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RBI CIRCULAR NO. 16: A BOON FOR FDI

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INTRODUCTION

Transfer of shares/convertible debentures, through a private arrangement, by residents to non-residents¹, and vice-versa required prior regulatory approval of the Foreign Investment Promotion Board (“FIPB”) and Reserve Bank of India (“RBI”). These approvals involved time, too much of paperwork and, indirectly, discouraged foreign investment in Indian companies. This will now change. The RBI, through its Circular No.16 dated October 4, 2004 (“Circular”), has significantly simplified the procedure for foreign investment into India by eliminating the requirement of obtaining prior government approval for such transfers. In other words, the transfer of sale of shares/convertible debentures, between residents and non-residents has now been brought under the general permission (automatic route), subject to certain conditions including pricing norms, sectoral cap, etc.

1. Key Features of the Circular

1.1 Pre-conditions

- Companies must be engaged in an industry that qualifies under the “automatic route”² activity;
- For listed companies, the transfer must not attract the provisions of Securities and Exchange Board of India (“SEBI”)

(Substantial Acquisition of Shares and Takeovers) Regulations, 1997;

- Post-transfer, the non-resident shareholding must comply with the specified sectoral limits for that industry. For example, foreign equity in basic/cellular/paging activities in Telecom sector should be limited to 49%;
- The transfer/sale price³ must be in accordance with the pricing guidelines prescribed by SEBI/RBI;
- Pre-transfer declaration to Authorised Dealer (AD) banks is advised⁴ and post-transfer compliance is to be completed and documentation is required to be filed with the AD.

It is pertinent to state that the general permission is only under the foreign exchange laws and does not obviate the necessity of other applicable approvals that may apply to a particular transaction, such as SEBI Regulations when the shares relate to those of a listed company and others like Foreign Venture Capital Investor Regulations, 2000, SEBI Insider Trading Regulations, regulations in relation to disclosures and investor protection etc.

1.2 Exceptions

Financial services sector (i.e. Banks, Non-Banking Financial Companies and Insurance), are excluded from the purview of the Circular and will continue to take prior regulatory approvals. Further, NRIs, who have purchased shares under the portfolio investment scheme, are restricted from transferring the shares by way of sale under private arrangement.

¹ Incorporated non-resident entity other than erstwhile Overseas Corporate Body (OCB), foreign nationals, Non Resident Indian (NRI), Foreign Institutional Investor (FII).

² Press Note 2 dated 11th February, 2000 brought all items/activities under the automatic route for FDI/NRI and OCB investment except the activities specifically mentioned in it, e.g. proposals where the foreign collaborator has a previous venture/tie-up in India.

³ As prescribed in paragraph 2 of Annex to Circular

⁴ This is on the basis of information provided by RBI.

2. Benefits of the Amendment

A key benefit of this amendment is the elimination of the excessive time that was taken to secure relevant regulatory approvals involving transfer of shares.

The transfer of shares is a prerequisite in the case of a merger and acquisition (M&A) transaction. Foreign companies looking at expansion in India, either through a joint venture or a wholly owned subsidiary, were often dissuaded or disillusioned by the large paperwork, bureaucracy and red tape involved and were reluctant to consider domestic acquisitions due to the stringent norms. Post due-diligence exercise and an agreement between parties, it generally used to take a minimum of about 45 days for an FIPB approval while about another 15 days for the RBI clearance for a share transfer deal.

With the current liberalization, since the rigours of transfer have been minimized, foreign companies can, without delay, directly transfer shares or subscribe to the fresh issue of shares of Indian companies and have them transferred in their name,

without waiting for any clearances as long as they are not hit by the restrictions. Absence of two important regulatory approvals will, in turn expedite, setting up and/or increasing foreign stake in Indian companies by several weeks.

CONCLUSION

By bringing the transfer of shares between residents and non-residents under the automatic route, the Circular will have a positive impact and should make M&A activity more favorable notwithstanding the fact that this permission is subject to certain conditions.

It is expected that (a) foreign companies will view India both at the tactical and strategic levels; (b) the Circular will trigger and ensure that foreign investment in India will no longer be considered as a short-term strategy needing periodic reviews. Instead, foreign companies will be looking at India from a long-term perspective.

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