Japan Desk

May 22, 2019

FOREIGN DIRECT INVESTMENT POLICY OF 2015: INDIA

The foreign direct investment ("**FDI**") policy of 2015 has been made effective recently. We have highlighted some of the key changes which will be of interest to Japanese investments / companies doing business in India:

A. CLARIFICATIONS IN RELATION TO INVESTMENTS UNDER THE AUTOMATIC ROUTE

(i) *Mergers & acquisitions ("**M&A**") under the automatic route:* The earlier FDI policy was silent on whether Foreign Investment Promotion Board ("**FIPB**") approval was required in case of acquisition of shares by a non-resident under a scheme of merger/demerger/amalgamation, in the new company. The new FDI policy now clarifies that no FIPB approval will be required if the M&A has taken place in an industry which is covered under the automatic route.

(ii) *Government approval not required under the automatic route for NR to NR transfers*: The new FDI policy clarifies that transfer of shares from one non-resident ("**NR**") to another in sectors which are under the automatic route would not require prior government approval, whereas a transfer from an NR to an NR, in sectors which are under the approval route would require prior government approval.

(iii) *Issue of shares under ESOPs under the automatic route*: It has also been clarified under the new FDI Policy that issue of shares by a company (*engaged in sectors covered under the automatic route*) under an employee stock option scheme ("**ESOP**") to such of its employees or employees of its joint ventures of its wholly owned subsidiary abroad, who are resident outside India, would not require prior government approval.

(iv) *Filing of FC-TRS in case of acquisition of shares by NRs on the stock exchanges*: Until the new FDI policy was released, there was a lack of clarity regarding the party responsible for filing of Form FC-TRS (declaration for transfer of shares from and to NRs) for acquisition of shares by NRs on the floor of stock exchanges. It has now been clarified under the new FDI policy that in case of acquisition of shares by NRs (including non-resident Indians) on the stock exchanges, the investee company (whose shares are being acquired) would be required to file Form FC-TRS.

All of the above from (i) to (iv) seem to be in the nature of a clarification only and do not change any position from the earlier FDI policy.

B. ADDITIONAL FDI INTO THE SAME ENTITY

The new FDI policy clarifies that any additional foreign investment made into an investee entity under the approval route foreign equity percentage/or into a wholly owned subsidiary will not require fresh approval from the government.

Impact: The earlier FDI policy was silent on requirement of taking fresh approval for additional FDI in the same investee company under the approval route. This change should streamline the process of receiving FDI given that only a one-time approval will be required for receiving FDI in the same entity under the approval route.

C. ISSUE OF SHARES AGAINST FUNDS PAYABLE BY THE INVESTEE COMPANY

The new FDI policy clarifies that for issue of equity shares against any funds payable (*other than lump sum technical know-how fee and royalty due for payment*), remittance of which would not require prior RBI and / or Government approval, would be permitted subject to the following conditions:

(i) The shares shall be issued in accordance with the extant FDI guidelines – including sectoral caps, pricing guidelines etc;

(ii) Shares will be issued subject to tax laws as applicable to the funds payable and the conversion to equity should be net of applicable taxes.

Impact: The erstwhile FDI Policy did not provide for issuance of shares against funds payable other than those mentioned above. This change would allow investee companies to conserve immediate liquidity by issuing shares against any funds payable.

D. SECTOR SPECIFIC CHANGES

(i) *Railways:* With a view to liberalise FDI in the railways sector, FDI in certain activities (including suburban corridor projects through public-private partnerships, high speed train projects, mass rapid systems etc.) pertaining to the railways industry was allowed up to 100% under the automatic route subject to the sectoral guidelines to be issued by the Ministry of Railways. Accordingly, under the new FDI policy, the list of 'prohibited sectors' has been revised to replace 'railway transport' with 'railway operations', thus permitting foreign investment in 'railway transport' under the automatic route.

