

In brief

Issue of Non-debt
Instrument Rules and
new definition of Non-
debt Instruments

**This issue**

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Foreign Exchange Management Act, 1999 (FEMA)

Foreign Exchange Management (Non-debt Instruments) Rules, 2019

The Finance Ministry has notified Foreign Exchange Management Act (Non-debt Instruments) Rules, 2019 vide Notification dt.17th October, 2019 (NDI Rules)

The existing Notification FEMA 20(R) on Transfer of Issue of Security by a Person Resident outside India & FEMA 21R/2018-RB on Acquisition and Transfer of Immovable Property in India have been combined under NDI Rules.

The said rules have introduced new definitions / rules and modified the existing one.

New definitions inserted

- ♦ **Debt Instruments** means all instruments other than non-debt instruments.
- ♦ **Non-debt Instruments** means the following instruments; namely:-
 - a. all investments in equity instruments in incorporated entities: public, private, listed and unlisted;
 - b. capital participation in LLP
 - c. all instruments of investment recognized in the FDI policy notified from time to time;
 - d. investment in units of Alternative Investment Funds (AIFs), Real Estate Investment Trust (REITs) and Infrastructure Investment Trusts (InvITs);
 - e. investment in units of mutual funds or Exchange-Traded Fund (ETFs) which invest more than 50% in equity;
 - f. junior-most layer (i.e. equity tranche) of securitization structure;
 - g. acquisition, sale or dealing directly in immovable property;
 - h. contribution to trusts; and
 - i. depository receipts issued against equity instruments

Introduction of the new term Hybrid Securities in FEMA regulation and amendment of existing definitions

- ♦ **Hybrid Securities** means hybrid instruments such as optionally or partially convertible preference shares or debentures and other such instruments as specified by the Central Government from time to time, which can be issued by an Indian company or trust to a person resident outside India. No reference to this definition in NDI Rules

Following existing definitions have been amended by the NDI Rules.

- ♦ **Indian Company** mean a company incorporated in India.
- ♦ **Equity Instruments** means equity shares, convertible debentures, preference shares and share warrants issued by an Indian company. This definition is the replacement for the definition “Capital Instruments” under FEMA 20(R).
- ♦ **Investment Vehicle** definition has been expanded to include “Mutual funds” *which invest more than 50% in equity governed by the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996.*

- ♦ **Investment by foreign portfolio investors (FPIs)**

In erstwhile FEMA Regulations, 2017, investment by FPIs was limited to 10% on an individual basis and 24% on an aggregate basis of the paid-up value of each series of debentures, preference shares or share warrants issued by an Indian company. The NDI rules provide that as from 1st April 2020, the aggregate limit will be the sectoral caps applicable to the Indian company as set out in the rules.

The aggregate limit may be decreased by the Indian company (prior to 31st March 2020) or increased with the approval of its Board of Directors and shareholders by a Special Resolution.

The aggregate limit for an Indian company in a sector where FDI is prohibited shall be 24%.

FPIs may invest in Category III AIFs and offshore funds for which no-objection certificate has been issued under the SEBI (Mutual Funds) Regulations, 1996 and that, in turn, invest more than 50% in equity instruments or in units of REITS and InvITs, all on a repatriation basis.

- ♦ **Merger or Demerger or Amalgamation of Indian Companies-** listed companies will now have to comply with the Securities and Exchange Board of India (SEBI) (Listing Obligation and Disclosure Requirement) Regulations, 2015.

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Changes in merger demerger/amalgamation of Indian companies, pricing guidelines and, sectoral caps

Introduction of SNRR account as new mode of payment / receipt for FDI transactions

- ♦ **Pricing Guidelines** now do not require the upfront determination of the conversion price or conversion formula for the issuance of convertible debentures and preference shares, which was compulsory under the erstwhile regulation.

Other Key Amendments

- ♦ Foreign venture capital institutions (FVCIs) may invest in equity, equity-linked instruments or debt instruments
- ♦ NRI / OCI may without limit purchase or sell units of domestic mutual funds which invest more than 50% in equity.
- ♦ Schedule I on Sectoral caps remain same as such except the following changes-

▲ E-commerce

Definition of “E-commerce entity” has been modified to exclude a foreign company covered under section 2 (42) of the Companies Act, 2013 or an office, branch or agency in India as provided in Section 2 (v) (iii) of FEMA, 1999, owned or controlled by a person resident outside India and conducting the e-commerce business. In effect, only a company incorporated under the Companies Act, 1956 / 2013 can undertake E-commerce activities.

