Comments and Recommendations by 'Nishith Desai Associates' on the Consolidated FDI Policy

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1.	The approval letter that RBI has been issuing, provides a clause that reads as follows: *infrastructure sector and/or in IVCU's engaged in the following nine sectors namely biotechnology, IT related to hardware and software development, nanotechnology, seed research and development, research and development of new chemical entities in pharma sector, dairy industry, poultry industry, production of bio fuels and in hotel-cum-convention centers with seating capacity of more than three thousand*	RBI has prescribed that investments by FVCI entities be restricted to very select sectors.	FVCI investments should not be subject to sectoral restrictions. Concerned paragraph 3 of the RBI approval letter spelling such restriction should be done away with (with retrospective effect to allow existing FVCIs with such restrictions the same relief)
2.	Under **Clause 5.31.4** of the Consolidated FDI Policy: a) an FVCI can invest in a VCF that is set up as a trust registered under the Indian Trust Act, 1882 upon obtaining a prior government approval; and b) investment in a trust which is not registered with SEBI as a VCF, is henceforth not permitted.	FVCI can invest in a VCF that is set up as a trust registered under the Indian Trust Act, 1882, only upon obtaining a prior government approval. Further, it provides that FIPB does not have the authority anymore to approve investments in unregistered trusts	Investments in a VCF set up as trusts should not be mandated under the government route as both the FVCI and the investee VCF are regulated by SEBI. Further, instead of blanket restriction, investments in unregistered trust should be allowed under the government route.
3.	**Clause 3.2.1** of the Consolidated FDI Policy requires that the pricing of the capital instruments that the Indian companies can issue under the FEMA regulations, should be "… *decided/determined upfront at the time of issue of such*	Clause 3.2.1 essentially states that the ratio of conversion of the convertible instruments such as CCDs / CCPS should be decided at the time of issuance itself.	1) As long as the issuer company's equity base value is met upfront, the subsequent conversion should be allowed to be a function of performance and actual balance sheet of the issuer company. The Consolidated FDI Policy should be

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	instruments".		amended to such effect. 2) Consider removal of determination of pricing / conversion ratio of convertible instruments at the time of issuance of such instruments. Anti-Dilution: In the PE/VC industry, at the time of making investments, the investors invest partly by way of subscription to direct equity and partly by subscribing to convertible instruments. The purpose of subscribing to convertible instruments is to protect the value of the investment in the portfolio company which is more commonly known as 'anti-dilution price protection'. In a situation where the portfolio company is issuing shares to a third party investor at a price lower than the price at which the first investor had invested earlier, the investor should have a right to match its per share price to such lower price. This does not result into any cash outflow from the portfolio company. 3) Consider an upward revision of the conversion ratio of convertible instruments. Upward revision: In a situation where the investor proposes to have the terms of conversion of instruments based on the performance parameters of the portfolio company, and if the conversion ratio at the time of such conversion is lower than that agreed upon, it would result into the investor reducing its stake in the portfolio company.

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			4) Consider specific removal of FVCIs from the purview of fixing the ratio of convertibles at the time of issuance of such investment. Schedule VI of the Foreign Exchange Management (Transfer Or Issue of Securities By a Person Resident Outside India) Regulations, 2000 issued by the Reserve Bank of India allows the SEBI registered FVCIs to purchase or sell shares / convertible debentures / units or any other investment held by it at a price that is mutually acceptable to the buyer and the seller / issuer. Thus, the pricing guidelines are not applicable to a FVCI making investment under the FVCI route. In light of this, the FVCIs should be permitted to convert their convertibles at any ratio, mutually decided by and between the parties.
4.	**Clause 2.1.5** of the Consolidated FDI Policy provides that warrants (along with partly paid shares, is not to be considered as part of capital (for the investee Indian company). The definition of the term "Capital" contains a short note which reads as follows: "*Any other type of instruments like warrants, partly paid shares etc are not considered as capital and cannot be issued to persons resident outside India.*" Accordingly, warrants and partly paid shares may not be issued under the FDI route (i.e. under	The Consolidated FDI Policy seems to place a bar against the issuance of warrants and partly paid up shares. This implies that the FIPB now would not have the authority to consider or approve issuance of warrants, partly paid up shares or any other security that is not explicitly permitted under the Consolidated FDI policy.	The definition of the term 'capital' should be revised to allow for issuance of warrants to persons resident outside India.

