

UPDATE

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UNLOCKING NEW HORIZONS: AN UPDATE ON THE KEY CHANGES TO THE FEMA NON-DEBT INSTRUMENTS RULES, 2019.

A. *Introduction*

In order to facilitate and provide further clarity on the existing foreign direct investment (“FDI”) regime, the Hon’ble Finance Minister, Smt. Nirmala Sitharaman, announced the Indian Government’s intention to facilitate global expansion of Indian companies and create an investor friendly regime in her annual budget speech on 23 July 2024 this year. Following such announcement, the Department of Economic Affairs, Ministry of Finance, has notified the Foreign Exchange Management (Non-Debt Instruments) (Fourth Amendment) Rules, 2024, (“**Amendment Rules 2024**”) on 16 August 2024 which amends the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 (“**NDI Rules 2019**”).

B. *Key Amendments which are Proposed to be Brought by the Amendment Rules 2024*

i. Liberalized share swap mechanism to enhance global integration

The Amendment Rules 2024 introduce a new provision relating to transfer of equity instruments of an Indian company by a swapping mechanism between a person resident in India (**PRI**) and a person resident outside India (**PROI**). Such cross border transfer of equity instruments of an Indian company can occur either by way of a (i) swap of equity instruments, or (ii) swap of equity capital of a foreign company, in compliance with existing rules and regulations. In this context, the definition of equity capital has been clarified to align with the Foreign Exchange Management (Overseas Investment) Rules, 2022. Whereas the earlier NDI Rules 2019 limited share swaps to issuance of equity instruments by an Indian company to a PROI, the Amendment Rules 2024 now expressly allow a secondary swap of shares either under the automatic route for sectors for which no prior Government approval is applicable or under the Government route for sectors for which prior Government approval is mandated or where such investment exceeds the prescribed sectoral caps stipulated in Schedule I of the NDI Rules 2019. A similar amendment has been incorporated in Schedule I in paragraph (1), for sub-paragraph (d) to align it with Rule 9A.

Analysis: This amendment with respect to a secondary swap of shares will ensure clarity with respect to share swap mechanisms and help achieve inorganic growth of India Inc. by enabling wider integration with the global market through strategic initiatives like joint ventures and acquisitions.

ii. Foreign Direct Investment in White Label ATM Operations (WLAO)

The Amendment Rules 2024 has aligned the NDI Rules 2019 with the FDI Policy 2020 by incorporating a specific provision with respect to foreign direct investment (FDI) in WLAO by permitting 100% (hundred per cent) FDI under the automatic route for White Label ATMs, which are ATMs established, owned, and managed by entities other than banks. The prescribed conditionalities include *inter alia* net worth requirements, compliance obligations, minimum capitalization norms and regulatory guidelines for WLAOs. For example, non-bank entities planning to establish WLAOs must maintain a minimum net worth of INR 100,00,00,000 (Indian Rupees One Hundred Crores only).

Analysis: It is pertinent to note that WLAO was incorporated pursuant to Paragraph 5.2.25 of the Consolidated FDI Policy 2020, effective from October 15, 2020, and the current amendment has been enacted to update the NDI Rules 2019 to align with the FDI policy. This overdue clarification will enhance the infrastructural environment for ATMs in India and support expansion and use of ATMS on a wider scale even in remote parts of the country.

iii. Clarity to indirect foreign investment:

The Amendment Rules 2024 amends the explanation to the definition of indirect foreign investment to include investments made on a non-repatriation basis by Indian entities owned and controlled by Overseas Citizens of India (OCIs including companies, trusts, and partnership firms incorporated outside India and owned and controlled by an OCI. This amendment has brought in parity between investments made by Non-Resident Indians (NRIs) and OCIs on a non-repatriation basis under Schedule IV of the NDI Rules 2019. Such investments shall now not be taken into account for calculation of indirect foreign investment. As per NDI Rules 2019, 'NRI' means an individual resident outside India who is a citizen of India whereas 'OCI' means an individual resident outside India who is registered as an Overseas Citizen of India Cardholder under Section 7A of the Citizenship Act, 1955.

Analysis: This amendment brings investments by OCIs at-par with investments by NRIs and is clarificatory in nature.

iv. Alignment of various definitions

Vide the Amendment Rules 2024, the definition of 'control' in the NDI Rules 2019 has been aligned with the extant definition of control under the Companies Act, 2013. As per the current revised definition, the term 'control' therefore, not only includes the right to appoint

majority of the directors or to control the management or policy decisions of a company but also includes the right to appoint majority of designated partners in case of LLPs.

With respect to *start-ups*, the Amendment Rules, 2024 has updated the notification number to harmonise the definition of a 'start-up' with the latest notification number G.S.R. 127(E), dated the 19 February 2019 issued by Department for Promotion of Industry and Internal Trade, Ministry of Commerce and Industry as amended from time to time. Accordingly, start-ups will include, for a period of 10 (ten) years, a private limited company/ LLP/ registered partnership firm whose turnover for any of the financial years since incorporation/ registration has not exceeded INR 100,00,00,000 (Indian Rupees Hundred Crores) provided that such entity is working towards *inter alia* innovation, 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.

Analysis: This amendment seeks to harmonise various established statutory provisions by providing a clear and consistent definition, thereby reducing ambiguity in interpretation.

The Amendment Act 2024 are a step in the right direction by providing a more consistent, clear and investor-friendly ecosystem. With weakening FDI inflows in last financial year ending on 31 March 2024¹, these measures are widely welcomed by the Indian business sector.

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¹ *Economic Survey 2023-24*, Department of Economic Affairs Economic Division, Ministry of Finance, Government of India, Available at: <https://www.indiabudget.gov.in/economicsurvey/doc/echapter.pdf> (Last Accessed on 28 August 2024).