Master Direction RBI– Foreign Investment in India

(Updated as on January 20, 2025)

The Reserve Bank of India ("**RBI**") on 20 January 2025[1] made amendments to the master direction issued on 4th January 2018, by providing clarity as well as great flexibility to the FOCC's looking to acquire stakes in India by allowing them to buy and swap shares with the local businesses, which in turn will streamline the downstream investment process in India.

Downstream Investment is a sort of Indirect Foreign Investment where a company that has already received Foreign Direct Investment (FDI) further invests in another Indian entity. The framework and regulation guidelines with respect to this investment structure is provided under the FEMA (Non-Debt Instruments) Rules, 2019 ("**NDI Rules**").

According to NDI Rules[2], Indirect Foreign Investments are defined as downstream investments received by an Indian entity from:

1. Another Indian entity that has received Foreign Investment and such intermediary Indian Company is either not owned and controlled by resident Indian citizens or is owned or controlled by persons resident outside India.
2. Through investment vehicles such as mutual funds, venture capital funds, or alternative investment funds, whose sponsor is either not owned and controlled by resident Indian citizens or is owned or controlled by persons resident outside India[3].

What are Foreign Owned and Controlled Company ("FOCC")?

A company is considered foreign owned and controlled when either of two key conditions are met:

1. If foreign entities own more than half (exceeding 50%) of the company's shares or equity, or
2. if foreign entities exercise effective control over the company's operations through special management rights granted to foreign investors, or through significant representation on the company's board of directors.

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[1] RBI Notification dated 4 January 2018, **Master Direction – Foreign Investment in India (FEMA/ NDI Rules/FEMA 395)** *(Last amended 20 January 2025)* https://www.rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=11200 (*Last accessed on 29 January 2025)*

[2] Available at: https://incometaxindia.gov.in/Documents/Provisions%20for%20NR/FEM-Non-debt-Instruments-Rules-2019.htm

[3] Explanation (i) to Rule 23 of Foreign Exchange Management (Non-Debt Instruments) Rules, 2019.

Hence, the Indian entities that have received foreign investment and is either not owned and controlled by resident Indian citizens or is owned or controlled by persons resident outside India ("**PROI**") is classified as a FOCC[4].

On the other hand, when an Indian Company that has received foreign investment but has not qualified as being 'owned' or being 'controlled' by a PROI but makes an invest in another Indian entity, then this investment is classified as domestic investment.

Issued faced:

Earlier, there were significant hurdles that were faced by the FOCC's, in the indirect foreign investment scenario, in acquiring stakes in the Indian entities due to reliance on pure cash transactions involving fresh capital or retained earnings or specific regulatory approvals that were required with regard to such deals.

Some of the highlights of the RBI's Amended policy are:

1. **Approved Stock Swapping:**
   The RBI, through its guidelines, have now allowed the FOCC's to buy shares and swap stocks with local businesses providing greater flexibility in acquiring Indian stakes further simplifying cross-border acquisitions. The ability to use share swaps as consideration represents a significant shift from traditional cash-only transactions, potentially making acquisitions more feasible for companies that prefer non-cash arrangements making stock-swapping a viable alternative to cash transactions.

2. **Relived Foreign Exchange Regulations:**
   A significant modification has been introduced by the RBI which specifically addresses the handling of compulsorily convertible debentures (CCDs) and compulsorily convertible preference shares (CCPS) by Indian companies. Indian companies now have the flexibility to modify the conversion timeline of these instruments. This change is particularly relevant in scenarios where market conditions might make conversion unfavourable. While such tenor modifications have been permitted under the Companies Act already, the RBI's endorsement provides comprehensive regulatory coverage.

3. **Payment Structure:**
   Previously, when making a downstream investment, companies had to pay the entire amount upfront - meaning 100% of the investment value had to be paid

[4] Anoop Omkar and Abhishek Thakur, Understanding Downstream Investment In India, 27 September 2024, available at https://www.mondaq.com/india/inward-foreign-investment/1522840/understanding-downstream-investment-in-india

immediately. This could create substantial financial pressure on investing companies. The updated rules have introduced more flexibility by allowing a split payment structure that mirrors the traditional FDI payment model. Under the new 75:25 payment framework, companies only need to make an initial payment of 75% of the total investment value. The remaining 25% can be paid later, with companies having up to 18 months to complete this deferred payment offering valuable financial flexibility that can help optimize capital deployment strategies.

4. **Land Bordering Countries**

The Central Bank has also firmly clarified that Indian companies owned by investors from 'land-bordering countries' cannot freely acquire companies in India even from their retained earnings in India without the Government approval route.

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