentration norms differ.

c. Capital adequacy to be maintained - Each NBFC should maintain a certain capital adequacy ratio, this capital adequacy ratio, as detailed above, is a ratio of Tier 1 and Tier 2 capital. Maintenance of this ratio limits the external debt that an NBFC can borrow.

d. Asset classification and provisions - The assets should be classified based on the probability of recovery of the loan given and their performance. The provisions should be created based such asset classification.

II. Alternative Investment Fund

A. Introduction

Alternative Investment Fund means any fund established or incorporated in India which is a privately pooled investment vehicle which collects funds from sophisticated investors, whether Indian or foreign, for investing it in accordance with a defined investment policy for the benefit of its investor and is regulated under Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012 (“AIF Regulations”). AIF can be set up as either a Trust, Company or LLP

Categories of AIF

i. Category I AIF: Invest in start-up or early stage ventures or social ventures or SMEs or infrastructure or other sectors or areas which the government or regulators consider as socially or economically desirable and shall include venture capital funds, SME Funds, social venture funds, infrastructure funds and such other AIFs as may be specified
ii. Category II AIF - Do not fall in Category I and III and which do not undertake leverage or borrowing other than to meet day-to-day operational requirements

iii. Category III AIF - employ diverse or complex trading strategies and may employ leverage including through investment in listed or unlisted derivatives.

Refer Annexure III for comparative analysis of the three categories.

<table>
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<th>PROS</th>
<th>CONS</th>
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<tbody>
<tr>
<td>No limitation on the instruments (NCD/ OCD/ RPS permitted)</td>
<td>25% of corpus - diversification requirement over the life of the fund</td>
</tr>
<tr>
<td>Much liberalized concentration limits of 25% of corpus as compared to NBFC</td>
<td>Manager / sponsor has to be an Indian incorporated entity, though foreign ownership of such entity is permitted</td>
</tr>
<tr>
<td>Light touch regulations</td>
<td>Sponsor commitment of 2.5% of the corpus, or INR 50 million, whichever is lower</td>
</tr>
<tr>
<td>Ease of upstreaming with limited tax leakage</td>
<td>Leverage at the fund level is not permitted for Category I and Category II AIFs</td>
</tr>
<tr>
<td>Direct foreign investment permitted with ease</td>
<td>If sponsor/ manager is not resident owned or controlled, investments in “capital instruments” by AIF is indirect foreign investment</td>
</tr>
</tbody>
</table>

B. Conditions

a. AIF may be registered as a Trust under the Registration Act, 1908, incorporated as a Company under the Companies Act, 2013, set up as a Limited Liability Partnership (“LLP”) under the Limited Liability Partnership Act, 2008 or et-up as body corporate and specifically permitted to carry on activities of an AIF by the central or state legislature. Most of the AIFs registered with SEBI are in trust form.

b. Each scheme of AIF shall have a maximum of 1000 investors.

c. AIFs shall raise funds through private placement by issue of a Private Placement Memorandum (PPM).

d. An AIF can have multiple schemes but each scheme shall have a minimum corpus of at least INR 20 crores. Each investor shall invest a minimum of INR 1 crore.

e. The AIF Regulations require that the sponsor/ manager of an AIF shall have a certain continuing interest in the AIF. For Category I and II AIFs, such interest must be not less than 2.5% (two and half percent) of the corpus or INR 5 crores, whichever is lesser and for Category III AIFs, the interest must be not less than 5% (five percent) of the corpus or INR 10 crores, whichever is lesser.

f. The key investment team of the Manager of Alternative Investment Fund has adequate experience, with at least one key personnel having not less than five years experience in advising or managing pools of capital or in fund or asset or wealth or portfolio management or in the business of buying, selling and dealing of securities or other financial assets and has relevant professional qualification.

g. Category I and II AIFs are required to be close ended have a minimum tenure of 3 years. Category III AIFs may be open ended or close ended. No maximum tenure is prescribed.

h. Category I and II Alternative Investment Funds shall not invest more than 25% (twenty five percent) of the investable funds in one Investee Company. Such limit shall be 10% (ten percent) in case of a Category III AIF.
C. Important Terms

a. **Corpus** - means the total amount of funds committed by investors to the Alternative Investment Fund by way of a written contract or any such document as on a particular date. This refers to the total commitment and not actual drawdowns or funds received.

b. **Sponsor** - means any person or persons who set up the Alternative Investment Fund and includes promoter in case of a company and designated partner in case of a limited liability partnership.

c. **Manager** - means any person or entity who is appointed by the Alternative Investment Fund to manage its investments by whatever name called and may also be same as the sponsor of the Fund.

d. **Fund of Funds** – means an AIF which has invested in other AIFs.

e. **Investible funds** - means corpus of the Alternative Investment Fund net of estimated expenditure for administration and management of the fund.

f. **Investee Company** - means any company, special purpose vehicle or limited liability partnership or body corporate or real estate investment trust or infrastructure investment trust in which an AIF makes an investment.

D. Indicative Structure

![Diagram of Indicative Structure]

E. Advantages

a. Investors can invest in various categories of instruments, including FPIs, FDIs and FVCIs routes.

b. AIF regulations are not as restrictive as the regulations applicable to an NBFC.

c. Tax is charged in the hands of the investor and not in the hands of the AIF. Due to such pass-through taxation regime there is minimal tax leakage during upstreaming of returns.

d. Trusts registered as AIFs are easier to setup than other type of entities.
F. Challenges

a. **Investment in instruments** – Category I and Category II AIFs may only invest in unlisted shares. Only Category III AIFs are permitted to invest in listed shares. Investment in debentures. However, debt funds, which are primarily Category II funds, may invest in listed or unlisted debt securities.

b. **Private placement only** – The AIF Regulations prohibit solicitation or collection of funds except by way of private placement.

c. **Leverage** – Category I and Category II AIFs are not permitted to raise any leverage funds, apart from what is required for day to day operations. Category III AIFs can raise leverage but only to the extent of 2 times of the net asset value of the fund.

d. **Listing** – The regulations provide for listing of units of close ended AIFs subject to a minimum tradable lot of INR 1 crore. However, as the AIF Regulations are still relatively new, there are no listed AIFs in the market.

e. **Diversification** – Category I and II AIFs can only invest a maximum of 25% of their investible funds in a single investee company. This limit is reduced to 10% in case of Category III AIFs. The diversification test is company wise and not a group test. Hence, it is possible that in certain cases where more than 25% of the investible funds are in the same group.

f. **No Taxation Pass-Through for Category III AIFs** – Tax pass-through is only available to Category I and Category II AIFs and income earned by Category III AIFs is taxable in its hands. Hence the benefits as detailed above are not available to the investors.
5. Taxation

I. Taxation

A. Withholding Tax

Tax would have to be withheld at the applicable rate on all payments made to a non-resident, which are taxable in India. The obligation to withhold tax applies to both residents and nonresidents. Withholding tax obligations also arise with respect to specific payments made to residents. Failure to withhold tax could result in tax, interest and penal consequences.

B. Corporate Tax

Income tax in India is levied under the ITA. Resident companies are taxed at approximately 34% (if net income is in the range of INR 1 crore – 10 crores) and around 35% (if net income exceeds INR 10 crores). However, for financial year 2018-19, companies with turnover in the financial year 2016-17 not exceeding INR 250 crores shall be taxed at the rate of 29% (plus surcharge and cess). This reduction in corporate tax rates has been the a step towards meeting Government’s promised goal of reducing corporate tax rates from 30% to 25% (excluding surcharge and cess) over the next 4 years, coupled with rationalization and removal of various exemptions and rebates. Non-resident companies are taxed at the rate of about 42% (if net income is in the range of INR 1 crore – 10 crores) and approximately 43% (if net income exceeds INR 10 crores). While residents are taxed on their worldwide income, non-residents are only taxed on income arising to them from sources in India. A company is said to be resident in India if it is incorporated in India or has its place of effective management (POEM) in India. Minimum Alternate Tax ("MAT") at the rate of around 20% (18.5% plus surcharge and education cess) is also payable on the book profits of a company, if the company’s income due to exemptions is less than 18.5% of its book profits. With respect to ‘eligible start-ups’ meeting certain specified criteria, a 100% tax holiday for any 3 consecutive assessment years out of a block of 7 years beginning from the year in which such start up is set up has been provided for in Budget for the financial year 2018-2019.

C. Dividend and Buy Back Tax

Dividends distributed by Indian companies are subject to a Dividend Distribution Tax ("DDT") at the rate of 15% (exclusive of surcharge and cess) payable by the company on a gross basis. Currently, no further Indian taxes are payable by the shareholders on such dividend income once DDT is paid. However, the Income Tax Act, 1961 ("ITA") also provides that dividends declared by a domestic company and received by a specified assessee (individual, Hindu Undivided Family (HUF) or a firm who is resident in India), in excess of INR 10 lakhs, shall be chargeable to tax at the rate of 10% (on a gross basis) in the hands of the recipient. Further, an Indian company would also be taxed at the rate of 21.63% on gains arising to shareholders from distributions made in the course of buy-back or redemption of shares.

