

Matters Arising from new FDI Rules for Foreign Investments

(DPIIT Press Note 3, 17/4/2020)

With respect to **GOI Objectives** in issuing regulations requiring “prior approval” for investments from certain neighbouring countries (“*Restricted Investors*”), following clarifications were helpfully already provided by the minister, which are being presented for completeness:

1. Downstream investments (using accrued cash) will require prior approvals
2. Down sell of any existing shareholding will require prior approvals
3. Beneficial interest clarification is pending and under consideration
4. Impact on existing companies have not yet been discussed, and can be clarified

In light of above, following observations and questions are submitted for consideration, which are intended to seek clarity to both type of investors – those who are directly impacted and those who are indirectly impacted due to a *Restricted Investor’s* presence in the existing businesses.

1. Beneficial Interest:

- a. **Issue:** In current form, even if a *Restricted Shareholder* directly/indirectly holds 1 share in a business, it will trigger GOI approval.
- b. **Request:** A reasonable threshold of ownership by a *Restricted Shareholder* will be helpful in ensuring minimal disruption, while ensuring **GOI Objectives** are met (*Applicable Threshold*). We note in recent amendment to General Financial Rules, 2017, the beneficial owner has been defined to mean more than twenty-five (25%) of ownership (15% in case of partnerships) or ability to exercise control. Will be helpful to clarify the applicable threshold for purpose of Press Note 3 as well.

2. Impact on Existing Investments (partial/full *Restricted Investors’* ownership)

- a. **Issue:** Given FDI investment guidelines are applicable to FOCCs (Foreign Owned & Controlled Companies), these rules will apply to all existing companies which have any ownership from *Restricted Investor(s)*. Accordingly, any of the corporate actions these companies take such as A) making downstream investments through internal accruals or rights issue, B) acquiring new businesses C) selling existing businesses etc. will all require GOI approval, each time such a corporate action is taken.
- b. **Impact:** Existing investors (Restricted or not), will be unable to use cash accrued for reinvestments and growth; the accruals will need to be mandatorily distributed, disturbing the original business objectives. *Restricted Investors* will also not be able to exercise their existing right to reinvest under a rights issue (which is only to preserve existing shareholding, not increasing). Under such situations, clearly any existing business partnership will suffer in multiple ways, particularly the one which has some *Restricted Shareholders* and some *non-Restricted Shareholders*. Certain investors who are non-Restricted (e.g. from Canada or US or Europe etc..) will get impacted due to non-performance of this existing business leading to unnecessary concerns. This could also impact their future investments in India due to “policy risk”.
- c. **Request for Clarification:** It would be helpful to clarify whether A) existing businesses with *Restricted Shareholders* (with any % ownership) could be grandfathered and carved out? If not,

then B) at least can a reasonable timeframe be prescribed by which a *Restricted Shareholder* shall bring down its shareholding below the *Applicable Threshold*, so that the business can function normally without requiring approvals for every corporate action described above.

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