INFOLEX
NEWSALERT

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KEY HIGHLIGHTS OF THE CONSOLIDATED POLICY ON FOREIGN DIRECT INVESTMENT, 2017

1. INTRODUCTION

By way of Press Note No. 1 of 2017, the Department of Industrial Policy and Promotion (the "**DIPP**"), on August 28, 2017, released the consolidated foreign direct investment policy circular for 2017 (the "**2017 FDI Policy**")[1], effective from August 28, 2017.

With the 2017 FDI Policy, the DIPP has integrated all the changes introduced by it with respect to foreign direct investment ("**FDI**") in India, between June 2016 and August 2017, and has introduced certain other changes, which are highlighted below.

For our analysis of the previous FDI policy of 2016 (the "**Previous FDI Policy**") and of the earlier Press Note No. 9 of 2015, Press Note No. 12 of 2015 and Press Note No. 3 of 2016, please refer to our earlier Infolex News Alerts[2].

2. CHANGES INTRODUCED IN THE 2017 FDI POLICY

The 2017 FDI Policy, apart from consolidating the changes brought about by the earlier press notes released by the DIPP, and the notifications released by the Reserve Bank of India (the "**RBI**") regarding FDI in India, has introduced the following changes and clarifications,

2.1. The winding up of the Foreign Investment Promotion Board

Further to the abolition of the Foreign Investment Promotion Board (the "**FIPB**") by the Union Cabinet on May 24, 2017, the DIPP has made all necessary changes to the 2017 FDI Policy, by deleting provisions pertaining to the FIPB, replacing the FIPB with the concerned administrative departments notified in the Standard Operating Procedure released by the DIPP on June 29, 2017 (the "**SOP**"), introducing the Foreign Investment Facilitation Portal (the "**FIFP**"), and aligning it with the SOP (*please refer to paragraph 3.1 below*).

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[1] Press Note No. 1 of 2017 (*Consolidated FDI Policy*) is available at http://dipp.nic.in/sites/default/files/CFPC_2017_FINAL_RELEASED_28.8.17.pdf.

[2] The Infolex News Alert on the Previous FDI Policy (*Key Highlights in the Consolidated Policy on Foreign Investments in India*) is available at https://induslaw.com/publications/pdf/alerts-2016/key-highlights.pdf?src=website&Date=07-July-2016.

The Infolex News Alert on Press Note No. 9 of 2015 (*Review of the Existing Foreign Direct Investment Policy on Warrants and Partly Paid Shares*) is available at https://induslaw.com/publications/pdf/alerts-2015/september-23-15.pdf?src=Website&Month=23Sept2015.

The Infolex News Alert on Press Note No. 12 of 2015 (*Recent Reforms in India's Foreign Direct Investment Policy*) is available at https://induslaw.com/publications/pdf/alerts-2015/november-2015-final.pdf?src=30Nov2015.

The Infolex News Alert on Press Note No. 3 of 2016 (*Guidelines for Foreign Direct Investment in E-Commerce*) is available at https://induslaw.com/publications/pdf/alerts-2016/april-2016.pdf?src=Webiste&CTA=ReadMore.

The significant changes pursuant to this are as follows:

(a) In the provision governing downstream investments by eligible Indian entities not owned or controlled by any resident entity, the authority to be notified of such a downstream investment has been changed from the Secretariat of Industrial Assistance, DIPP and FIPB, to the RBI and the FIFP, in the form available in the web-link www.fifp.gov.in, replacing the earlier procedure set out in the web-link http://www.fipbindia.com under the Previous FDI Policy;

(b) With respect to both single-brand and multi-brand retail trading, the requirement for applications to determine whether the proposed investment satisfies the notified guidelines, to be processed by the DIPP before being considered by the FIPB, has been removed. Once the application is filed with the FIFP, the DIPP has to send it to the concerned administrative ministries and departments, as notified under the SOP. If necessary, the concerned administrative ministries and departments may seek clarifications from the DIPP. Therefore, the DIPP's role in this regard has been limited from *processing* applications to *facilitating* applications;

(c) The concerned administrative ministries or departments, as notified under the SOP, will monitor the compliance of conditions under the FDI approvals, including past cases approved by the Government. Such concerned administrative ministries or departments are referred to as the 'Competent Authority' under the SOP and the FDI Policy.

2.2. Committee to examine applications with respect to local sourcing norms

With respect to sourcing norms applicable to single-brand retail trading, the 2017 FDI Policy clarifies that now, a Committee under the Chairmanship of the Secretary of the DIPP, with representatives from NITI Aayog, the concerned administrative ministry and independent technical experts on the subject, will examine the claim of applicants.