D. Capital Gains Tax

Tax on capital gains depends on the period of holding of a capital asset. Short Term Capital Gains ("STCG") may arise if the asset is held for a period lesser than 3 years. Long Term Capital Gains ("LTCG") may arise if the asset is held for a period more than 3 years. Gains from listed shares which are held for a period of more than 12 months are categorized as long term. Unlisted shares and immovable property (being land or buildings or both) are treated as long term only when held for more than 24 months. Long term capital gains earned by a non-resident on sale of unlisted securities may be taxed at the rate of 10% (provided no benefit of indexation has been availed) or 20% (if benefit of indexation has been availed) depending on certain considerations. Long term gains on sale of listed securities on a stock exchange used to be exempted and only subject to a Securities Transaction Tax (STT).

The Finance Act, 2018 removed this exemption and introduced a levy of 10% tax on LTCG arising
from the transfer of listed equity shares, units of an equity oriented mutual fund, or units of a business trust where such gains exceed INR 100,000. This tax is applicable on LTCG arising on or after April 1, 2018 and no indexation benefits can be availed of. However, the Finance Act 2018 also introduced limited grandfathering in respect of protecting the gains realized on a mark to market basis up to January 31, 2018 and only an increase in share value post this date would be brought within the tax net. Short term capital gains arising out of sale of listed shares on the stock exchange are taxed at the rate of 15%, while such gains arising to a non-resident from sale of unlisted shares is 40%.

E. GAAR

India has introduced wide General Anti Avoidance Rules ("GAAR") which provide broad powers to the tax authorities to deny a tax benefit in the context of 'impermissible avoidance arrangements'. GAAR has come into effect from April 1, 2017 and overrides tax treaties signed by India. Investments made up to March 31, 2017 are grandfathered, and GAAR applies prospectively, i.e. to investments made after April 1, 2017.

Further, the Central Board of Direct Taxes ("CBDT") has clarified that general and specific anti avoidance rules can co-exist and applied as and when necessary as per the facts of the situation. Although the CBDT has noted that anti-abuse rules in tax treaties may not be sufficient to address all tax avoidance strategies and therefore domestic anti-avoidance rules should be applied, it has also clarified that if avoidance is sufficiently addressed by Limitation of Benefits clauses in treaties, i.e. clauses which limit treaty benefits to those persons who meet certain conditions, GAAR would not apply. 3

Generally, statutory GAARs across various jurisdictions are used to achieve one or more of the following purposes: (a) to target transactions which seemingly comply with the literal interpretation of tax legislations, but which generate tax advantages that the State considers to be against the legislative intent; (b) to establish economic substance or to test the business purpose of a transaction in order to determine whether it is lawful; (c) to determine the features of an artificial transaction, scheme or arrangement that has been entered into solely to attract a tax advantage. 4

The legislative intent of introducing the GAAR provisions is explained in the Memorandum of the Finance Bill, 2012. This states that GAAR has been introduced to deal with aggressive tax planning and the need for GAAR provisions were to codify the doctrine of ‘substance over form’. To prevent situations where the transaction and the structure is seemingly in line with the tax laws but the transaction has been entered into to attract a tax advantage or avoid tax consequences. The real intention of the parties will be considered and purpose and need for the transaction will be analysed.

F. Thin Capitalization Norms

The FA, 2017 introduced thin capitalization rules within the ITA ("Thin Capitalization Norms") to curb companies from enjoying excessive interest deductions, while effectively being akin to an equity investment. This move would have a significant impact on investments into India through the debt route – both in respect of CCDs and NCDs which are widely used methods for structured finance into India. Thin Capitalization Norms provide that where an Indian company or PE of a foreign company makes interest payments (or similar consideration) to its associated enterprise, such interest shall not be deductible at the hands of the Indian company / PE to the extent of the “excess interest”. Excess interest means an interest amount that exceeds 30% of the EBITDA of the Indian company / PE. In the event the interest payment payable / paid is less than excess interest, the deduction will only be available to the extent of the interest payment payable / paid.

3. Central Board of Direct Taxes, Circular No. 07 of 2017, dated 27th January, 2017

II. Tax Treaties And Jurisdictions

India has entered into more than 80 treaties for avoidance of double taxation. A taxpayer may be taxed either under domestic law provisions or the tax treaty to the extent it is more beneficial. A non-resident claiming treaty relief would be required to file tax returns and furnish a tax residency certificate issued by the tax authority in its home country. The tax treaties also provide avenues for exchange of information between countries and incorporate measures to curb fiscal evasion. Based on analysis of various tax treaties and its comparison against the Indian Information Technology (“IT”) Act we have prepared the comparative table in Annexure IV.

India has also recently signed the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (“MLI”), in furtherance of the OECD’s Base Erosion and Profit Shifting (“BEPS”) project. The MLI is to be applied alongside existing tax treaties, modifying their application in order to implement BEPS measures. Specifically, the provisions of the MLI require the mandatory amendment of bilateral tax treaties to allow for certain minimum standards to be applied in respect of bilateral treaties. Importantly, the minimum standards include the denial of treaty benefits, if obtaining such benefits was one of the purposes of a transaction resulting in the benefit. From a business point of view, this will create difficulties for businesses, based on the manner of its subjective application. These provisions raise the level of uncertainty when it comes to structuring business operations, and their applicability alongside the recently introduced GAAR may reduce ease of doing business due to the ambiguity on whether both provisions could potentially be applied at the same time or to the same transaction. The MLI has come into force on July 1, 2018, following the deposit of the instrument of ratification by a fifth country.
6. Dispute Resolution

I. Specific Relief Act

The Specific Relief Act, 1963 ("Specific Relief Act") provides for specific relief for the purpose of enforcing individual civil rights and not for the mere purpose of enforcing civil law. Under the Specific Relief Act, courts are mandated to grant specific relief unless the relief is expressly barred under the limited grounds provided in the statute. Specific performance is an order of the court which requires a party to perform a specific act in accordance with the concerned contract. While specific performance can be in the form of any type of forced action, it is usually used to complete a previously established transaction, thus, being the most effective remedy in protecting the expectation interest of the innocent party to a contract. The aggrieved party may approach a Court for specific performance of a contract. The Court will direct the party in breach to fulfill his part of obligations as per the contract capable of being specifically performed. The Specific Relief Act was recently amended and received Presidential assent on August 1, 2018 ("Specific Relief Amendment Act"). However, its provisions are yet to be notified. The Specific Relief Amendment Act has altered the nature of specific relief from an exceptional rule to a general rule which will certainly ensure contractual enforcement. Some salient features of the Specific Relief Amendment Act are below: Courts must now grant specific performance of a contract when claimed by a party unless such remedy is barred under the limited grounds contained in the statute. If a contract is broken due to nonperformance of a promise by a party, the party suffering the breach has the option of substituting performance through a third party or through its own agency. A suit filed under the Specific Relief Amendment Act must be disposed of by the court within 12 months. Such period can be extended by 6 months after recording written reasons by the court. No injunction can be granted by the court in relation to an infrastructure project if such injunction would cause delay or impediment in the progress or completion of the infrastructure project.

II. Insolvency Code

The Insolvency and Bankruptcy Code, 2016, ("Bankruptcy Code"), which came into effect on December 15, 2016, is a welcome overhaul of the erstwhile fragmented and time-consuming bankruptcy regime in India. The Bankruptcy Code is a comprehensive insolvency legislation as it consolidates the existing laws relating to insolvency of companies, limited liability entities (including limited liability partnerships), unlimited liability partnerships, and individuals into a single legislation. Some of its most noteworthy features are:

- Time-Bound Resolution: The Bankruptcy Code creates time-bound processes for insolvency resolution - as per its provisions, every insolvency resolution process must conclude within 180 days of commencement which is extendable by another 90 days in case of delay. This amendment marks the onset of a monumental change in the corporate insolvency regime, and has renewed faith amongst investors, both nationally and internationally.

- Streamlined Processes: The resolution processes are conducted by licensed Insolvency Resolution Professionals ("IRPs"); and the specialised National Company Law Tribunal adjudicates insolvency resolution for corporate entities. The Bankruptcy Code establishes a specialised Insolvency and Bankruptcy Board of India which is responsible for the regulation of various aspects of insolvency and bankruptcy, including issuing and formulating regulations, and regulation of insolvency professionals. Specific Information Utilities have been established which collect, collate and disseminate financial information related to debtors.