▲ Single Brand Product Retail Trading

The NDI rule has again reverted back to the entry route for Single Brand Product Retail Trading to 49% Automatic and Government route beyond 49%, this was 100% automatic under FEMA 20(R) as per the amendment made in 2018

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Foreign Exchange Management (Deposit) (Third Amendment) Regulations, 2019 Notification No. FEMA 5 (R)/(3)/2019-RB) read with A.P. (DIR Series) Circular No. 09 dated 22nd November 2019

Special Non-Resident Rupee Account (SNRR account) has been brought into the purview of Master Direction - Deposits and Accounts (Master Direction 14/2015-16 – Deposits and Accounts)

The scope of SNRR Account is expanded to permit a person resident outside India to open such account for:

- a. External Commercial Borrowings in INR;
- b. Trade Credits in INR;
- c. Trade (Export/ Import) Invoicing in INR; and

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Inclusion of SNRR account as a mode of payment

Issue of Debt Instrument rules and definition of Debt Instruments

d. Business related transactions outside International Financial Service Centre (IFSC) by IFSC units at GIFT city like administrative expenses in INR outside IFSC, INR amount from sale of scrap, government incentives in INR, etc. The account will be maintained with bank in India (outside IFSC).

Non-resident Rupee Accounts – Review of Policy [Read more](#)

Foreign Exchange Management (Deposit) (Third Amendment) Regulations, 2019 [Read more](#)

Foreign Exchange Management (Mode of Payment and Reporting of Non-Debt Instruments) Regulations, 2019

Consequent to issue of NDI Rules, The RBI has issued Foreign Exchange Management (Mode of Payment and Reporting of Non-Debt Instruments) Regulations, 2019, wherein the RBI has provided an additional mechanism in form of SNRR account for receipt and payment of funds purchase / sale proceeds on issue / transfer of securities apart from the existing available modes. This regulation also provides that SNRR account can be used for permissible debits / credits for import payments and export receipts.

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Foreign Exchange Management (Debt Instruments) Regulations, 2019

The Central Government hereby determines the following instruments as debt instruments (“DI”), namely:—

- a. Government bonds;
- b. corporate bonds;
- c. all tranches of securitization structure which are not equity tranche;
- d. borrowings by Indian firms through loans;
- e. depository receipts whose underlying securities are debt securities

The RBI has vide the above regulation consolidated the provisions of Foreign Direct Investments (FDI) with respect to debt instruments. The Regulation provides permission to invest in debts instruments by person resident outside India basically into 4 parts -Investments by FPI, by NRI and OCIs on repatriation basis, by NRI and OCI on non-repatriation basis and by foreign central banks / multilateral development banks for purchase of government securities.

FPI may purchase debt instruments on repatriation basis including “Municipal Bonds” which were a part of the erstwhile regulations and are now considered under Debt Instruments Regulations, 2019

In brief

RBI has laid down conditions for lending by banks to InvITs

NRI and OCI may now also purchase on repatriation/ non repatriation basis without any limit, Exchange- Traded Funds (ETFs) which invest less than or equal to 50% in equity.

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Reserve Bank of India (RBI)

Lending by banks to InvITs

RBI/2019-20/83 dated 14th October 2019

As per the above Notification, Banks are permitted to lend to Infrastructure Investment Trusts (**InvITs**) subject to certain conditions. Among other matters, they include the following -

- ♦ Banks should put in place a Board approved policy on exposures to InvITs which should *inter alia* cover the appraisal mechanism, sanctioning conditions, internal limits, monitoring mechanism, etc.
- ♦ Banks should undertake assessment of all critical parameters including sufficiency of cash flows at InvIT level to ensure timely debt servicing.
- ♦ The Audit Committee of the Board of banks should review the compliance to the above conditions on a half yearly basis.

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Key Take Away

- The introduction of the above mentioned notifications is done to simplify the provisions governing foreign investment in India.
- The Government has for the ease of understanding, reporting and to bring in the transparency in FEMA provisions, bifurcated the FDI framework between debt and the non-debt instrument.
- The NDI and DI norms clearly distinguish between debt and non-debt instruments and demarcate the authority responsible for each kind of instrument, i.e., the central government for NDI and the RBI for DI. This clarity is likely to ease the approval process for investors and bridge the gap relating to various issues which were caused by erstwhile regulations.
- Banks will now be allowed to lend to InvITs, however, the sanctioning of these loans would be subject to tighter parameters of scrutiny such as having board-approved policies on exposures, compliances etc.

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