The Committee will specifically examine whether the products are in the nature of '*state-of-art*' and '*cutting-edge*' technology where local sourcing is not possible, and thereafter give recommendations for relaxation of the local sourcing requirement.

2.3. Conversion of and conversion to a limited liability partnership

The 2017 FDI Policy clarifies that the conversion of a limited liability partnership (an "**LLP**") into a company, where the LLP has foreign investment and operates in sectors where 100% (one hundred per cent) FDI is allowed with no FDI-linked performance conditions, is allowed under the automatic route. The same applies to the conversion of a company operating in such sectors into an LLP. The Previous FDI Policy was silent on this and it was not clear, on what conditions an LLP, having foreign investment can be converted into a company and *vice versa*.

2.4. Government approval for additional FDI beyond INR 5,000 crores

The 2017 FDI Policy has also added, that *prior approval* of the Government for bringing in additional foreign investment into the same entity, within an approved foreign equity percentage, or into a wholly owned subsidiary ("**WOS**") will not be required, only if the foreign investment is up to a cumulative amount of INR 5,000 crores (approximately USD 781.75 million). Thus, in case an entity seeks cumulative foreign investment beyond INR 5,000 crores, Government approval will be required.

2.5. FDI in e-commerce

With regard to FDI in e-commerce activities, the 2017 FDI Policy clarifies that an e-commerce entity shall not permit more than 25% (twenty five per cent) of the sales value, *on a financial year basis,* affected through its marketplace from one vendor or its group companies. The Previous FDI Policy did not specify the time period for computation of the 25% (twenty five per cent) of sales through one vendor (or its group company) requirement.

2.6. Retail trading for certain traders

The 2017 FDI Policy has amended the provision regarding retail trading to state that, instead of only "*single brand retail trading*", as was the case under the Previous FDI Policy, a wholesale or cash and carry trader can now undertake "*retail trading*", subject to applicable conditions. It has therefore been clarified that *wholesale* or *cash and carry* traders are permitted to undertake single and multi-brand retail trading, under the conditions applicable to both kinds of retail trading and subject to relevant approvals that may be applicable.

2.7. Cargo airlines

'*Cargo airlines*' have been excluded from the definition of '*non-scheduled air transport service*', under the 2017 FDI Policy.

3. CHANGES CONSOLIDATED IN THE 2017 FDI POLICY

In the wake of the current government's efforts to make India a more attractive destination for foreign investment, over the past year, the DIPP had released press notes and press releases to clarify its position on various aspects of FDI. The 2017 FDI Policy integrates all these changes introduced by the DIPP. Below is a summary of the major changes introduced in the past year and consolidated in the 2017 FDI Policy:

3.1. SOP for processing FDI proposals

The DIPP, on June 29, 2017, introduced the SOP[3] which set out the process for filing and processing FDI proposals, the time limits, and the internal mechanisms for monitoring FDI proposals in sectors requiring government approval (the "**Approval Route**"). By way of this SOP, the scrutiny of all such proposals will now be handled by the department or ministry governing the sector that the FDI relates to. The 2017 FDI Policy has amended the Previous FDI Policy to incorporate this change, as well.[4]

3.2. The issue of 'convertible notes' to foreign investors by start-up companies

On January 10, 2017, the Reserve Bank of India (the "**RBI**") amended the Foreign Exchange Management (Transfer or issue of Security by a Person Resident outside India) Regulations, 2000 (the "**TISPROI Regulations**") to provide an impetus to start-ups in India.[5] This amendment to the TISPROI Regulations has introduced the following major changes, all of which have been incorporated and consolidated in the 2017 FDI Policy:

(a) A '*convertible note*' has been defined as an instrument issued by a start-up, evidencing receipt of money initially as debt, which is either repayable at the option of the holder, or convertible into equity shares within a period of 5 (five)

[3] The SOP introduced by the DIPP is available at http://dipp.nic.in/sites/default/files/Standard%20Operation%20Procedure%20%28SOP%29%20for%20Processing%20FDI%20Proposals.pdf.

[4] For more information on this SOP, please refer to our Infolex News Alert '*The New Regime for Processing FDI Proposals*', available at https://induslaw.com/publications/pdf/alerts-2017/infolex-newsalert-the-new-regime-for-processing-fdi-proposals.pdf?src=Website&CTA=ReadMore&Date=05-Jul-2017.

