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# Foreign Direct Investment | Financial Services, Trading and E-Commerce

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FEMA

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# FDI | General Update

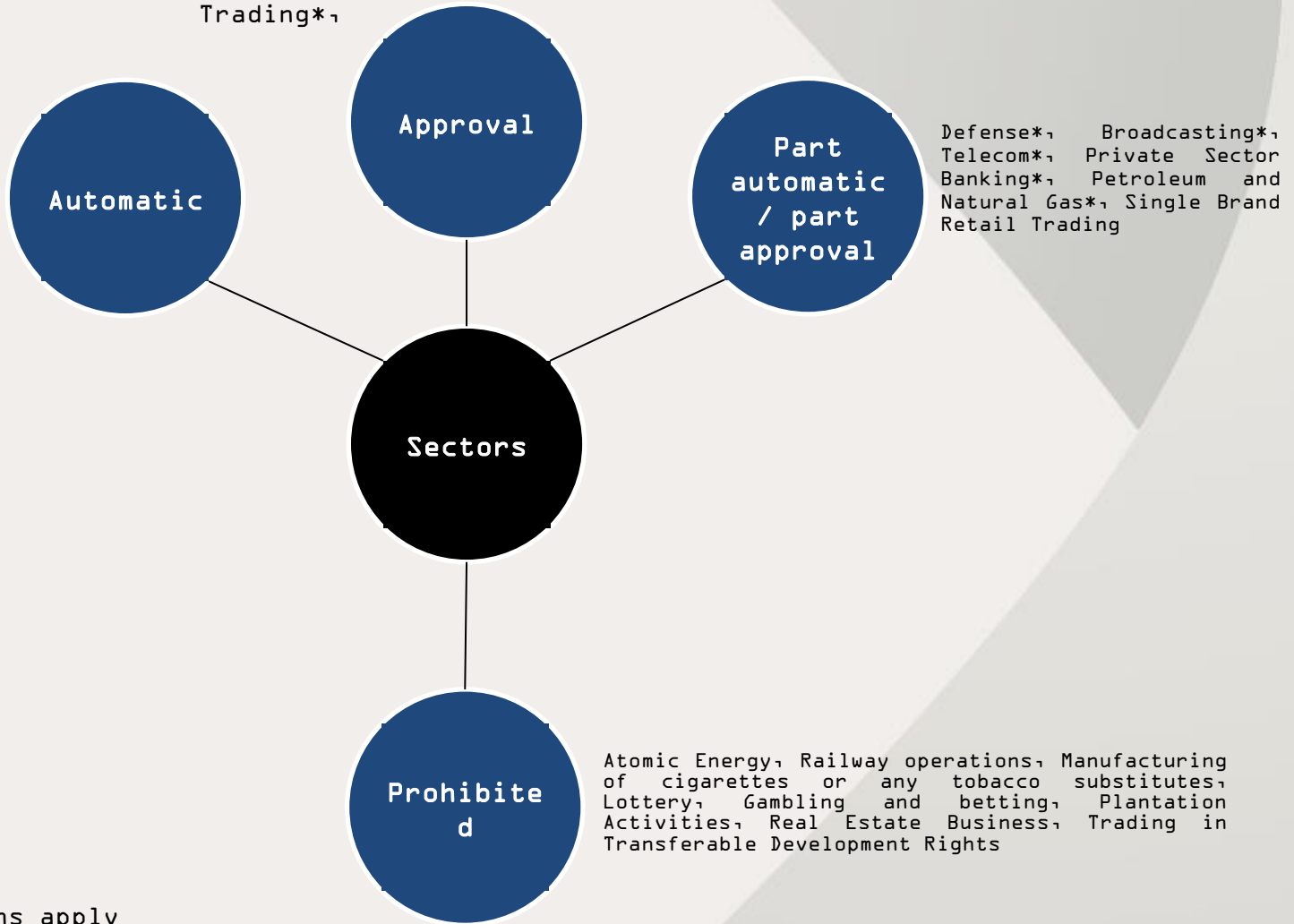
- In 2019, certain changes were introduced in the foreign investment norms governing single-brand retail trading, contract manufacturing, coal mining and digital media. The intent behind these changes was to increase India's competitiveness and making it a manufacturing hub, thereby creating more jobs.
- In a move to overhaul the regulatory regime, the Ministry of Finance introduced the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 ("**NDI Rules**") and the Foreign Exchange Management (Debt Instruments) Rules, 2019. Pursuant to this, powers of RBI and the Central Government contemplated under the Foreign Exchange Management Act, 1999 have been clearly laid down.
- Under the NDI Rules, a clear distinction has been made between the powers of the RBI and the Central Government, in relation to the regulatory transactions contemplated under the Foreign Exchange Management Act, 1999.



