Update

VINOD KOTHARI & COMPANY

THE NEW FDI POLICY – MIX OF RELIEF AND BURDEN OF ADDITIONAL COMPLIANCES AND LIMITATIONS

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Update

The Department of Industrial Policy and Promotion today issued the revised Consolidated Policy for Foreign Direct Investments into India. After the Budget 2012-13 disappointments, the foreign investors are expected to be relieved by some of the steps taken by the government to relax the FDI norms.

Following is the author's observation on the some of the key changes made in the New FDI Policy.

1. Clarification on 'leasing' activity of NBFCs

The Government has clarified that one of the 18 permitted activities of an NBFC, viz. leasing and finance, in which foreign investment under FDI route is permitted under automatic route, pertains only to financial leases and not operating leases. This makes it clear that an NBFC classification will only be required if a company is undertaking financial leasing and not when it is undertaking operating leasing.

2. Pharmaceutical sector

A new sector limitation has been added under the New FDI Policy for the pharmaceutical sector. Earlier, 100% FDI was permitted under the automatic route with no classification or differentiation based on green-field or brown-field investment. Now, though the government has retained that 100% FDI in pharmaceutical sector is permissible, it has restricted investment under the automatic route only to the green-field investments. Brown-field investment in the pharmaceutical sector is differentiated and is made permissible only pursuant to the FIPB approval (i.e. the government route).

The amendment seems to have risen from the concern of the government that the foreign entities, instead of investment in green-field ventures were choosing to take-over existing pharmaceutical companies in India. As was also reported by The Hindu in September 2011, between 2006 and 2010, 6 major Indian companies, including Matrix Lab by Mylan, Dabur Pharma by Fresenius Kabi, Ranbaxy Labs (which was India's largest pharmaceutical company) by Daiichi Sankyo, Shanta Biotech (Sanofi Aventis), Orchid Chemicals (Hospira) and Piramal Healthcare (Abbott), have been taken over by MNCs and only 10% of FDI has gone to green-field ventures. This had ignited concern on India's health care scenario, one of the most important being pricing of the drugs. In view of the same, this seems to be a positive change as the approval route gives an opportunity to the government to review the investment on a case by case basis and impose restrictions and conditions as may be appropriate.

3. Foreign Venture Capital Investors ("FVCIs") permitted to do secondary purchases

Recently, the FVCIs were permitted to undertake secondary purchases, with earlier was not permissible and FVCIs could only make primary purchases in accordance with the SEBI (FVCI) Regulations, 2000. The same has now been incorporated in the New FDI Policy. This is a welcome change as there have been concerns with the FVCIs for not being able to make secondary purchases.

However, since SEBI's Regulations on the Alternative Investment Funds (AIF) has not been released as of now, the New FDI Policy states that FVCI can investment 100% of its corpus in Indian Venture Capital Undertaking (IVCU) and Venture Capital Funds (VCF). However, the same is likely to change once the SEBI (VCF) Regulations, 1996 are repealed with the notification of the AIF Regulations.

4. Provision on Qualified Financial Investor ("QFI") inserted

A new type of a foreign investor – not being a SEBI registered FII and FVCI – has been inserted in the New FDI Policy called a QFI who would meet SEBI requirements for making investment into India. Such QFIs are permitted to make primary as well as secondary investments of listed companies (i.e. invest in equity shares of listed Indian companies as well as in equity shares of Indian companies which are offered to public in India). QFls have also been permitted to acquire equity shares by way of right shares, bonus shares or equity shares, on account of stock split/consolidation or equity shares on account of amalgamation, demerger or such corporate actions. The individual and aggregate investment limit for QFIs is 5% and 10%, respectively, of the paid up capital of a company.

This opens additional doors for foreign investors for making investments into India. Currently, investment could be made under the FDI route, as a SEBI registered FII (or an FII sub-account) or as a SEBI registered FVCI. One positive point from a foreign investor perspective is that no separate registration is required for investment as a QFI. It would be wait and watch to see if SEBI would like to issue guidelines for operation of QFIs.

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5. Relaxation in approvals for investment in Commodity Exchanges

Whilst the sectoral limit for FDI in commodity exchanges remains unchanged, the Government has removed the requirement to obtain FIPB approval for investments by FIIs and has only retained the requirement to obtain FIPB approval for the FDI component of the investment. As stated by the government, this change aligns the policy for FDI in commodity exchanges, with that of other infrastructure companies in the securities markets, such as stock exchanges, depositories and clearing corporations.

6. Single brand retailing

Earlier, investment under the government route in single brand retailing was permissible to the extent of 51% percent only. Though the government has continued to monitor the investment in the single brand retail sector by keeping it under the government route, it has enhanced the sector limit to 100%.

This surely is a step forward taken by the government to further incentivise the foreign investment in the retail sector by continuing to act as a watch-dog at the same time.

7. Investment by Foreign Institutional Investors (FIIs)

At present, FII may invest in the capital of an Indian Company under the Portfolio Investment Scheme which limits the individual holding of an FII to 10% of the capital of the company and the aggregate limit for FII investment to 24% of the capital of the company. This aggregate limit of 24% can be increased to the sectoral cap / statutory ceiling, as applicable, by the Indian Company concerned, through a resolution by its board of directors, followed by a special resolution to that effect.

With a view to make this increase in the sectoral limit stricter, prior intimation to RBI is now required if the investment is made exceeding the aggregate limit of 25% but within the specified sectoral caps. It is to be noted that only intimation is required, approval has not been mandated. This does not additionally burden the FII with approval requirements but at the same time keeps the government informed of the FII investments.

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8. Import of capital goods/ machinery/ equipment (including second-hand machinery)-conversion to equity

Presently, conversion to equity is permitted for import of capital goods/ machinery/ equipment including second-hand machinery. With a view to incentivizing machinery embodying state-of-the-art technology, compliant with international standards, in terms of being green, clean and energy efficient, second-hand machinery has now been excluded from the purview of this provision.

Overall, the changes brought in by the government are to balance the interest of the foreign investors to bring them in line with the economic goals of the government.

The detailed FDI Policy can be read at:
http://dipp.nic.in/English/Policies/FDI_Circular_01_2012.pdf