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Foreign Investment Series

New Foreign Investment Rules For New India: Expanded Scope With Sectoral Caution

On 21 July 2026, the Reserve Bank of India ("**RBI**") has released the draft Foreign Exchange Management (Foreign Investment) Rules, 2026 ("**Draft Rules**") proposing to supersede the erstwhile Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 ("**NDI Rules**"). The Draft Rules are published and available for public comments till 31 August 2026.

The Draft Rules are aimed at reducing complexity by consolidating the operational (sectoral caps, investment routes) and technical (simplifying definitions, streamlining instrument-based chapters and sections) concepts. As a measure of consolidation, the Draft Rules also subsume the Foreign Direct Investment ("**FDI**") Policy as one of the annexures.

Structurally, the draft is laid out in four chapters: (a) preliminary; (b) foreign Investment in an eligible investee entity; (c) conditions applicable on foreign investment; and (d) general provisions and three annexures that set out the procedural aspects of the Draft Rules. The key changes introduced to the Draft Rules are set out below.

A. Shift from "Non-Debt Instruments" to "Foreign Investment"

While the amendment may only appear as a mere shift in the nomenclature, it is one of the most significant structural changes in the framework itself. Unlike the NDI Rules, which primarily regulated specified capital instruments, the Draft Rules regulate foreign investment in equity of eligible investee entities, indicating a move from an instrument centric regime to an investment / transaction centric framework.

Rule 2 of the Draft Rules captures any foreign investment in equity by a person resident outside India ("**PROI**") or transfer thereof and carves out investments into a financial institution set up in an International Financial Services Centre which are to be separately governed by the International Financial Services Centre Authority Act, 2019 and the rules made thereunder.

B. Replacement of "Equity Instruments" with "Equity" under the Draft Rules

The Draft Rules dispense with the long-standing concept of equity/capital instruments, which formed the backbone of the NDI Rules. This was an exhaustive list of instruments comprising equity shares, fully and mandatorily convertible debentures ("**CCDs**"), fully and mandatorily convertible preference shares ("**CCPS**") and share warrants. Now, the proposed Rule 3(1)(d) defines "equity" to solely include (a) instruments classified as equity under applicable accounting standards; (b) units of investment vehicles; and (c) participating interests or rights in oil fields and mines. This change in the definition of equity also leads the way for any other instruments which may be classified as equity in the future

This marks a shift from an exhaustive list of regulated instruments to a principle-based approach linked to the accounting standards. For instance, an instrument that requires the issuer to repay cash on redemption (such as redeemable preference shares) would typically be classified as a financial liability as per accounting standards, irrespective of its nomenclature. On the contrary, an instrument that can only be settled through the issuance of the issuer's own equity (such as a typical compulsorily convertible preference share with no redemption classification) may be classified as equity, depending on the applicable accounting standards. Accordingly, instruments like CCPSs and CCDs, which were expressly recognised as capital instruments under the NDI Rules, would now qualify as "equity" under the Draft Rules only to the extent they are classified as equity in accordance with the applicable accounting standards.

C. Introduction of "Eligible Investee Entity"

The Draft Rules introduce the concept of "Eligible Investee Entity", replacing multiple standalone references to companies, limited liability partnerships ("**LLPs**"), investment vehicles and other entities throughout the NDI Rules. The definition now includes: (a) companies; (b) LLPs; (c) investment vehicles registered with SEBI; (d) partnership firms; and (e) proprietary concerns.

It is worth noting that under the NDI Rules, foreign investments in partnership firms and proprietary concerns were only permitted to non-resident Indians and overseas citizens of India on a non-repatriation basis and subject to other restrictions. The Draft Rules fold these two as eligible investee entities which would support investment in small-scale and unincorporated businesses in India.

This consolidation substantially simplifies the Draft Rules by bringing all investee entities under one single umbrella concept.

D. The Rule of 10 and introduction of Foreign Controlled Entity

The Draft Rules classify the investment category based on the threshold of investment:

- Foreign Direct Investment: Investment of 10% or more; and
- Foreign Portfolio Investment: Investment of less than 10%

Further, downstream investment through a foreign owned and controlled entity under the NDI Rules has also been brought into the broader definition of 'Foreign Investment in Equity' which includes indirect investment.

The Draft Rules introduce a clear definition of "foreign investment in equity" and suggest that foreign investment can be done (i) directly; or (ii) indirectly through a (a) Foreign Controlled Entity or (b) through a PROI which is owned and controlled by another PROI. For the purposes of indirect investment through PROI, the term 'control' would include any management rights held by a non-resident entity/person having more than 10% voting rights.

The Draft Rules introduce the concept of Foreign Controlled Entity ("**FCE**"). The definition consolidates the existing downstream investment framework by treating investments made through foreign-controlled entities as foreign investment and provides a uniform ownership and control test. However, for the purposes of determining 'ownership and control' under FCE, the sectoral regulations will apply. In the absence of a definition under sector-specific regulations, the definitions will be governed by Companies Act 2013, LLP Act 2008 or SEBI (AIF) Regulations.