- Regulatory & Legislative Impetus: The central government, central banking institute, and the central securities exchange regulator in India have added teeth to the Bankruptcy Code by ensuring that its implementation is smooth and efficient. With their inputs, the Bankruptcy Code is not merely an amendment to a statue - but an overhaul of the entire framework. It is evident that the Indian government is leaving no stone unturned in its aim to improve the Ease of Doing Business in India. The legislature, RBI, SEBI, and the judiciary have
presented a unified front, unprecedented in India so far. Any apparent loopholes are being plugged at the earliest and the law is evolving rapidly. It comes as no surprise, then, that as in June 2017, India had already secured its position in the top 30 developing countries for retail investment worldwide and that insolvency resolution in India has become a more streamlined, consolidated and expeditious affair.

III. Arbitration

Due to the huge pendency of cases in courts in India, there was a dire need for effective means of alternative dispute resolution. India’s first arbitration enactment was the Arbitration Act, 1940 which was complimented by the Arbitration (Protocol and Convention) Act of 1937 and the Foreign Awards Act of 1961. Arbitration under these laws were not effective and led to further litigation as a result of the rampant challenge of arbitral awards. The current Arbitration & Conciliation Act, 1996 (the “A&C Act 1996”) was enacted to make both, domestic and international arbitration, more effective in India.

Broadly, the A&C Act 1996 covers the following recognized forms of arbitration:

a. Ad-hoc Arbitration Ad-hoc arbitration is where no institution administers the arbitration. The parties agree to appoint the arbitrators and either set out the rules which will govern the arbitration or leave it to the arbitrators to frame the rules. Ad-hoc arbitration is quite common in domestic arbitration in India and continues to be popular. In cross border transactions it is quite common for parties to spend time negotiating the arbitration clause, since the Indian party would be more comfortable with ad-hoc arbitration whereas foreign parties tend to be more comfortable with institutional arbitration. However, with ad-hoc arbitrations turning out to be a lengthy and costly process, the preference now seems to be towards institutional arbitration as the process for dispute resolution.

b. Institutional Arbitration Institutional arbitration refers to arbitrations administered by an arbitral institution. Institutions such as the International Court of Arbitration attached to the International Chamber of Commerce in Paris (ICC), the London Court of International Arbitration (LCIA) and the American Arbitration Association (AAA), the Hong Kong International Arbitration Centre (HKIAC) and China International Economic and Trade Arbitration Commission (CIETAC) are well known world over and often selected as institutions by parties from various countries. Within India, greater role is played by Singapore International Arbitration Centre (SIAC) or the Mumbai Centre for International Arbitration (MCIA) or the Delhi High Court Arbitration Centre.

c. Statutory Arbitration Statutory arbitration refers to scenarios where the law mandates arbitration. In such cases the parties have no option but to abide by the law of the land. It is apparent that statutory arbitration differs from the above types of arbitration because (i) the consent of parties is not required; (ii) arbitration is the compulsory mode of dispute resolution; and (iii) it is binding on the Parties as the law of the land. Sections 24, 31 and 32 of the Defence of India Act, 1971, Section 43(c) of The Indian Trusts Act, 1882 and Section 7B of the Indian Telegraph Act, 1885 are certain statutory provisions which deal with statutory arbitration.

d. Foreign Arbitration When arbitration proceedings are seated in a place outside India, such a proceeding is termed as a Foreign Arbitration. The provisions of Part I of A&C Act 1996 are not applicable to foreign awards and foreign seated arbitrations where the arbitration agreement was entered into on or after September 6, 2012. This has considerably reduced the level of interference by Indian courts in foreign arbitrations. Awards passed in such foreign seated arbitrations would not be subject to challenge under the A&C Act 1996. The parties to a foreign seated arbitration can seek interim reliefs in aid of arbitration from the Indian courts in exceptional circumstances.
IV. Contract Act and Damages

Under Indian law, parties can choose to opt for the remedy of specific performance or damages upon a breach of contract. The goal of damages in tort actions is to make the injured party whole through the remedy of money to compensate for tangible and intangible losses caused by the tort. The remedy of damages for breach of contract is laid down in Sections 73 and 74 of the Contract Act. Section 73 states that where a contract is broken, the party suffering from the breach of contract is entitled to receive compensation from the party who has broken the contract. However, no compensation is payable for any remote or indirect loss or damage. Section 74 deals with liquidated damages and provides for the measure of damages in two classes: (i) where the contract names a sum to be paid in case of breach; and (ii) where the contract contains any other stipulation by way of penalty. In both classes, the measure of damages is the reasonable compensation not exceeding the amount or penalty stipulated for.
7. Security Enforcement

Significant changes have taken place in the past three years in the way in which debt enforcement mechanisms work in India. Previously, there were only a few options to recover debts owed by a defaulting debtor. Arbitration under the Arbitration and Conciliation Act, 1996, civil suits for recovery of money or enforcement of mortgage, the procedure laid down under the SARFAESI, or proceedings to wind up a company under the Companies Act, 1956. These options were time consuming and the changes that have taken place have ensured not only speedy recovery of debts, but also control in the hands of the creditor.

The mechanism that existed prior are as follows:

i. The parties could adopt arbitration so as to crystalize the debt. However, the arbitration process was protracted there were no obligations on the arbitrator to comply with a reasonable time period to complete the arbitration proceedings. Further, arbitral proceedings often ended up in protracted court litigation, which could take upwards of ten years, due to high degree of court interference.

ii. The creditor could file a civil suit in a court of appropriate jurisdiction for recovery of debts or for enforcement of mortgage. However, it was hard for creditors to prove outstanding debts, even if such debts were apparent from the books. Further, convoluted court procedures allowed defaulters to extend the litigation, leading to the litigation becoming time intensive.

iii. Under the SARFAESI Act, 2002, banks, Asset Reconstruction Companies and Financial Institutions could recover outstanding debts by claiming ownership (for the purposes of sale) over assets that were part of the security. Upon default, secured creditors could then sell the assets to satisfy the debt and interest amounts. However, the applicability of this Act was restricted to Banks, ARCs and specified FIs alone.

iv. A creditor could file a petition for winding up of a company on account of insolvency under the Companies Act, 1956. However, proving insolvency of the debtor, and once proved, the process of liquidation, usually took upwards of a decade. The liquidator would be from the office of the government liquidator and would not act efficiently resulting in wasted leakage of value at the liquidation stage and further delays.

The present government has maintained a strong focus on improving India’s rankings in the World Bank’s ease of doing business rankings. This has led to the government introducing seminal reforms to improve enforcement of contracts in India, which has consequently improved security enforcement. Further, it has been a consistent policy of the government to place offshore investors and domestic investors on the same footing. The negative impact of inefficient debt enforcement mechanisms on India’s sovereign ratings have ensured that it remains a priority in the eyes of the government. These measures and their impact are:

I. Revamped Arbitration Regime

a. A new arbitration regime has been introduced which provides for fast track arbitration, loser pays cost regime, faster enforcement of awards etc. A key feature of the amendment is that it introduces a timeline of 12-18 months for completion of arbitration.

b. There has been a complete change in attitude of courts towards arbitration proceedings. The recent series of judgments reflect that the courts take hands off approach when dealing with challenges to arbitral awards. Furthermore, merely pendency of a challenge in court can no longer be a ground to resist enforcement of an award. This has removed the time lag in enforcement of an award. (See Associate Builders v. Delhi Development Authority, 2014 (4) ARBLR 307(SC); Etizen Bulk A/S v Ashapura Minechem Ltd. and Anr., Civil Appeal Number 5131-5133 of 2016 (SC);)
c. There were a number of cases where defaulters or parties reneging from freely entered contractual obligations relied upon the exchange control regulations to defeat claims of the creditors. However, courts have consistently refused these grounds and allowed for enforcement of foreign arbitral awards in India. (See Cruz City 1 Mauritius Holdings v. Unitech Ltd.; POL India Projects Ltd. v. Aurelia Reederi Eugen Friederich GmbH; Ntt Docomo Inc vs Tata Sons Limited)

d. Further, arbitration proceedings may take place in India or abroad, and the award could be enforced in India as a decree of a court.

II. Enforcement of Security without Court Interference

a. In 2016 the government amended the SARFAESI and extended its benefits to debenture holders. Now a Debenture Trustee stands on equal footing with the banks, ARCs and specified financial institutions.

b. A debenture trustee has the power to directly take possession (after 60 days' notice) and sell security interest without approaching a court.