# FDI | Automatic and Approval Route

Print Media, Private Security Agencies\*, Multi Brand Retail Trading\*

Not covered in the table, Non-Banking Financial Corporations\*, Construction of Townships\*, E-Commerce, Wholesale Trading



\* Sectoral conditions apply



# FDI | Regulatory Framework

Currently, FDI in India is governed by the following regulatory framework:

- Foreign Exchange Management Act, 1999
- NDI Rules
- FDI Policy



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## AGENDA

Part A	FDI in Financial Services
Part B	FDI in E-Commerce
Part C	FDI in Trading



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# Part A | FDI IN FINANCIAL SERVICES



# FDI | Financial Services

## Position prior to Press Note No. 6 (2016 Series)

- FDI was permitted only in 18 identified activities, subject to stringent minimum capitalization norms.
- FDI was permitted in NBFCs up to 100% under the automatic route.



# FDI | Financial Services

- The Government had prescribed the following minimum capitalization norms:

S NO	THRESHOLD/ NATURE OF ACTIVITY	MINIMUM CAPITALIZATION REQUIREMENT (IN USD)
1.	If the foreign investment is up to 51%	0.5 million to be brought upfront
2.	If the foreign investment is more than 51% and up to 75%	5 million to be brought upfront
3.	If the foreign investment is more than 75%	50 million (7.5 million to be brought upfront and the balance in 24 months)
4.	NBFCs having foreign investment more than 75% and up to 100% (having a minimum capitalization norm of USD 50 million) intending to set up a step down subsidiary for specific NBFC activity	No additional capital required
5.	JV operating NBFCs that have 75% or less than 75% foreign investment, intending to set up subsidiaries for undertaking other NBFC activities	As provided in 1, 2 or 3 hereinabove
6.	Non-fund based activities - such as investment advisory services, financial consultancy, forex broking, money changing business and credit rating agencies.	0.5 million





# FDI | Financial Services

## Position after Press Note No. 6 (2016 Series) - Current Position

- FDI up to 100% allowed in certain identified financial services, subject to conditionalities.
- 100% FDI allowed under the automatic route in “*other financial services*”, provided these activities are regulated by financial regulators (*ie, SEBI, RBI, PFRDA or any other such regulator*).
- Other financial service activities that are not regulated by any financial sector regulator or where there is a doubt regarding regulatory oversight, investment up to 100% allowed under the Government approval route, subject to conditionalities, including minimum capitalization norms, as may be prescribed by the relevant regulators.



# FDI | Other Financial Services

- Now, for investment in unregulated financial service activities, the Ministry of Finance has prescribed the following capitalization norms:

S NO	NATURE OF ACTIVITY	MINIMUM CAPITALIZATION REQUIREMENT (IN USD)
1.	<u>Fund based activities</u> - merchant banking, underwriting, portfolio management services, stockbroking, asset management, venture capital, custodian services, factoring, leasing and finance, housing finance, credit card business, micro credit and rural credit.	20 million
2.	<u>Non - fund based activities</u> - investment advisory services, financial consultancy, forex broking, money-changing business and credit rating agencies.	2 million

- As per the NDI Rules, downstream investment by any of these entities engaged in 'other financial services' that is treated as indirect foreign investment for the investee entity shall be subject to the NDI Rules.



# Financial Services | Identified Sectors

- **Asset Reconstruction Companies (ARC)**

Asset reconstruction means acquisition by any securitisation company or reconstruction company of any right or interest of any bank or financial institution in any financial assistance for the purpose of realisation of such financial assistance. An ARC is a company *a company registered with Reserve Bank under section 3 for the purposes of carrying on the business of asset reconstruction or securitisation, or both.*

Presently, 100% FDI is allowed in ARCs under the automatic route, subject to the following conditions:

- Investment limit: The investment limit of a sponsor or institutional or non-institutional investor shall be governed by the Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest Act, 2002.
- FPI investment: FPIs can invest in the security receipts (SRs) issued by the ARCs, up to 100% of each tranche in SRs issued by the ARCs, subject to the guidelines of RBI.