[5] For more information on this SOP, please refer to our Infolex News Alert '*Boost to Funding Startups: The Issue of Convertible Notes to Foreign Investors*', available at https://induslaw.com/publications/pdf/alerts-2017/Infolex-Newsalert-boost-to-funding-startups-january.pdf?src=Website&CTA=ReadMore&date=31-Jan-2017.

years from the date of its issue;

(b) Foreign investors are required to invest at least INR 25,00,000 (approximately USD 39,000) or more, in a single tranche, to subscribe to these *convertible notes*;

(c) In addition to the usual permitted modes of remittance, escrow arrangements are now permitted for making remittance of consideration for subscription to *convertible notes*, subject to certain conditions; and

(d) Foreign investors are also permitted to acquire or transfer *convertible notes* by way of a sale, in accordance with the RBI's pricing guidelines.

Clarifying the position of the government on the issue of instruments to foreign investors by start-ups, the RBI, by way of a circular dated October 20, 2016[6], stated that start-ups could issue equity or equity-linked instruments or debt instruments to Foreign Venture Capital Investors (as defined under the SEBI (FVCI) Regulations, 2000).

It is noteworthy however, that the above stipulations apply only to 'startups' as defined under the DIPP notification dated May 23, 2017.[7]

3.3. The liberalisation of FDI allowance in certain sectors

The 2017 FDI Policy consolidates the press releases in the past year that have liberalized the amount of FDI permitted in sectors like defense, civil aviation, construction and development, private security agencies and news broadcasting, amongst others.

IndusLaw View:

To a great extent, the 2017 FDI Policy has simply consolidated the earlier press releases, press notes, notifications and circulars released by the DIPP and the RBI between June 2016 and August 2017.

The new changes introduced by the 2017 FDI Policy, include certain welcome clarifications and measures, including the setting up of a committee of experts for determining applications for local sourcing norms for single-brand retail trading, and the basis for the computation of sales by an e-commerce entity through one vendor and its group companies.

However, ambiguities remain with certain terms used but not defined in the 2017 FDI Policy, such as '*state-of-the-art*' and '*cutting-edge*' technology with respect to local sourcing norms applicable to single-brand retail trading, and the term '*other financial services*', a sector in which 100% (one hundred per cent) FDI is permitted through the automatic route.

This lack of clarity over the meaning of the term '*other financial services*' (which has been defined very broadly at present)[8] and *which* activities may be treated as being regulated by a financial sector regulator, has proved an obstacle for newly-emerging players in the financial technology sector who wish to receive foreign investment.

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[6] The RBI circular A.P. (DIR Series) Circular No. 7 (*Investment by a Foreign Venture Capital Investor (FVCI) registered under SEBI (FVCI) Regulations, 2000*) is available at https://www.rbi.org.in/scripts/NotificationUser.aspx?Id=10649&Mode=0.

[7] 'Startup' has been defined under the DIPP notification G.S.R. 501 (E) dated May 23, 2017, as an entity: (a) incorporated as a private limited company, registered as a partnership firm or a limited liability partnership in India; (b) up to 7 years from the date of its incorporation/ registration (however, in the case of startups in the biotechnology sector, the period shall be up to 10 years from the date of its incorporation/ registration); (c) whose turnover for any of the financial years since incorporation/ registration has not exceeded INR 25 crores; and (d) which is working towards innovation, development or improvement of products or processes or services, or if it is a scalable business model with a high potential of employment generation or wealth creation. Any such entity formed by splitting up or reconstruction of a business already in existence shall not be considered a 'Startup'.

[8] 'Other financial services' are defined as "*financial services activities regulated by financial sector regulators, viz., RBI, SEBI (Securities and Exchange Board of India), IRDA (Insurance Regulatory and Development Authority), PFRDA (Pension Fund Regulatory and Development Authority), NHB (National Housing Board) or any other financial sector regulator as may be notified by the Government of India.*"

The requirement to obtain fresh Government approval in case of foreign investment *within* an approved foreign equity percentage, or into a WOS, has been restricted. Thus, only such entities seeking foreign investments up to a cumulative limit of INR 5,000 crores (approximately USD 781.75 million), can benefit from the relaxation of obtaining Government approval. Entities which breach this limit of cumulative foreign investment, will have approach the Government for approval.

Since, in the Government's view, liberalization of FDI is a continuous process, further relaxations and clarity may be expected by way of further press notes and releases from DIPP this year.

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