III. Introduction of Insolvency Code

a. The Bankruptcy Code revamps the insolvency resolution process in India by shifting the control to the hands of the creditor, instead of allowing a defaulting debtor continuing control.

b. Upon a default on debt or interest payment by the debtor company, a creditor may move an application for insolvency to the National Company Law Tribunal ("NCLT") without providing notice to the debtor. While the NCLT may accept or reject such application (within 14 days of filing), rejection is uncommon.

c. Upon acceptance, within 15 days, a Committee of Creditors ("CC") is formed, and an Insolvency Resolution Professional ("IRP") is appointed to take over the powers of the Board. The CC is responsible for coming up with a Restructuring Proposal/Plan, which is to be accepted by 75% of all creditors (by value) before being implemented.

d. Failure to come up with a Restructuring Proposal, or failure for 75% of creditors (by value) to accept a proposal within the time frame of the Bankruptcy Code will trigger mandatory fast track liquidation of the company.

e. A priority waterfall or the order in which subsisting debts will be satisfied has also been laid out under the Bankruptcy Code (Section 53), with priority being given to insolvency related costs, followed by secured creditors and workmen dues (unpaid up to 24 months). Secured creditors therefore have a priority over unsecured creditors and even government debts.

f. The Bankruptcy Code also lays out a strict timeline of 180 days (extendable once to 270 days) for resolution, failing which there is mandatory liquidation of the debtor company.

g. The liquidator is now a form of an insolvency resolution professional that is appointed by the CC. Insolvency Resolution Professional could now also be in form of a partner from the Big Four Accounting Firm allowing for efficient and quick liquidation.

h. In the debate between SARFAESI and the Bankruptcy Code, the single largest secured creditor may prefer proceedings under SARFAESI so as to protect his collateral. However, upon initiation of the resolution process under the IBC, all the assets of the debtor will fall within the ambit of the resolution plan, and all pending proceedings under SARFAESI are suspended. As a result, creditors who wish to proceed under the SARFAESI procedure must invoke existing pledges at the earliest default. Once a security has been invoked under SARFAESI, then the security cannot become part of the resolution process under the IBC.
A. Enforcement of Various Types of Securities:

i. **Mortgage of Land:** The usual remedy of a suit for enforcement of mortgage is time consuming and may take between 3-5 years. Accordingly, proceeding against such security interest under SARFAESI remains the preferred option for creditors. Historically, applicable only for Banks and FI’s, now available to all listed debt and NBFCs. These proceedings can be completed in about 18 months. The lender has the right to sell the property without intervention of the courts.

ii. **Corporate & Personal Guarantee:** A guarantee can now be easily enforced through arbitration. It should not be noted that post the amendment, merely filing a challenge against the award passed by the arbitrator does not stay its enforcement. Thus, an award against a guarantor can be quickly enforced as a decree of the court. Additionally, corporate creditors can proceed against the guarantor under the Bankruptcy Code as well.

iii. **Escrow Mechanism:** All cashflows from identified projects are deposited in an escrow. Escrow account is managed by an escrow agent which could be the debenture trustee. Escrow agent operates on the instructions of debenture holders/trustee. Outflows from the escrow will be to operational account to use the proceeds for expenses or to the investor account, to use the proceeds for servicing the debt.

iv. **Pledge of Shares:**

   a. A pledge on dematerialized shares can be created and enforced in a simple manner. A Pledgor files a simple form with the depository participant (DP) to create pledge and the pledged shares get frozen in the pledgor’s account. Upon invocation, pledgor merely needs to instruct the DP to transfer the pledged shares to the pledgee’s account. This is an immediate process. DP is mandated to follow the instruction of the pledgor without going into the merits of default and / or reasons for invocation.

   b. It should be noted that once the pledged shares are credited to the pledgee, pledgee must sell such shares within a reasonable time with prior notice to the pledger. In case of listed shares prior notice of 2 days or more could be considered as sufficient. In case of unlisted shares a notice of 15 days or more is usually provided. An obligation lies on the pledgee to make reasonable attempts to sell the shares. Such sale may be to a third party or to the lender itself, at FMV. Proceeds from the sale will be applied towards repayment of dues.

   c. In case the shares are in physical form, it is advisable to have them dematerialized prior to creation of pledge. If the pledge is created on shares in physical form, the share certificates along with blank share transfer forms & power of attorney are required to be provided. However, share transfer forms expire in 60 days. Further board approval is required for recording share transfer. The debtor has the opportunity of creating issues by revoking the power of attorney or resisting the recordal of share transfer at board level.

   d. In the event that a Holding Company holds shares in a Special Purpose Vehicle that are pledged to a lender, and the Holding Company goes insolvent and in control of an IRP, then:

      - If the pledge had not been invoked prior to commencement of insolvency proceedings then, un-invoked pledges would fall within the purview of the asset of the holding company to be distributed as per the stipulated waterfall.

      - If the pledge had been invoked prior to the initiation of the insolvency process then the shares (being in the demat form) having transferred to the account of the creditor, would outside the purview of the insolvency process and the secured creditor in question can exercise his right to sell.

      - If the shares are in the physical form, they will fall within the purview of the IRP even after a pledge has been invoked.
B. Key Highlights of the Insolvency Regime:

The Bankruptcy Code has put in place a regime which has professionals such as those from the big 4 accounting firms taking charge of the insolvency process and driving it forward. Under the earlier regime the office of Official Liquidator would take charge of the process which brought with it huge inefficiencies and propriety issues. Further Bankruptcy Code also has prescribed timelines for completion of this process.

The key features and impact of the Bankruptcy Code is as following:

i. Increased impact of the threat of insolvency proceedings: Once Bankruptcy Code proceedings are triggered, the control of the Company moves out of the hands of the promoter and who is also subsequently prohibited from participating in the insolvency resolution process. This has increased the impact of threat of insolvency proceedings. It is noticed that if faced with a prospect of losing control of the company to the insolvency professional many debtors choose to pay up the dues. As per the Indira Gandhi Institute of Development Research ("IGIDR") report published on August 31, 2018, 10% of the cases dismissed were settled out of court and the creditors recovered their dues.2 The data on cases settled prior to filing of an application before the NCLT would not be publicly available though we are aware of examples where this has occurred. The Supreme Court in the Lokhandwala Kataria Construction Pot. Ltd case on July 24, 2017 ruled that a case can be withdrawn after insolvency proceedings have started against a company if a settlement is considered. This position as upheld in a few cases such as Mothers Pride Dairy India Pot. Ltd case and Utara Foods and Feeds Pot. Ltd. This further reflects that insolvency proceedings have created high degree of pressure on promoters to arrive at settlement and pay of the dues.

ii. Expedited appointment of Insolvency Resolution Professional: Under the old law admission of the winding up petition and appointment of provisional liquidator would take months and in some cases years. Further the appointment of the provisional liquidator would not provide protection and surety given the nature of official liquidator's office and their performance. However, under the new law a creditor nominated insolvency resolution professional is appointed to take charge of the assets and to drive the insolvency resolution process. The average time taken from the date of filing the insolvency petition to the date on which it first came up for hearing is around 18 days and for appointment of insolvency resolution professional 28 days. This means that companies' assets have been taken over by creditor nominated insolvency resolution professional within 28 days of filing.

iii. Insolvency Resolution Process: As per the IBC, the corporate insolvency resolution process shall close within 180 days from the date of admission with a provision to extend the period by 90 days. Landmark cases which are under Insolvency Resolution Process. In June 2017, Reserve Bank of India ("RBI") sent the list of top 12 defaulters to the respective creditors for a quick launch of the resolution process. Namely, Bhushan Steel, Lanco Infra, Essar Steel, Bhushan Power, Alok Industries, Amtek Auto, Monnet Ispat, Electrosteel Steels, Jaypee Infratech, ABC Shipyard, Jyoti Structures and Era Infra.

iv. Liquidation of Assets: If no resolution plan has been agreed to by the CoC within the timeline mentioned, then NCLT shall pass an order to commence the liquidation of the corporate debtor. Once the liquidation order is passed, the resolution professional acts as the liquidator of the corporate debtor. He takes control of all assets of the corporate debtor which can be utilized and distributed subsequent to liquidation. As per the regulations, the entire liquidation process including the sale of assets and distribution of liquidation proceeds has to be completed within 2 years. We have seen cases where the same has been completed in 5-8 months.
# Annexure I