In addition, another noteworthy change appears in the proviso to Rule 8(1)(a). While foreign investment is generally required to comply with the applicable entry route, sectoral cap and sectoral conditions under Annexure II, the proviso clarifies that foreign investment by an FCE will be subject to these requirements only for sectors specifically identified in the FDI Policy.

This appears to move away from a blanket application of indirect investment conditions to a sector-specific approach. If this interpretation is borne out in the final FDI Policy, indirect investments by FCEs may be subject to entry-route, sectoral cap and sectoral condition requirements only in sectors where the Policy expressly provides so. This can also lead to an inference that the investors can expect introduction of a new FDI policy which will make this sector specific carve-out for investment through FCE.

E. Rights and Bonus Issue Requirements

The second proviso to Rule 8(1)(a) of the Draft Rules provides that the entry route, sectoral cap and sectoral conditions will not apply to the issue of equity to a PROI on a bonus or rights basis, provided the shareholding pattern remains unchanged. This recognises that a pro rata bonus or rights issue does not alter the proportionate foreign holding and therefore does not warrant fresh regulatory scrutiny.

The exemption, however, is conditional. Where the shareholding pattern changes; for instance, because rights entitlements are renounced in favour of another investor, the carve-out ceases to apply, and compliance with the applicable FDI Policy conditions is required.

The Draft Rules also omit the express pricing requirement contained in the NDI Rules, under which equity issued on a rights basis to a PROI could not be priced below that offered to resident shareholders. Instead, the proviso to Rule 8(2) simply states that the pricing guidelines do not apply to subscriptions pursuant to a rights issue.

F. *Simplification of Pricing Guidelines*

Rule 8(2) of the Draft Rules removes the standard framing of not less than / not more than by streamlining the pricing framework. Instead of prescribing separate pricing methodologies for various categories of transactions, the Draft Rules classify pricing requirements into three broad categories on the basis of listing status of entities: (a) listed entities; (b) entities listed on recognised international exchanges; and (c) in all other cases as per internationally accepted pricing methodology for valuation on an arm's length basis.

Simply put, the Draft Rules also reformulate the pricing provisions. Under the NDI Rules, a foreign investment could only be made at a price which was "not less than" the fair market value which was the ceiling. The Draft Rules replace this with a requirement that the transaction be undertaken at a predetermined price in accordance with the prescribed valuation methodology. Although this may appear to be a drafting simplification, it arguably represents a substantive shift. Feedback from industry stakeholders will be very valuable in this regard especially for pre-revenue or loss-making enterprises with growth potential.

G. *Listing on International Stock Exchanges*

As a major addition to the regulatory framework, the Draft Rules introduce a scheme permitting Indian public companies to issue equity or enable existing shareholders to sell equity directly on recognised international stock exchanges (NASDAQ, NYSE, etc).

This creates a dual-listing pathway for growth-stage Indian companies and celebrates the precedents of entities like Freshworks or MakeMyTrip which were well received when the foreign subsidiaries were listed on international exchanges. However, the Draft Rules also mandate that the equity held by PROI (through exchanges) should not exceed the overall sectoral cap and the entry routes will have to be complied with. There are further restrictions related to transfer of such equity from a PROI to a person resident in India.

H. *Miscellaneous*

Simplified Acquisition and Transfer Framework

Instead of prescribing separate provisions / sections / chapters for different modes of investment across the rules, the Draft Rules consolidate various acquisition mechanism under a single framework. Foreign investors may now simply acquire equity by way of (a) subscription; (b) purchase; (c) gift; (d) pledge; (e) depository receipts; (f) acquisition through recognised international exchanges; and (g) other specified modes.

The Draft Rules also introduce specific conditions governing gifts where investments originally held on a non-repatriation basis become repatriable.

Express allocation of Regulatory Functions: RBI and DPIIT

Rule 4 of the Draft Rules expressly recognises the respective roles between the two authorities, i.e., the RBI and the Department for Promotion of Industry and Internal Trade ("**DPIIT**"). The RBI is vested with administration of the Draft Rules including but not limited to the power to interpret and to issue regulations, directions, circulars etc., for their effective implementation, mode of payment, reporting and other operational requirements. The DPIIT on the other hand is vested with the power to interpret the FDI Policy and to issue directions, circulars or clarifications in relation to it.

This appears to be a valuable change as practitioners will recall instances where the coexistence of the FDI Policy and the NDI Rules created several divergences in language and interpretation. By now having the FDI Policy as Annexure II to the Draft Rules, the attempt appears to keep the legislations in a single framework yet giving them complete operative independence. We will need to review whether existing FDI approvals/undertakings need to be revisited once the Draft Rules are finalised and FDI Policy is notified to align with the new regime.

Conclusion

The Draft Rules represent a material departure from an instrument-centric regulatory regime to a transaction-focused framework centred on foreign investment in equity. By broadening eligible investee entities, introducing direct international listing pathways, and enabling lesser compliance for rights/bonus issues, the framework accommodates diverse foreign investment structures while maintaining sectoral safeguards.

However, the Draft Rules also give way to introduction of a new / updated FDI Policy which is a critical unknown variable at the moment. Stakeholders should, therefore, closely monitor the final version of the Draft Rules, particularly the accompanying Annexures and RBI directions as several operational aspects of the proposed framework are intended to be prescribed outside the body of the Draft Rules.

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