# Financial Services | Identified Sectors

- **Credit Information Companies (CIC)**

*CIC is a company formed and registered under the Companies Act, 1956 and which has been granted a certificate of registration under sub-section (2) of section 5 of the Credit Information Companies (Regulation) Act, 2005 and collects credit information such as amounts and nature of loans, security taken or guarantee furnished by a borrower.*

CICs provide such credit information about individuals and assigns ranks to them based on their past repayment track record. 100% FDI is allowed in CICs under the automatic route, subject to the following conditions:

- Regulatory clearance: FDI in CICs shall require regulatory clearance from RBI as under the Credit Information Companies (Regulation) Act, 2005.
- FPI investment: FPI investment by a single entity should be below 10%. Any acquisition in excess of 1% will have to be reported to RBI. FPIs can not seek representation on the Board of the CIC.



# Financial Services | Identified Sectors

## ▪ Banking - Private Sector

Presently, 74% FDI (up to 49% under the automatic route and government route beyond 49% and up to 74%) is allowed in private sector - banking activities, subject to the following conditions:

- Shareholding by residents: At least 26% of the paid up capital shall of the entity is to be held by residents at all times (except with regards to a WOS of a foreign bank).
- Insurance sector: Applications for FDI in private banks having JV/ subsidiary in the insurance sector will have to be addressed to RBI in consultation with IRDAI.
- Transfer of shares from resident to non-resident: All transfer of shares from resident to non-resident shall require RBI approval and/ or approval by the Government.
- Control: RBI guidelines in relation to acquisition of capital instruments shall apply in case FDI results in any person owning or controlling 5% or more of the paid up capital of the private bank.
- Setting up subsidiary of private bank: Setting up a subsidiary of a private bank (holding FDI) will have to comply with the norms provided under the NDI Rules.



# Financial Services | Identified Sectors

- **Banking - Public Sector**

Presently, FDI up to 20% is allowed in public sector - banking activities under the Government route. All investments will have to comply with the provisions of the Banking Companies (Acquisition & Transfer of Undertakings) Act, 1980.

- **Infrastructure Companies in the Securities Market**

Up to 49% FDI is allowed in infrastructure companies in the securities market (*ie, stock exchanges, commodity derivative exchanges, depositories, clearing corporations*), under the automatic route, in compliance with the applicable SEBI Regulations.

- **Commodities Spot Exchange**

Up to 49% FDI is allowed in commodities spot exchanges under the automatic route. All investments made will be required to comply with guidelines prescribed by the Central or the State Government.

- **Power Exchanges**

Up to 49% FDI is allowed under the automatic route. All investments made will be required to comply with the Central Electricity Regulatory Commission (Power Market) Regulations, 2010.



# Financial Services | Identified Sectors

- Insurance sector

FDI up to 49% is permitted in the insurance sector under the automatic, subject to the following conditions:

- License/ approval: FDI is subject to compliance with the Insurance Act, 1938 and license/ approval from the IRDAI.
- Control: Indian entity will have to ensure that control and ownership remains with resident Indian entities.
- Primary business: In case the entity is like a bank whose primary business is outside the insurance area (where revenues more than 50% are derived from this primary business), foreign equity investment caps applicable in that sector shall continue to apply.



# Financial Services | Identified Sectors

- Pension sector

FDI up to 49% is allowed in the pension sector under the automatic route, subject to the following conditions:

- Registration from PFRDA: Investment in pension funds will be subject to registration from PFRDA.
- Ownership/ control: Indian pension fund will have to ensure that ownership and control remains at all times with the resident entities.





# FDI | Financial Services

Whether core investment companies are 'unregulated other financial service'?

- By way of the Press Note 1 (2018 Series), it was clarified that FDI in investment companies registered as non-banking financial companies with RBI, being overall regulated, will be permitted under 100% automatic route.
- Foreign investment in CICs is permitted under the Government approval route alone. This seems to be because CICs which are not systemically important, which do not qualify as NBFCs are not required to be registered with RBI. Necessitating government approval to undertake FDI in CICs may raise the following concerns:
  - Company receiving FDI through the automatic route may face a predicament if their business activities unexpectedly qualify to be in the nature of a CIC.
  - Systemically important CICs are required to register with the RBI. Hence, they would be regulated by the RBI and should not require government approval.