## Private Equity vs Private Debt

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Particulars</th>
<th>Debt</th>
<th>Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Assured returns</td>
<td>Investors are eligible for assured returns on their investment through interest and redemption premium.</td>
<td>Returns on PE investments cannot be assured. Call/ Put Options are not looked at favorably and are subject to the conditionalities prescribed under the FDI Policy.</td>
</tr>
<tr>
<td>2.</td>
<td>Capital repatriation</td>
<td>Debt capital can be fully repatriated.</td>
<td>While permitted to be repatriated under the FDI Policy, repatriation of capital is limited to buy-back or reduction of capital, subject to the conditionalities prescribed under the FDI Policy.</td>
</tr>
<tr>
<td>3.</td>
<td>Tax benefits</td>
<td>Interest payments are deductible as an expense for the borrower. Interest payments made to a non-resident lender may be subject to withholding tax in India. Credit in the home country may be available for the taxes withheld in India.</td>
<td>Dividend payment and buyback proceeds are taxed at the hands of the investee company at 20.36% or 23.72% respectively, in addition to the corporate income tax of 30%. The investor cannot claim credit for any of the above.</td>
</tr>
<tr>
<td>4.</td>
<td>Sources of payment</td>
<td>Interest may be paid out of any source of the borrower (including by way of refinancing debt).</td>
<td>Dividends can be paid out of profits only (unless government approval is sought). Reduction of capital may be done without profits, but is a tribunal driven process and subject to approvals from the creditors. Another alternative is buy-back of shares. However, the same is subject to host of conditions, including limits on how much of the share capital can be bought back.</td>
</tr>
<tr>
<td>5.</td>
<td>Security</td>
<td>Debt may be secured by creation of security interest, including over the assets of the borrower.</td>
<td>No security creation is possible to secure the investment amount or returns thereon.</td>
</tr>
<tr>
<td>6.</td>
<td>Returns on Investment</td>
<td>Returns may be structured as interest or redemption premium and linked to cash flow, share price etc. hence achieving equity like structure with tax optimization.</td>
<td>Returns may be structured by way of dividends or capital reduction or buy-back, all of which are tax inefficient structures.</td>
</tr>
</tbody>
</table>

5. The effective rate for domestic companies is 30.9% where income is less than or equal to INR 10 million, 33.063% where income exceeds INR 10 million but is less than or equal to INR 100 million and 34.608% where the income exceeds INR 100 million.
Annexure II

Investment Instruments

<table>
<thead>
<tr>
<th>Particulars</th>
<th>CCD</th>
<th>NCD</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Equity Ownership</strong></td>
<td>Initially debt, but equity on conversion</td>
<td>Mere lending rights; however, veto rights can ensure certain degree of control.</td>
</tr>
<tr>
<td><strong>ECB Qualification</strong></td>
<td>Assured returns on FDI compliant instruments, or put option granted to an investor, may be construed as ECB.</td>
<td>Purchase of NCDs by the FPI from the Indian company is expressly permitted and shall not qualify as ECB.</td>
</tr>
<tr>
<td><strong>Coupon Payment</strong></td>
<td>Interest is repatriable without any restrictions (net of taxes).</td>
<td>Arm's length interest pay out should be permissible resulting in better tax efficiency. Higher interest on NCDs may be disallowed. Interest can be required to accrue only out of free cash flows. Redemption premium may also be treated as business expense.</td>
</tr>
<tr>
<td></td>
<td>Though it is not provided in text, as a market practice, interest pay out may be limited to SBI PLR + 300 basis points as the same ceiling is applicable in case of payment of dividend with respect to compulsorily convertible preference shares.</td>
<td>Parties may agree that interest can accrue and be paid only out of free cash flows.</td>
</tr>
<tr>
<td><strong>Pricing</strong></td>
<td>CCDs have to be issued pursuant to the RBI’s pricing guidelines which prescribe for internationally accepted pricing methodologies</td>
<td>Valuation is not applicable</td>
</tr>
<tr>
<td><strong>Security Interest</strong></td>
<td>Creation of security interest is not permissible either on immovable or movable property</td>
<td>NCDs can be secured (by way of pledge, mortgage of property, hypothecation of receivables etc.) in favor of the debenture trustee who acts for, and in the interest of, the NCD holders.</td>
</tr>
<tr>
<td><strong>Sector-based conditionality</strong></td>
<td>Only permissible for FDI compliant activities</td>
<td>Sector restrictions not applicable; provided that unlisted NCDs cannot be issued for raising capital for “real estate business”.</td>
</tr>
<tr>
<td><strong>Equity Upside</strong></td>
<td>Investor entitled to equity upside upon conversion.</td>
<td>NCDs are favorable for the borrower to reduce book profits or tax burden. Further, equity upside can also be structured which can be linked to any variable agreed between the borrower and the investor.</td>
</tr>
</tbody>
</table>
## Annexure III

### Pooling Vehicle – Trust/ Company/ LLP

<table>
<thead>
<tr>
<th>Issue</th>
<th>Trust</th>
<th>Limited Liability Partnership</th>
<th>Company</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>General</strong></td>
<td>The person who reposes or declares the confidence is called the “author of the trust”; the person who accepts the confidence is called the “trustee”; the person for whose benefit the confidence is accepted is called the “beneficiary”; the subject matter of the trust is called “trust property”; the “beneficial interest” or “interest” of the beneficiary is the right against the trustee as owner of the trust property; and the instrument, if any, by which the trust is declared is called the “instrument of trust”/ “indenture of trust”</td>
<td>The concept of LLP was recently introduced in India under the Limited Liability Act, 2008 (“LLP Act”). An LLP is a hybrid form of a corporate entity, which combines features of an existing partnership firm and a limited liability company (i.e. the benefits of limited liability for partners with flexibility to organize internal management based on mutual agreement amongst the partners). The functioning of an LLP is governed by the LLP agreement.</td>
<td>A Company can be incorporated under the Companies Act, 2013.</td>
</tr>
</tbody>
</table>

### Entities Involved

<p>| The Settlor: The Settlor settles a trust with an initial settlement. Terms of the indenture of trust shall administer the functioning of the trust. | Partner: A ‘partner’ represents an investor in the fund. To that extent, a partner has an obligation to fund its ‘commitment’ to the fund and is entitled to distributions based on fund documents (being the LLP Agreement in this case). | Shareholders: Shareholders hold the shares of the company and are granted special privileges depending on the class of shares they own. |
| The Trustee: The Trustee is in charge of the overall administration of the Trust and may be entitled to a trusteeship fee. The Trustee may also appoint an investment manager, who in turn manages the assets of the Trust and the schemes/ funds as may be launched under such Trust from time to time. | Designated Partner: Though the expression ‘designated partner’ is not explicitly defined, however, on a plain reading of the LLP it is understood that such ‘designated partner shall be the person responsible and liable in respect of the compliances stipulated for the LLP. | Directors: Directors have a fiduciary duty towards the company with respect to the powers conferred on them by the Companies Act and by the Memorandum of Association and Articles of Association of the company. They are trustees in respect of powers of the company that are conferred upon them, for instance, powers of (a) issuing and allotting shares; (b) approving transfers of shares; (c) making calls on shares; and (d) forfeiting shares for non-pay-ment of call etc. They must act bona fide and exercise these powers solely for the benefit of the company. |
| The Contributor: The contributor is the investor to the Trust (the Fund) and makes a capital commitment under a contribution agreement. |                                                                                             |                                                                                               |</p>
<table>
<thead>
<tr>
<th><strong>Management of entities</strong></th>
<th>The Trustee is responsible for the overall management of the Trust. In practice this responsibility is outsourced to an investment manager pursuant to an investment management agreement.</th>
<th>The LLP relies on the Designated Partner in this respect. In practice, this responsibility may be outsourced to an investment manager pursuant to an investment management agreement.</th>
<th>The board of directors manages the company involved. In practice this responsibility is outsourced to an investment manager pursuant to an investment management agreement.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Market Practice</strong></td>
<td>Almost all funds formed in India use this structure. The regulatory framework governing trust structures is stable and allows the management to write its own standard of governance.</td>
<td>Only a few funds are registered under this structure. The Registrar of Companies does not favor providing approvals to investment LLPs. As per section 5 of the LLP Act, 2008, only an individual or a body corporate is eligible to be a partner in an LLP.</td>
<td>There are no clear precedents for raising funds in a ‘company’ format.</td>
</tr>
</tbody>
</table>
## Annexure IV

### Jurisdiction Comparison

<table>
<thead>
<tr>
<th></th>
<th>Mauritius</th>
<th>Singapore</th>
<th>Netherlands</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Capital gains tax on sale of Indian securities</strong></td>
<td>No local tax in Mauritius on capital gains. Mauritius residents not taxed on gains resulting from the transfer of shares in an Indian company acquired prior to April 1, 2017. Gains arising to Mauritius residents from alienation of Indian shares (acquired after April 1, 2017), between April 1, 2017 and March 31, 2019 shall be subject to tax at 50% of the Indian tax rate.</td>
<td>No local tax in Singapore on capital gains (unless characterized as business income). Singapore residents not taxed on gains accruing before the date on which the India-Mauritius Protocol comes into force. Gains accruing after such time are subject to tax in India. (Please refer to section on “Investing into India: Considerations from a Singapore-India Tax Perspective”)</td>
<td>Dutch residents not taxed if sale made to non-resident. Exemption for sale made to resident only if Dutch shareholder holds lesser than 10% shareholding in Indian company. Local Dutch participation exemption available in certain circumstances.</td>
</tr>
<tr>
<td><strong>Tax on dividends</strong></td>
<td>Indian company subject to DDT at the rate of 15% (exclusive of surcharge and cess) on a gross basis.</td>
<td>Indian company subject to DDT at the rate of 15% (exclusive of surcharge and cess) on a gross basis</td>
<td>Indian company subject to DDT at the rate of 15% (exclusive of surcharge and cess) on a gross basis.</td>
</tr>
<tr>
<td><strong>Withholding tax</strong></td>
<td>No relief. Taxed as per Indian domestic law.</td>
<td>15%</td>
<td>10%</td>
</tr>
<tr>
<td><strong>Other</strong></td>
<td>India and Mauritius have recently signed a Protocol, which significantly amends the provisions of the tax treaty between the two countries, giving India a source based right to taxation. (Please refer to section on “Investing into India: Considerations from a Mauritius-India Tax Perspective”)</td>
<td>There are specific limitations under Singapore corporate law (e.g. with respect to buyback of securities).</td>
<td>To consider anti-abuse rules introduced in connection with certain passive holding structures.</td>
</tr>
</tbody>
</table>
# Annexure V

