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GOVERNMENT OF INDIA
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GOVERNMENT ACCEPTS THE REPORT OF THE COMMITTEE FOR RATIONALISING THE DEFINITION OF FDI AND FII

New Delhi, June 21, 2014

The Government of India had constituted a Committee for rationalising the definition of FDI and FII as per the announcement of the then Union Finance Minister during the Budget Speech 2013-14 (Para No. 95) which reads as follows:

"In order to remove the ambiguity that prevails on what is Foreign Direct Investment (FDI) and what is Foreign Institutional Investment (FII), I propose to follow the international practice and lay down a broad principle that, where an investor has a stake of 10 percent or less in a company, it will be treated as FII and, where an investor has a stake of more than 10 percent, it will be treated as FDI. A committee will be constituted to examine the application of the principle and to work out the details expeditiously."

The Committee has now submitted its report which has been accepted by the Government .Report of the Committee is available on the web-site of Ministry of Finance- **www.finmin.nic.in**. Major features of the report are as follows:

The core recommendation of the committee is that it should be the endeavour to simplify the classification of foreign investment and enable basically two classes of foreign investors in the long run viz. Portfolio Investors and FDI Investors, and at best carve outs therein for NRIs, in view of their special status.

The committee adopted the conceptual framework that Foreign Direct investment (FDI) is characterised by a lasting interest i.e. existence of a long term relationship, significant degree of influence. Normally, ownership of 10 percent or more of the ordinary shares OR voting power signifies this relationship and it involves both initial and subsequent transactions. On the other hand Portfolio Investment is characterised by the largely anonymous relationship between the issuers and holders, and the degree of

trading liquidity in the instruments. Further it covers, but is not limited to securities traded on organized or other financial markets.

The Committee has recommended the merger of the FII and Qualified Foreign Investors (QFI) regimes under the new “Foreign Portfolio Investors” (FPI) regime, and this has been notified by SEBI and RBI in their respective regulations.

The FPI regime will be subject to the prevailing SEBI (SAST) Regulations to prevent persons acting in concert. There is no change proposed in the monitoring mechanism. However, it has been proposed in addition, that the onus of adherence to the aggregate FPI limit will also be cast on the Investee Company, which can be asked to get the compliance to the foreign investment limit verified by the Statutory Auditor on a half-yearly basis.

Foreign investment of 10 percent or more through eligible instruments made in an Indian listed company would be treated as FDI. All existing foreign investments below the threshold limit made under the FDI Route shall however, continue to be treated as FDI. Foreign Investment in an unlisted company irrespective of threshold limit may be treated as FDI. An investor may be allowed to invest below the 10 percent threshold and this can be treated as FDI subject to the condition that the FDI stake is raised to 10 percent or beyond within one year from the date of the first purchase. The obligation to do so will fall on the company. If the stake is not raised to 10% or above, then the investment shall be treated as portfolio investment. In case an existing FDI falls to a level below 10 percent, it can continue to be treated as FDI, without an obligation to restore it to 10% or more. In a particular company, an investor can hold the investments either under the FPI route or under the FDI route, but not both.

A relook at the Foreign Venture Capital Investors (FVCI) scheme is called for since these investors are basically in the nature of FDI.

Regarding NRI investors, they have a special place in the foreign investment regime since NRI funds flow even through deposits and remittances. Special privileges are also available to NRIs in terms of the Overseas Citizenship Act and the provision to make ‘non-repatriable’ investments. This position would remain and to reinforce the same, it may be further examined if non-repatriable investment by an NRI can be treated

as “domestic” as also an enabling mechanism to enable such investment to come through via a corporate form.

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