# FDI | Financial Services

- RBI has issued FAQs on Core Investment Companies. FAQ No. 26 states that:

*“26. A company has investments in Group companies but does not meet the criteria of principal business as defined in terms of asset-income criteria to be as an NBFC. Can the company still be registered as a CIC or does it need to first register as an NBFC?”*

*Ans: CICs need not meet the principal business criteria for NBFCs.”*

- Bare reading of this FAQ seems to suggest that an entity may be CIC even if it does not qualify to be an NBFC.

*Does this FAQ have any binding value?*



# Financial Services | Case Study

- **Case:** A non-resident sets up an Indian entity (“X”). X intends to register as an NBFC (after fulfilment of the principal business criteria) under the relevant regulations issued by RBI.
- The net owned fund requirement to register as an NBFC is INR 2 crores.
- X will have to receive funds from the non-resident entity, amounting to 2 crores before applying for an NBFC registration.

*What happens in case X receives these funds but is unable to receive NBFC registration by RBI?*



# Financial Services I Case Study

- **Case:** A non-resident sets up an entity (“Y”) under the automatic route. In one financial year, Y does not have substantial operations.
- In this financial year, Y has surplus funds and decides to invest these funds in other entities.

*Will Y be considered to be an entity in the nature of CIC if they invest in other companies/ its group entities in this financial year?*

*Will Y be required to receive an approval from the Department of Economic Affairs to continue operations?*



# Financial Services | Case Study

- **Case:** An entity A is a registered mutual fund distributor. A is engaged in the business of mutual fund products. X, a non-resident intends to invest in A.

*Whether A would be considered a 'regulated entity' or an 'unregulated entity'?*

*Whether foreign investment in A will require prior approval of the Government?*



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## **Part B | E-COMMERCE**



# FDI | E-Commerce Activities

- In 2000, 100% FDI was permitted in the business-2-business (“B2B”) e-commerce activities under the automatic route, subject to inter alia the condition that such companies would divest 26% of their equity share capital in favour Indian residents in 5 years of the investment, if such company is listed in other jurisdictions. **This requirement was removed in 2006.**
- In 2010, e-commerce was redefined as *“buying and selling by a company through e-commerce platform”*. Thereafter, Press Note No. 3 (2016 Series) and Press Note No. 2 (2018 Series) brought revisions to the FDI norms in relation to e-commerce.



# FDI | E-Commerce Activities

- By way of Press Note No. 3 (2016 Series), the FDI Policy distinguished between inventory-based model and marketplace-based model of e-commerce:

- *“A marketplace-based model of e-commerce means providing of an information technology platform by an e-commerce entity on a digital & electronic network to act as a facilitator between buyer and seller”.*

The e-commerce entity is only a ‘facilitator’ or a ‘marketplace’ which facilitates the sale between the seller and the end-consumer. The entity will not exercise ownership over the inventory, or the business will be rendered into an inventory-based model.

- The e-commerce entity does not own the products/services sold. *In an inventory-based model of e-commerce, the inventory of goods and services is owned by the e-commerce entity and is sold to the consumers directly.*

The e-commerce entity sells the goods/services to the end-consumer.

- While FDI up to 100% under automatic route in marketplace model of e-commerce was permitted, FDI in an inventory-based e-commerce was not permitted.





# FDI | E-Commerce Activities - Recent Changes

- Press Note No. 2 (2018 Series) reviewed the Government stance on FDI in e-commerce. (discussed later)
- E-commerce was redefined as *“buying and selling of goods and services including digital products over digital & electronic network.”*
- Pursuant to the NDI Rules, e-commerce activities can now only be undertaken by a company incorporated or existing under the Companies Act, 2013.
- Presently, B2B e-commerce and market-place model of e-commerce are permitted to receive FDI up to 100% under the automatic route.
- Single brand retail trading can no longer be a foreign company or an office, branch or agency in India owned and controlled by a person resident outside India and conducting the e-commerce business.
- FDI is not permitted in inventory-based model of e-commerce.