## Types of NBFC

<table>
<thead>
<tr>
<th>Type of NBFC</th>
<th>Eligibility Requirements</th>
</tr>
</thead>
</table>
| Asset Finance Company            | • company which is a financial institution  
• principal business\(^6\) includes financing of physical assets which support productive/economic activity, such as automobiles, tractors, earth moving and material handling equipments, moving on own power and general purpose industrial machines |
| Investment Company               | • company which is a financial institution  
• principle business is the acquisition of securities                                                                                                                                                                   |
| Loan Company                     | • company which is a financial institution  
• principle business is providing finance, whether by way of making loans or advances or otherwise, for any activity other than its own, but does not include an Asset Finance Company |
| Infrastructure Finance Company (*NBFC-IFC*) | • an NBFC which meets the following four requirements:  
  • at least 75% of its total assets is deployed in infrastructure loans  
  • has a minimum net owned fund of INR 300 crores  
  • has a minimum credit rating of ‘A’ or equivalent  
  • maintains a capital to risk weighted assets ratio (*CRAR*) of 15% |
| Systemically Important Core Investment Company | • an NBFC carrying on the business of acquisition of shares and securities  
  • must satisfy the following requirements:  
    • at least 80% of its total assets is in the form of investment in equity shares, preference shares, debt or loans in group companies  
    • at least 60% of its total assets is invested in equity shares of group companies (including CCPS/CCDs with a maturity period of maximum 10 years)  
    • it does not trade its investment in shares, debt or loans, except for the purposes of disinvestment or dilution  
    • it does not carry on any other financial activity except bank deposits, money market instruments, government securities, loans to and investments in debt issuances of group companies or guarantees issued on behalf of group companies  
    • it has a minimum asset size of INR 100 crore  
    • it accepts public funds |

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\(^6\) For this purpose, principal business is defined as aggregate of financing real/physical assets supporting economic activity and income arising therefrom to be not less than 60% of the company’s total assets and total income respectively.
| NBFC – Infrastructure Debt Fund | company registered as NBFC  
| | facilitates flow of long term debt into infrastructure projects  
| | raises resources through rupee or dollar denominated bonds only, with a minimum maturity of 5 years  
| | only an IFC can be a sponsor  
| NBFC – Micro Finance Institution | non-deposit taking NBFC  
| | at least 85% of its total assets should satisfy the following requirements:  
| | loan disbursed to a borrower with a rural household, with annual income not exceeding INR 1 lakh, or to an urban/semi-urban household with annual income not exceeding INR 1.6 lakh  
| | loan amount does not exceed INR 50,000 in first cycle, and INR 1 lakh in subsequent cycles  
| | total indebtedness of the borrower should not exceed INR 1 lakh  
| | for loan amounts in excess of INR 15,000, tenure should be at least 24 months with facility of prepayment without penalty  
| | loan should be extended without collateral  
| | aggregate amount of loans, given for income generation, is not less than 50 per cent of the total loans given by the micro finance institutions  
| | loan repayable on weekly, fortnightly or monthly basis, at the option of the borrower  
| NBFC – Factors | non-deposit taking NBFC  
| | principal business is factoring  
| | at least 50% of its total assets should be in factoring business, and income derived from such business should be at least 50% of its total income  
| Mortgage Guarantee Companies | financial institution  
| | at least 90% of business turnover is the mortgage guarantee business, or at least 90% of gross income is from mortgage guarantee business  
| | minimum net owned fund shall be INR 100 crore  
| NBFC – Non-Operative Financial Holding Company (“NOFHC”) | financial institution  
| | promoter/promoter group of the wholly owned NOFHC will be permitted to set up a new bank through the entity  
| | NOFHC permitted to hold the bank and other financial services companies, regulated by the RBI or other regulatory bodies, to the extent applicable |
## Annexure VI

### Comparative analysis of NBFC

Based on this characterization, the following table offers a comparative description of prudential requirements for each type of NBFC:

<table>
<thead>
<tr>
<th>Prudential Norm</th>
<th>NBFC-D</th>
<th>NBFC-ND-NSI</th>
<th>NBFC-ND-SI</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Tier I Capital</strong></td>
<td>Owned funds reduced by investment in shares of other NBFCs, and in shares, bonds, debentures, outstanding loans and advances (including hire purchase and lease financing) made to and deposits with subsidiaries and companies in the same group, exceeding 10% of the owned fund, in aggregate</td>
<td>Owned funds reduced by investment in shares of other NBFCs, and in shares, bonds, debentures, outstanding loans and advances (including hire purchase and lease financing) made to and deposits with subsidiaries and companies in the same group, exceeding 10% of the owned fund, in aggregate; Further perpetual debt instruments issued by a non-deposit taking NBFC in each year, to the extent it does not exceed 15% of the aggregate Tier I Capital of such company, as of March 31 of the previous year</td>
<td>Owned funds reduced by investment in shares of other NBFCs, and in shares, bonds, debentures, outstanding loans and advances (including hire purchase and lease financing) made to and deposits with subsidiaries and companies in the same group, exceeding 10% of the owned fund, in aggregate; Further perpetual debt instruments issued by a non-deposit taking NBFC, with assets between Rs. 100 crore and Rs. 500 crore as per the last audited balance sheet, in each year, to the extent it does not exceed 15% of the aggregate Tier I Capital of such company, as of March 31 of the previous year</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Tier II Capital</strong></th>
<th>Includes:</th>
<th>Includes:</th>
<th>Includes:</th>
</tr>
</thead>
<tbody>
<tr>
<td>■ preference shares (other than CCPS)</td>
<td>■ preference shares (other than CCPS)</td>
<td>■ preference shares (other than CCPS)</td>
<td>■ revaluation reserves, at a discounted rate of 55%</td>
</tr>
<tr>
<td>■ revaluation reserves, at a discounted rate of 55%</td>
<td>■ revaluation reserves, at a discounted rate of 55%</td>
<td>■ revaluation reserves, at a discounted rate of 55%</td>
<td>■ general provisions and loss reserves</td>
</tr>
<tr>
<td>■ general provisions and loss reserves</td>
<td>■ general provisions and loss reserves</td>
<td>■ general provisions and loss reserves</td>
<td>■ hybrid debt capital instruments</td>
</tr>
<tr>
<td>■ hybrid debt capital instruments</td>
<td>■ hybrid debt capital instruments</td>
<td>■ hybrid debt capital instruments</td>
<td>■ subordinated debt</td>
</tr>
<tr>
<td>■ subordinated debt to the extent that the aggregate does not exceed Tier I Capital</td>
<td>■ subordinated debt to the extent that the aggregate does not exceed Tier I Capital</td>
<td>■ subordinated debt</td>
<td>■ perpetual debt instruments, which is in excess of what qualifies as Tier I Capital to the extent that the aggregate does not exceed Tier I Capital</td>
</tr>
<tr>
<td>■ perpetual debt instruments, which is in excess of what qualifies as Tier I Capital to the extent that the aggregate does not exceed Tier I Capital</td>
<td>■ perpetual debt instruments, which is in excess of what qualifies as Tier I Capital to the extent that the aggregate does not exceed Tier I Capital</td>
<td>■ perpetual debt instruments, which is in excess of what qualifies as Tier I Capital to the extent that the aggregate does not exceed Tier I Capital</td>
<td></td>
</tr>
<tr>
<td><strong>Capital Adequacy Requirements</strong></td>
<td>Capital Risk Adequacy Ratio must be 15% Provided that, Tier II Capital shall not exceed 100% of Tier I Capital</td>
<td>Capital Risk Adequacy Ratio must be 15% Provided that, Tier II Capital shall not exceed 100% of Tier I Capital</td>
<td>Capital Risk Adequacy Ratio must be 15% Provided that, Tier II Capital shall not exceed 100% of Tier I Capital</td>
</tr>
<tr>
<td>----------------------------------</td>
<td>-------------------------------------------------------------------------------------------------</td>
<td>-------------------------------------------------------------------------------------------------</td>
<td>-------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td><strong>Credit Concentration Requirements</strong></td>
<td>NBFC-D cannot:</td>
<td>Not applicable</td>
<td>NBFC-ND-SI which accepts public funds will have the credit concentration requirements as applicable to NBFC-D</td>
</tr>
<tr>
<td></td>
<td>- Lend to:</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>- A single borrower in excess of 15% of Owned Funds</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>- A single group of borrowers in excess of 25% of Owned Funds</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Invest In:</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Shares of another Company in excess of 15% of Owned Fund</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Shares of single group of companies in excess of 25% of Owned Funds</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Lend and Invest:</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>- In excess of 25% of Owned Fund to a single party</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>- In excess of 40% of Owned Fund to a single group of parties</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Annexure VII

Death Knell for Foreign Investors in Indian Corporate Debt Markets?