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	Schedule 1 to FEMA Regulations).		
5.	**Chapter 4** of the Consolidated FDI Policy	Whether a company would be construed as owned and/or controlled by Indian residents and/or non-residents, in case such a company is a joint venture wherein 50% equity is held by Indian residents and remaining 50% is held by non-residents?	Such a situation of vanilla joint ventures, which is prevalent in India, is not envisaged in the Consolidated FDI Policy; and accordingly, a clarification to this effect should be provided.
6.	**Chapter 4** of the Consolidated FDI Policy	Would a company be construed as owned and controlled by non-residents if, in addition to the equal equity interest in the company with the Indian residents, the non-residents also additionally hold debt instruments or CCPS? Whether the debt instruments and CCPS are to be computed on an as-converted basis? Or, whether such conversion needs to be taken into consideration at the actual time of conversion of the debt instruments or CCPS, as the case may be?	A clarification to this effect needs to be addressed under the Consolidated FDI Policy.
7.	**Clause 5.2.13.2(3)** under Development of Townships, Housing, Built-up infrastructure and Construction-development projects. "*Original investment cannot be repatriated before a period of three years from completion of minimum capitalization. Original investment means the entire amount brought*	Whether the lock-in provision would apply to a subsequent holder of the securities of the Indian company wherein the original holder has already complied with the three years of lock-in as provided under sub-clause 5.2.13.2 (3) of the Consolidated FDI Policy?	We are of the view that, upon successful compliance of the aforesaid period of three years by the original investor ("**Seller**"), if the Seller does a secondary sale of the securities of the underlying Indian company to any other offshore entity ("**Purchaser**"), such lock-in restrictions should not apply afresh on the Purchaser. Such lock-in restrictions should not

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	in as FDI. The lock-in period of three years will be applied from the date of receipt of each installment/tranche of FDI or from the date of completion of minimum capitalization, whichever is later. However, the investor may be permitted to exit earlier with prior approval of the Government through the FIPB."		apply to the Purchaser as the same have already been complied by the Seller, and further, such transfer of securities of the Indian company would also be compliant with the above regulation as, despite being a transfer from one non-resident (Seller) to another non-resident (Purchaser), there will not be any repatriation (outside India) of the investment that was made into the Indian company by the original investor.
8.	**Clause 5.2.7.2.2(2)** of the Consolidated FDI Policy states the cap for the following: Non-Scheduled Air Transport Service/ Non-Scheduled airlines, Chartered airlines, and Cargo airlines.	The FDI cap and routes for investment in Non-Scheduled Operators in the Air Transport Sector as provided in the following documents stands at 74% under the automatic route: • Schedule I to the Foreign Exchange Management (Transfer or Issue of a Security by a Person Resident outside India) Regulations, 2000; • Press Note 4 of 2008 issued by the DIPP (containing the FDI policy for the aviation sector); • Press Note 7 of 2008 issued by the DIPP (the Consolidated FDI Policy); • RBI's master circular on foreign investments issued on July 1, 2010; and • Civil Aviation Ministry's circular AIC 7/2008 dated June 30, 2008. Whereas the Consolidated	There is an apparent discrepancy between the cap/route and existing and law notified by the RBI / DIPP. This discrepancy must be reconciled.

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		FDI Policy allows FDI up to 49% under the automatic route and between 49% and 74% under the government route.	
9.	**Clause 3.1.4** of the Consolidated FDI Policy states as follows: "*3.1.4(i) An FII may invest in the capital of an Indian company either under the FDI Scheme/Policy or the Portfolio Investment Scheme. 10% individual limit and 24% aggregate limit for FII investment would still be applicable even when FIIs invest under the FDI scheme/policy.* *(ii) The Indian company which has issued shares to FIIs under the FDI Policy for which the payment has been received directly into company's account should report these figures separately under item no. 5 of Form FC-GPR (**Annex-1**) (Post issue pattern of shareholding) so that the details could be suitably reconciled for statistical/monitoring purposes.* *(iii) A daily statement in respect of all transactions (except derivative trade) have to be submitted by the custodian bank in floppy / soft copy in the prescribed format directly to RBI to monitor the overall ceiling/sectoral cap/statutory ceiling.*"	Investments made by foreign investors, also registered with SEBI as FIIs, under the FDI route in accordance with Schedule I of Foreign Exchange Management (Transfer or issue of Security by a Person Resident outside India) Regulations, 2000 ("**TISPRO Regulations**") should not be reckoned towards the investments limits available to such foreign investors under the FII route in accordance with Schedule II of TISPRO Regulations.	In view of the different investment objectives that Schedule I and Schedule II of TISPRO Regulations seek to address, investments made by the foreign investors, who are also registered with SEBI as FIIs, under the FDI route in accordance with Schedule I of TIPRO Regulations should not be reckoned with portfolio investments made under the Schedule II of TISPRO Regulations. The Reserve Bank of India has always permitted entities registered with SEBI as FIIs to invest under the FDI route, provided such investments are made in accordance with Schedule I of TISPRO Regulations. The 10% investment limit applicable for FIIs is solely in respect of investments made under the Portfolio Investment Scheme, which is governed as per Schedule II of TISPRO Regulations and the SEBI (Foreign Institutional Investors) Regulations, 1995. Therefore, we believe that aggregating the investment limits provided under the Schedule I and Schedule II of TISPRO Regulations would be against the objective of each of the said schedules.