# FDI | E-Commerce Activities - Recent Changes

Position prior to Press Note No. 2 (2018 Series)	Present Position
E-commerce entity prohibited from undertaking more than 25% of its total sales through its market place from one vendor or its group companies.	If more than 25% purchases are made from a vendor /its group companies, the inventory of the vendor will be deemed to be controlled by the e-commerce market place entity.
-	An entity having equity participation by e-commerce market place entities /its group companies, or having control on its inventory by e-commerce marketplace entities / its group companies, will not be permitted to sell its products on the platform run by such marketplace entity.
-	Services by e-commerce marketplace entity (or other entities where it has direct /indirect participation) to be provided to vendors on an arm's length basis, and in a fair and non-discriminatory manner. ( <i>ie services such as warehousing, advertisement, financing, etc.</i> )



# FDI | E-Commerce Activities - Recent Changes

Position prior to Press Note No. 2 (2018 Series)	Position after Press Note No. 2 (2018 Series)
-	Cashback provided by group companies of marketplace entity to buyers shall be fair and non-discriminatory. For determining 'fair and non-discriminatory', the test to be undertaken is whether provision of services to any vendor on such terms were made available to all other vendors in similar circumstances.
-	E-commerce marketplace entity will not mandate any seller to sell any product exclusively on its platform only.
-	FDI is not permitted in inventory based model of e-commerce.



# E-Commerce | Case Study

- **Case:** Y is an Indian entity holding foreign investment and operating in the e-commerce sector. On its platform, Y sells products from several vendors. Y also holds equity participation in one these vendors, ie, A, amounting to a majority stake.
- Press Note No. 2 (2018 Series), an entity having equity participation by e-commerce marketplace entity or its group companies, or having control on its inventory will not be permitted to sell its products on its platform.

*Will Y be reclassified as an inventory-based model of e-commerce?*

*Will Y have to divest its stake in A to continue operations?*



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## PART C I TRADING



# FDI | Single Brand Retail Trading (SBRT)

- In 2006, by way of Press Note No. 4 (2006 Series), the Government allowed FDI up to 51% with prior Government approval in SBRT entities.
- In 2012, the Government relaxed this limit and permitted FDI up to 100% in the SBRT sector under the government route, by way of Press Note No. 1 (2012 Series).
- Currently, by way of Press Note No. 4 (2019 Series), FDI up to 100% under automatic route is allowed in SBRT, subject to certain conditions:
  - International brand - The products sold by the entity must be sold under the same brand internationally.
  - Agreement to undertake retail trading - Non-residents (whether owner of the brand or otherwise) shall be permitted to undertake SBRT in India for the specified brand, either directly by the brand owner or through an agreement.
  - Local outsourcing requirement - Where the FDI is beyond 51%, sourcing of 30% of the value of the goods procured will have to be done from India, preferably from MSMEs, village and cottage industries. This requirement is to be met in the first instance as an average of 5 years of total value of goods purchased beginning 1 April of the year of the commencement of business.



# FDI | Single Brand Retail Trading (SBRT)

- Retail trade by brick and mortar stores - Brick and mortar stores may also undertake retail trade through e-commerce.
- Restrictions on Indian brands: Indian brands should be owned and controlled by resident Indian citizens and/ or companies which are owned and controlled by resident Indian citizens.
- Businesses operating in state of art/ cutting-edge technology: Sourcing norms will not be applicable for up to 3 years from commencement of business, for entities undertaking SBRT and operating in activities involving 'state of art'/ 'cutting edge technology', where local outsourcing is not possible.



# FDI | SBRT - Recent Changes

Position prior to Press Note No. 4 (2019 Series)	Present Position
-	For meeting local sourcing requirement, all procurements made from India shall be counted towards local sourcing, irrespective of whether the goods procured are sold in India or exported.
SRBT would be permitted to set off of incremental sourcing of goods from India for global operations restricted to the initial 5 years beginning, 1st April of the year of the opening of first store, against the mandatory sourcing requirement of 30% of purchases from India. . After completion of this 5 years period, the SBRT entity shall be required to meet the 30% sourcing norms directly towards its India's operation, on an annual basis.	A SBRT entity is permitted to set off sourcing of goods from India for global operations against the mandatory sourcing requirement of 30% without any restrictions.