1. Background

In 2008, SEBI introduced the SEBI (Issue and Listing of Debt Securities), Regulations 2008, which paved the way for companies to issue their debt securities, primarily, non-convertible debentures (“NCD”) to investors. Subsequently, the Foreign Exchange Management (Transfer and Issue of Securities to Persons Resident outside India) Regulations, 2000 (“TISPRO 2000”) was amended to permit foreign institutional investors (and later Foreign Portfolio Investors (“FPI”)) to invest in listed NCDs, and subsequently in to-be-listed NCDs.

In February 2015, the Reserve Bank of India (“RBI”) and the Securities Exchange Board of India (“SEBI”) further amended TISPRO 2000 and the SEBI (Foreign Portfolio Investors), Regulations 2014 (“FPI Regulations”) stipulating a minimum residual maturity for NCDs which FPIs could invest in. This was considered as a major impediment to foreign investment, since this restricted raising short term financing through NCDs.

Despite the introduction of a minimum residual maturity, issuance of NCDs by Indian corporates were at an all-time high. This was evident in the fact that the prescribed overall limits for corporate debt had been exhausted, and limits were thereafter, available only under auction.

In light of the issues faced by the market participants, the RBI has introduced 2 circulars, Circular No. 24 dated April 27, 2018 (“Circular 1”) and Circular No. 26 dated May 1, 2018 (“Circular 2”) to introduce certain changes.

II. Changes And Analysis

A. Minimum residual maturity:

1. Background

In February 2015, the RBI and SEBI amended relevant regulations to provide for a minimum residual maturity of 3 years. This minimum maturity applied to primary subscriptions, as well as secondary acquisition of NCDs by FPIs. By way of a press release, RBI also clarified that optionality clauses enforceable prior to the minimum residual maturity of 3 years was not permitted. This was considered a major concern since, pre-payment was also considered as optionality rights which the borrower had. Further, the regulations also restricted pre-payments even in default cases where the lender could seek pre-payments.

2. Changes

By Circular 1, RBI has now reduced the minimum maturity from 3 years to 1 year.

3. Analysis

This is a welcome move since it was felt that the restriction of a minimum maturity of 3 years was too onerous, and impacted fund raising by Indian corporates. In the absence of a similar restriction on resident NCD holders, companies intending to
pre-pay NCDs were facing substantial challenges, if even a single NCD was held by a FPI. Further, this regulatory arbitrage led to a situation where FPIs would transfer the NCDs to an Indian entity to provide for the redemption prior to the 3 year period. While NCDs having residual maturity of less than 3 years were not permitted to be redeemed prior to the expiry of the 3 year period, FPIs were permitted to transfer the NCDs to a resident entity prior to expiry of the 3 year period.

The change would now permit resident Indian NCD holders and FPIs to be treated at par with respect to repayments / redemptions, without FPIs being required to restructure their holdings in case of a pre-payment (such as the warehousing structure mentioned above). Further, the 1 year restriction would not impact NCD issuances substantially, since RBI regulates issuance of NCDs with less than 1 year maturity separately, and the NCDs issued by corporates to such FPIs are generally for a period greater than 1 year.

Another important consideration is that the changes are prospective in nature, i.e. the changes do not impact NCDs issued prior to the notification of the changes.

B. Single issuance concentration norms

i. Background

NCDs have been used by corporates as an effective mechanism to raise debt from offshore, especially from FPIs. This was a preferred route for corporates, since the NCD holders were not subject to strict regulatory compliances otherwise applicable to banks, provided substantial flexibility with respect to structuring returns and was tax efficient for the holders and the issuers. This made the NCD-FPI route attractive and a large number of corporates raised debt from a single FPI investor by issuing NCDs to them, especially since the FPIs were permitted to hold 100% of the NCDs issued by a borrower (as opposed to limits prescribed on the equity investments by FPIs). The limits prescribed apply to an FPI along with all related FPIs.

ii. Changes

- By Circular 1, RBI has introduced limits on the extent of an issuance that FPIs can subscribe to. Under Circular 1, RBI has prescribed that the investment by an FPI shall not exceed 50% of the issuance of NCDs by a corporate. In cases, where this limit has been breached, the FPI shall not be permitted to make any further investments till the exposure of the FPI in such issuance has met the 50% condition.

- Circular 2 has clarified that ‘related FPIs’ means all FPIs registered by a non-resident entity.

iii. Analysis

The imposition of a limit of 50% of a bond issuance that can be subscribed to by an FPI is expected to have major implications on the viability of the NCD route as a mode for raising funds. Currently, a single FPI can subscribe to the entire issuance of NCDs by a company. However, with this new restriction, a minimum of 2 FPIs would be required for any corporate to undertake an issuance. This is unnecessarily onerous in the current framework, where a borrower generally negotiates the terms with an FPI and issues NCDs to such FPI.

An important point to note is that the restriction has been imposed on the FPI, but not the issuer. It would need to be seen how are FPIs supposed to monitor the same, since it may not have full clarity on the subscribers.

While Circular 1 states that if the FPI holds more than 50% of the issue size, it shall not invest any further funds into the issue till such 50% limit is adhered to. It is unclear in which situation would the FPI exceed the 50% limits prescribed, considering that the FPIs are not permitted to subscribe to more than 50% of the issue. This is also linked to the previous point, on the practicability of the FPI to monitor its investment. As an illustration, if a company intends to issue 100 NCDs (with each NCD having the same face value), an FPI’s investment cannot exceed 50 NCDs. However, it is unclear that if the total NCDs issues (due to lack of subscription) is 95, would the issuance to the FPI be restricted to 47 (instead of 50)? Or would the FPI be
issued 50 NCDs, and it would not be permitted to make any further investments in the issuance.

Another important aspect to be considered is what the RBI means by a single ‘issuance’. If a borrower issues multiple tranches of NCDs under a single prospectus (termed a ‘shelf prospectus’), would each tranche refer to a single issuance, or would all tranches collectively be referred to a single issuance?

While the text is not abundantly clear at this stage, considering that the intent of RBI is to limit an FPI's exposure to 50%, it would be safe to assume that the RBI would want to consider these limits strictly for each issuance.

The definition of ‘related FPIs’ under Circular 2 seems to be vague, and incoherent with the existing FPI Regulations. Under the definition provided under Circular 2, if a single investor invests through multiple FPIs which are set up by different entities, the investments would not be clubbed. This does not seem to be a logical interpretation of the intent. The RBI / SEBI may refer back to the ultimate beneficial ownership test applicable for FPIs currently, where if an investor has investments through multiple FPIs, the limits would be clubbed for all purposes.

C. Single group concentration norms

i. Background

Under the current regulatory framework, a single FPI can have only one NCD as its entire debt portfolio, i.e. there is no concentration norms requiring an FPI to spread its investments across portfolios. This provided the FPIs flexibility to invest into NCDs at their discretion, without any requirement for a minimum number of investments.

i. Changes

- Under Circular 1, RBI has prescribed 20% of the debt portfolio of the FPI as the limit of exposure of a FPI into a single corporate entity, along with related entities.
- If the exposure of a FPI is more than 20% of the debt portfolio of the FPI to a single corporate group, the FPI shall not undertake any fresh exposure in such entity or any related entity, till the 20% limit is met.
- New FPIs (i.e. FPIs registered after April 27, 2018) shall be required to comply with the 20% limit within 6 months from being registered as an FPI.
- Circular 2 clarifies that related entities would have the meaning ascribed to them under the Companies Act, 2013.

ii. Analysis

The requirement for having multiple investments seems to stem from RBI's insistence on diversifying the risk for investors in FPIs. By having a maximum of 20% exposure to a single corporate entity (along with its related entities), FPIs would be mandatorily required to look for more investment opportunities and invest in multiple corporate entities.