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Impact: FDI in the railways sector was a much necessary measure in order to improve the infrastructure of the cash-strapped sector which is one of the most widely used mode of transportation in India.

For a detailed analysis of FDI in the Railways Sector, please refer to our hotline available here –

http://www.nishithdesai.com/information/research-and-articles/nda-hotline/nda-hotline-single-view/article/test-2.html?no_cache=1&cHash=9c55aeb1965f69d5265f9d79914dbd3d

(ii) *Pension Sector:* The New FDI Policy has affirmed that foreign investment in the pension sector will continue to be governed by the Press Note 4 of 2015 dated April 24, 2015 which permits foreign investment in the pension sector up to 49% as against the limit of 26%. FDI up to 26% will be allowed under the automatic route whereas FDI beyond 26% and up to 49% will be subject to the approval of the Foreign Investment Promotion Board ("**FIPB**").

Impact: The increase in FDI limits in the pension sector will lead to greater capital infusion in the insurance sector which, in turn, is likely to boost innovation and introduction of superior technology in the sector.

(iii) *Defence sector:* The new FDI policy also provides for FDI up to 49% (from the erstwhile 26%) in the defence sector, under the government approval route along with certain conditions that are required to be satisfied. Proposals above 49% will be considered on a case to case basis. For some of the other key changes under the defence sector *please refer to our hotline available at -*

http://www.nishithdesai.com/information/research-and-articles/nda-hotline/nda-hotline-single-view/article/test-2.html?no_cache=1&cHash=9c55aeb1965f69d5265f9d79914dbd3d.

Impact: The erstwhile conditions relating to the defence sector failed to attract sufficient foreign investment. However, it is believed that the conditions for FDI in defence as provided under the new FDI policy will enable India to access modern technology and reduce the level of imports. However, due to the presence of restrictions and the levels of approval that may follow, we are unsure of the impact that it may create to attract foreign investors.

(iv) *FDI in Pharmaceuticals*: The new FDI policy consolidates the changes in FDI in the pharmaceuticals sector, as notified earlier to provide for 100% FDI in 'greenfield' and 'brownfield' projects under the automatic route and approval route respectively, in the pharmaceuticals sector. DIPP had vide Press Note 2 of 2015 dated January 21, 2015 carved out medical devices out of the pharma sector and thereafter permitted FDI in the medical devices segment up to 100% under the automatic route.

Impact: Under the erstwhile FDI policy, medical devices and pharmaceuticals were being treated similarly even though the two industries are considered different from each other. The new FDI policy acknowledges this difference and provides for 100% FDI in medical devices separately from pharmaceuticals. As a result, the conditions applicable to the pharmaceuticals sector would not be applicable to the medical devices industry. For example, while the ban on 'non-compete' clauses in the pharmaceutical industry was justified, it would not yield desirable results if applied to the medical devices industry.

(v) *FDI in Insurance:* In a much awaited move, the government has increased the cap of FDI inflow into the insurance sector from 26% to 49%. Foreign investment would be under the automatic route up to 26% and under the government or approval route for any investment above 26% till 49%. Some of the other key changes under the insurance sector *please refer to our hotline available at -*

http://www.nishithdesai.com/information/research-and-articles/nda-hotline/nda-hotline-single-view/article/49-fdi-in-insurance-a-long-successful-battle.html?no_cache=1&cHash=7aee9d49dff4e4a14a7215b6ff739c2c

However, there has been a recent proposal by the Insurance Regulatory and Development Authority ("**IRDA**") which states that all insurance companies seeking higher foreign ownership should comply with norms that restrict such increase to only companies owned and controlled by Indians at the parent level.

Impact: This FDI change will not only boost foreign investment in the otherwise restricted insurance sector, but will also encourage global insurance companies to set up their operations in India. However, if the proposal of the IRDA is made law, this would become challenging for large multinational companies to make / increase their existing investments in Indian insurance companies.

You can direct your queries or comments to

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