# FDI | SBRT - Recent Changes

Position prior to Press Note No. 4 (2019 Series)	Position after Press Note No. 4 (2019 Series)
<p>A SBRT entity operating through brick and mortar stores, is permitted to undertake retail trading through e-commerce.</p>	<p>SBRT operating through brick and mortar stores is now permitted to undertake online trading prior to opening the brick and mortar store subject to the condition that the SBRT opens a brick and mortar store within 2 years.</p>



# FDI | Multi Brand Retail Trading (MBRT)

- Until 2012, FDI in the MBRT sector was not permitted by the Government. By way of Press Note No. 5 (2012 Series), the Government permitted FDI up to 51% in the MBRT sector, under the approval route. Press Note No. 5 was finally incorporated under the Consolidated FDI Policy of 2013.
- Subsequently, Press Note No. 5 (2013 Series) relaxed certain conditions in relation to FDI in the MBRT sector. However, the upper limit of permissible FDI was not eased.
- MBRT has been defined as *the selling of products of different brands under one roof.*



# FDI | Multi Brand Retail Trading (MBRT)

- Presently, under the NDI Rules, 51% FDI is permitted in the MBRT sector under the approval route, subject to certain conditions:
  - Retail of unbranded produce: Entities operating under the MBRT sector may retail fresh agriculture produce including fruits, vegetables, flowers, grains, pulses, fresh poultry, fishery and meat products as long as they are unbranded.
  - Minimum amount: Minimum FDI requirement under this sector is USD 100 million.
  - Investment of funds: At least 50% of the FDI brought in the first tranche of USD 100 million, shall be invested in back-end infrastructure, within 3 years.
  - Opening retail stores: Retail stores can only be opened in an area having a minimum population of 10 lakh persons as per the 2011 census, or any other cities as per the decision of the State Governments. However, retail trading, in any form by means of e-commerce shall not be permissible.



# FDI | Multi Brand Retail Trading (MBRT)

- Government's rights: Government shall have the first right to procure agricultural products.
- Investment of FDI: 50% of the total FDI brought in the first tranche of USD 100 million, shall be invested in 'back-end infrastructure' within 3 years.
- Sourcing of products: At least 30% of the value of procurement of manufactured or processed products purchased shall be sourced from Indian SME industries, which have a total investment in plant and machinery not exceeding USD 2 million. In 2013, this limit was USD 1 million, which was revised by way of the consolidated FDI Policy of 2014.

*Is FPI investment in MBRT permitted?*



# FDI | Cash and Carry Wholesale Trading / Wholesale Trading

- In 1997, FDI in cash and carry wholesale trading was first permitted, to the extent of 100%, under the Government approval route.
- By way of Press Note No. 4 (2006 Series), FDI in cash and carry wholesale trading was permitted under the automatic route. However, Further, the Government restricted wholesale trade between group companies to 25% of the total turnover of the wholesale venture.
- In 2010, in its consolidated FDI Policy, the Government the government sought to specifically define the scope of activities permissible under cash and carry wholesale trading as *sale of goods/ merchandise to retailers, industrial, commercial, institutional or other professional business users or to other wholesalers and related subordinated service providers.*

The yardstick to determine whether the sale is wholesale or not shall be the type of customers to whom the sale is made and not the size and the volume of sales.



# FDI | Cash and Carry Wholesale Trading / Wholesale Trading

- In November 2013, by way of Press Note No. 2 of 2013, the Government defined “group company” as two or more enterprises which directly, or indirectly, are in a position to:
  - exercise 26% or more voting rights in the other enterprise; or
  - appoint more than 50% of members of board of directors in the other enterprise.



# FDI | Cash and Carry Wholesale Trading / Wholesale Trading

- Presently, up to 100% FDI in carry and cash wholesale trading/ wholesale trading sector is permitted under the NDI Rules, under the automatic route, subject to the following conditions:
  - Cap in conduct of wholesale trading: Wholesale trading of goods to group companies should not exceed 25 per cent of the total turnover of the wholesale venture.
  - Licenses/ registrations: Wholesale traders must have requisite licenses / registrations / permits as specified under the relevant state acts/ regulations.
  - Single brand retail: A wholesale trader may undertake SBRT subject to conditions applicable for FDI in SBRT sector. This position was taken by the Government in 2016. Prior to 2016, SBRT by wholesale traders/ cash and carry traders was prohibited.



# Cash and Carry Wholesale Trading I Case Study

- **Case:** A is a non-resident company offering multiple retail brands under the same roof to its customers. A intends to enter the Indian market. However, A is restricted due to the stringent norms under the MBRT sector.

*Could A enter the cash and carry wholesale trading sector?*

*Would a partnership with an Indian entity operating MBRT retail stores be beneficial for A?*





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