The concentration norms as provided for FPIs are similar to those imposed on Alternative Investment Funds in India. However, one notable change in the FPI regime is that new FPIs are required to comply with the 20% concentration norms within a period of 6 months from the date of registration. This would necessarily imply that a newly registered FPI would need to make at least 5 investments of exactly 20% of its debt portfolio, or more than 5 investments, with each investment being lower than 20% of its debt portfolio. Coupled with the concentration norms on single issue concentration norms (covered in 2 above), this may pose a substantial challenge to newly set up FPIs.

Further, existing FPIs have not been given a time frame within which the above provisions would need to be complied with. There seems to be no rationale for the same, considering that the RBI has already restricted any additional exposure by an FPI into a corporate entity if the limits are breached. As an example, if an existing FPI has 3 investments with 33% investment in 3 corporate groups, they are anyway restricted from making any further investment in these 3 portfolio companies till the limits are below 20%. In this light, FPIs may benefit
from this regulatory arbitrage, unless a time bound obligation is imposed on the existing FPIs.

III. Conclusion

While RBI’s intent of Circular 1 and Circular 2 is to encourage companies to mobilize resources through public issuance of NCDs, the concentration norms seem to be unnecessary and excessive, considering the growth of the investor interest in the corporate debt markets. The impact can be observed in the net investment by FPIs in the debt segment being negative in the month of May already (net outflows as of May 22, 2018 in the debt segment is USD 274 million, as opposed to net inflows of USD 320 million as of April 22, 2018 (as per information available on NSDL’s website)). As mentioned earlier, while the changes seem to bring in diversification and expansion of the debt market, the implications seem to be far excessive and unnecessary.

The concentration norms have been enacted and successfully implemented in other financial services sectors to avoid systemic risk in the financial markets by encouraging diversification among investors, but limits on investment into issuances seems to be far excessive, and may prove to be the death knell for not only the debt segment for FPIs, but an important avenue for fund raising for Indian corporates.

For any queries please reach out to debtfulingteam@nishithdesai.com
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We are a research and strategy driven international firm with offices in Mumbai, Palo Alto (Silicon Valley), Bangalore, Singapore, New Delhi, Munich, and New York. Our team comprises of specialists who provide strategic advice on legal, regulatory, and tax related matters in an integrated manner basis key insights carefully culled from the allied industries.

As an active participant in shaping India’s regulatory environment, we at NDA, have the expertise and more importantly – the VISION – to navigate its complexities. Our ongoing endeavors in conducting and facilitating original research in emerging areas of law has helped us develop unparalleled proficiency to anticipate legal obstacles, mitigate potential risks and identify new opportunities for our clients on a global scale. Simply put, for conglomerates looking to conduct business in the subcontinent, NDA takes the uncertainty out of new frontiers.

As a firm of doyens, we pride ourselves in working with select clients within select verticals on complex matters. Our forte lies in providing innovative and strategic advice in futuristic areas of law such as those relating to Blockchain and virtual currencies, Internet of Things (IOT), Aviation, Artificial Intelligence, Privatization of Outer Space, Drones, Robotics, Virtual Reality, Ed-Tech, Med-Tech & Medical Devices and Nanotechnology with our key clientele comprising of marquee Fortune 500 corporations.

The firm has been consistently ranked as one of the Most Innovative Law Firms, across the globe. In fact, NDA has been the proud recipient of the Financial Times – RSG award 4 times in a row, (2014-2017) as the Most Innovative Indian Law Firm.

We are a trust based, non-hierarchical, democratic organization that leverages research and knowledge to deliver extraordinary value to our clients. Datum, our unique employer proposition has been developed into a global case study, aptly titled ‘Management by Trust in a Democratic Enterprise,’ published by John Wiley & Sons, USA.

A brief chronicle our firm’s global acclaim for its achievements and prowess through the years –

- **Chambers and Partners Asia Pacific 2019**: Band 1 for Employment, Lifesciences, Tax and TMT
- **IFLR1000 2019**: Tier 1 for Private Equity and Project Development: Telecommunications Networks.
- **AsiaLaw 2019**: Ranked ‘Outstanding’ for Technology, Labour & Employment, Private Equity, Regulatory and Tax
- **Merger Market 2018**: Fastest growing M&A Law Firm
- **IFLR**: Indian Firm of the Year (2010-2013)
- **Asia Mena Counsel’s In-House Community Firms Survey 2018**: Only Indian Firm for Life Science Practice Sector
- **Legal 500 2019**: Tier 1 for Dispute Resolution, TMT (Technology, Media & Entertainment and Telecom,), Tax, Investment Funds, Employment Law and Corporate M&A.

- **IDEX Legal Awards 2015**: Nishith Desai Associates won the “M&A Deal of the year”, “Best Dispute Management lawyer”, “Best Use of Innovation and Technology in a law firm” and “Best Dispute Management Firm”
Please see the last page of this paper for the most recent research papers by our experts.

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Contact

For any help or assistance please email us on ndaconnect@nishithdesai.com or visit us at www.nishithdesai.com
The following research papers and much more are available on our Knowledge Site: [www.nishithdesai.com](http://www.nishithdesai.com)

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Research @ NDA

Research is the DNA of NDA. In early 1980s, our firm emerged from an extensive, and then pioneering, research by Nishith M. Desai on the taxation of cross-border transactions. The research book written by him provided the foundation for our international tax practice. Since then, we have relied upon research to be the cornerstone of our practice development. Today, research is fully ingrained in the firm’s culture.

Our dedication to research has been instrumental in creating thought leadership in various areas of law and public policy. Through research, we develop intellectual capital and leverage it actively for both our clients and the development of our associates. We use research to discover new thinking, approaches, skills and reflections on jurisprudence, and ultimately deliver superior value to our clients. Over time, we have embedded a culture and built processes of learning through research that give us a robust edge in providing best quality advices and services to our clients, to our fraternity and to the community at large.

Every member of the firm is required to participate in research activities. The seeds of research are typically sown in hour-long continuing education sessions conducted every day as the first thing in the morning. Free interactions in these sessions help associates identify new legal, regulatory, technological and business trends that require intellectual investigation from the legal and tax perspectives. Then, one or few associates take up an emerging trend or issue under the guidance of seniors and put it through our “Anticipate-Prepare-Deliver” research model.

As the first step, they would conduct a capsule research, which involves a quick analysis of readily available secondary data. Often such basic research provides valuable insights and creates broader understanding of the issue for the involved associates, who in turn would disseminate it to other associates through tacit and explicit knowledge exchange processes. For us, knowledge sharing is as important an attribute as knowledge acquisition.

When the issue requires further investigation, we develop an extensive research paper. Often we collect our own primary data when we feel the issue demands going deep to the root or when we find gaps in secondary data. In some cases, we have even taken up multi-year research projects to investigate every aspect of the topic and build unparallel mastery. Our TMT practice, IP practice, Pharma & Healthcare/Med-Tech and Medical Device, practice and energy sector practice have emerged from such projects. Research in essence graduates to Knowledge, and finally to Intellectual Property.

Over the years, we have produced some outstanding research papers, articles, webinars and talks. Almost on daily basis, we analyze and offer our perspective on latest legal developments through our regular “Hotlines”, which go out to our clients and fraternity. These Hotlines provide immediate awareness and quick reference, and have been eagerly received. We also provide expanded commentary on issues through detailed articles for publication in newspapers and periodicals for dissemination to wider audience. Our Lab Reports dissect and analyze a published, distinctive legal transaction using multiple lenses and offer various perspectives, including some even overlooked by the executors of the transaction. We regularly write extensive research articles and disseminate them through our website. Our research has also contributed to public policy discourse, helped state and central governments in drafting statutes, and provided regulators with much needed comparative research for rule making. Our discourses on Taxation of eCommerce, Arbitration, and Direct Tax Code have been widely acknowledged.

Although we invest heavily in terms of time and expenses in our research activities, we are happy to provide unlimited access to our research to our clients and the community for greater good.

As we continue to grow through our research-based approach, we now have established an exclusive four-acre, state-of-the-art research center, just a 45 minute ferry ride from Mumbai but in the middle of verdant hills of reclusive Alibaug-Raigadh district. Imaginarium AliGunjan is a platform for creative thinking; an apolitical ecosystem that connects multi-disciplinary threads of ideas, innovation and imagination. Designed to inspire ‘blue sky’ thinking, research, exploration and synthesis, reflections and communication, it aims to bring in wholeness – that leads to answers to the biggest challenges of our time and beyond. It seeks to be a bridge that connects the futuristic advancements of diverse disciplines. It offers a space, both virtually and literally, for integration and synthesis of knowhow and innovation from various streams and serves as a dais to internationally renowned professionals to share their expertise and experience with our associates and select clients.

We would love to hear your suggestions on our research reports. Please feel free to contact us at research@nishithdesai.com