INDIA EASES FOREIGN INVESTMENT NORMS IN SINGLE BRAND RETAIL TRADING, CIVIL AVIATION AND OTHER KEY SECTORS

Introduction

On January 10, 2018, the Indian government approved a number of amendments to India's Foreign Direct Investment Policy (the "**FDI Policy**") with a view to further improve the ease of doing business in India. The reforms cover single brand retail trading, civil aviation, construction development, power exchanges and the medical devices sector. In addition, certain approval requirements under the FDI Policy have been eased, and the competent authority for examining foreign direct investment ("**FDI**") proposals from countries of concern (e.g., Pakistan and Bangladesh) has been altered.

This update discusses and critiques the reforms.

Single brand retail trading

Foreign investment in the single brand retail trading sector above 49% was permitted with the prior approval of the government. Now, 100% foreign investment in the single brand retail trading sector is permitted under the automatic route, and no prior approval of the government will be required. This is a welcome change which will reduce time for the foreign investment in this sector and will boost overall investor confidence.

Further, Indian entities engaged in the single brand retail trading sector and having foreign investment above 51% were subject to a mandatory local sourcing requirement (from India) of 30% of the value of the goods purchased, preferably from micro, small and medium enterprises. Now, such Indian entities can set-off their "incremental" requirement against goods produced for the global marker as well as the goods produced for the Indian market for a period of five (5) years from setting-up the first store in India. The mandatory local sourcing requirement has been an impediment ever since the single brand retail trading sector was opened up for foreign investment. High tech gadget brands have expressed concerns on quality issues in locally sourced products and have in the past applied for an exemption from the mandatory local sourcing requirement.

Civil aviation

Currently, foreign airlines are allowed to invest up to 49% with the prior approval of the government in Indian companies in the civil aviation sector to operate scheduled and non-scheduled air transport services. This policy is not applicable to Air India Limited ("**Air India**"), a government owned enterprise. Now, the government has extended this regime to Air India and has permitted foreign airlines to invest up to 49% in Air India with prior approval of the government. This is subject to the requirement of substantial ownership and control vesting in Indian residents. Air India is India's national air-carrier, and is currently heavily debt-ridden and has been facing major losses in the recent years in view of stiff competition from private airlines operating in India. Given this, the Indian government has decided to privatize Air India, and the move to permit foreign airlines to invest in Air India appears to be in furtherance of the government's disinvestment plan and to enable the government to realize a better price for the stake sale of Air India from foreign airlines as compared to domestic airlines.

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Construction development sector

Under the FDI Policy, foreign investment in the real estate business is prohibited. Further, the term "real estate business" has not been clearly defined in the FDI Policy. The FDI Policy only states that "real estate business" does not include development of townships, construction of residential or commercial premises, roads or bridges and Real Estate Investment Trusts ("**REITs**") registered and regulated under the SEBI (REITs) Regulations, 2014. It has now been clarified that real estate broking services will not come under the ambit of "real estate business," and 100% foreign investment will be allowed under the automatic route for real estate broking companies. This move will enable more global real estate broking companies to enter the Indian real estate market either by setting up subsidiaries or by way of joint ventures.

Power exchanges

In the power exchanges sector, up to 49% foreign direct investment in power exchanges registered under the Central Electricity Regulatory Commission (Power Market) Regulations, 2010 is permitted under the automatic route. However, Foreign Portfolio Investors ("**FPIs**") could only invest in this sector through the secondary market. The government has now removed this restriction, thus enabling FPIs to invest in power exchanges through the primary market. This change will enhance investments in the power exchanges sector.

Investment in the medical devices sector

Currently, foreign investment in the pharmaceuticals sector (for which government approval is required beyond 74%) is distinguished from the medical devices sector in which up to 100% foreign investment is permitted without approval of the government. Further, for the purpose of the FDI Policy, the term "medical devices" bears the meaning assigned to it under the Drugs and Cosmetics Act, 1940. The government has decided to remove reference to the Drugs and Cosmetics Act, 1940 from the FDI Policy in connection with the definition of "medical devices" and has proposed to revise the definition of "medical devices." As the official press release does not specify the new definition, we will need to assess the impact of this change once further details are made available.

Certain approval requirements under the FDI Policy done away with

Non-cash consideration for equity shares

Currently, issuance of equity shares against non-cash consideration (such as for pre-incorporation expenses and for the import of machinery) is permitted with the prior approval of the government. Further, a wholly owned subsidiary of a foreign investor can issue equity shares, preference shares, convertible debentures or warrants against pre-incorporation expenses up to 5% of its capital or US$500,000, whichever is less subject to compliance with certain conditions. The government has now decided to allow issue of equity shares against non-cash consideration under the automatic route for sectors which are under the automatic route. This is an important move and will enable foreign

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companies to invest in India against capital goods investments which will benefit the manufacturing sector.

Core Investing Companies

Presently, foreign investment in: (i) an Indian company engaged only in the activity of investing in the capital of other Indian companies or Indian limited liability partnership firms; and (ii) a core investment company, is allowed up to 100% with prior government approval. The government has decided to align this rule with the rules applicable to foreign investment in the financial services sector. Now, for companies regulated by any financial sector regulator, 100% foreign investment will be allowed under the automatic route. For companies not regulated by any financial sector regulator (or where only a part is regulated or there is doubt in relation to the regulatory oversight), the position will remain the same i.e., 100% foreign investment will be allowed only with prior government approval subject to conditions (such as minimum capitalization requirement). These amendments are a welcome step and will further facilitate foreign investment flow into India.

Change in competent authority for examining foreign investment proposals from countries of concern

Foreign investment applications from countries of concern (which include, Pakistan and Bangladesh) require security clearance from the Ministry of Home Affairs, Government of India, for investments coming under the automatic route. For government approval route sectors, security clearance is required from the concerned administrative ministries or departments. Investment applications from these countries under the automatic route sectors will now be processed by the Department of Industrial Policy and Promotion, while the concerned administrative ministries or departments will continue to process investment applications in the government approval route sectors. This change will provide administrative ease for investors from such countries.

Audit firms

The government has decided to introduce a new provision in which if a foreign investor appoints an audit firm which is part of an international network (e.g., a Big-4 firm's Indian affiliate) as the auditor for its Indian investee company or subsidiary, then it will also have to appoint an auditor who is not part of the same international network as a joint auditor of its Indian investee company or subsidiary. Currently, there is no such provision in the FDI Policy, and it appears that this move is protectionist in nature. The purported reason for this addition is to avoid audit frauds in foreign companies' Indian subsidiaries; however, the chances of audit frauds are equally high in Indian companies.

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