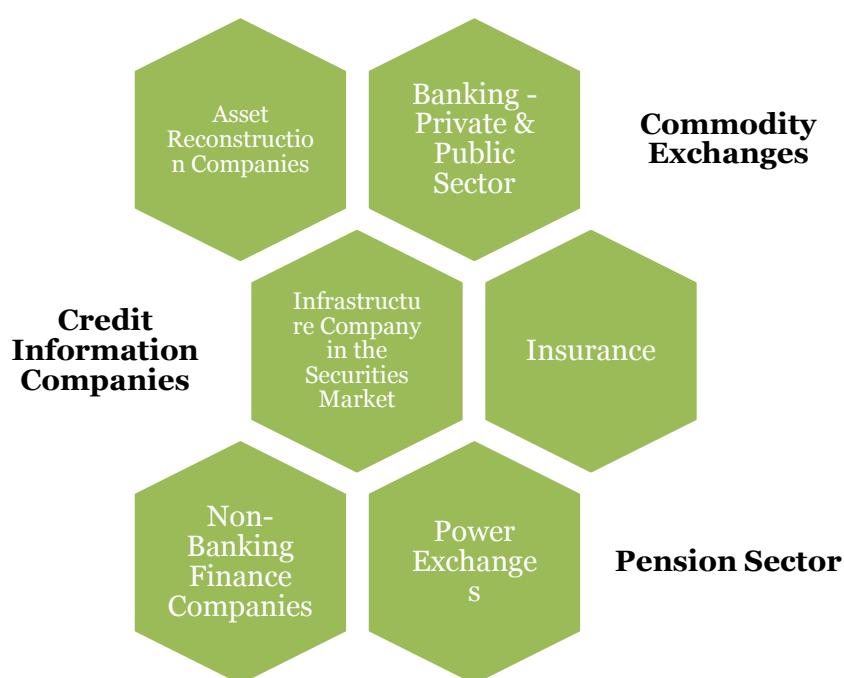


# SAMVĀD: PARTNERS

## RECENT CHANGES TO THE REGULATORY FRAMEWORK ON FOREIGN INVESTMENT IN OTHER FINANCIAL SERVICES

### I. BACKGROUND

- 1.1. Until recently, under the foreign direct investment policy, foreign investment in the following activities in the financial services sector were specifically regulated, each with its own sectoral caps, approval requirements and other conditions:



- 1.2. Within the non-banking finance companies sub-sector mentioned above, subject to certain conditions, 100% (hundred percent) automatic foreign investment was permitted in:

- ❖ 18 (eighteen) specified non-banking finance activities, and
- ❖ White label ATM operations.

- 1.3. The 18 (eighteen) specified non-banking finance activities were:

Merchant Banking	Factoring
Underwriting	Credit Rating Agencies
Portfolio Management Services	Leasing & Finance
Investment Advisory Services	Housing Finance
Financial Consultancy	Forex Broking
Stock Broking	Credit Card Business
Asset Management	Money Changing Business

Venture Capital	Micro Credit
Custodian Services	Rural Credit

## II. REVISED REGULATORY FRAMEWORK

- 2.1. The Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000 (“**FEMA 20**”), which laid down the norms for foreign investment in the financial services sector were recently amended through notification no. FEMA 375/2016-RB dated September 9, 2016.
- 2.2. Coverage: Through the amendment, the above list of 18 (eighteen) non-banking finance company activities has been replaced by allowing up to 100% (hundred percent) automatic foreign investment in “Other Financial Services” i.e. financial services activities regulated by certain financial sector regulators such as:
- ❖ Reserve Bank of India,
  - ❖ Securities and Exchange Board of India,
  - ❖ Insurance Regulatory and Development Authority,
  - ❖ Pension Fund Regulatory and Development Authority,
  - ❖ National Housing Bank, and
  - ❖ Other notified financial sector regulators.
- 2.3. In addition, under the revised regulatory framework, such foreign investment is subject to conditions (including minimum capitalization requirements) specified by the concerned regulator.
- 2.4. Exclusions: With respect to financial service activities that are unregulated or that are partly regulated by a financial sector regulator or where there is a lack of clarity regarding regulatory oversight, foreign investment is permitted up to 100% (hundred percent) under the government approval route, subject to conditions including minimum capitalization requirements that may be imposed by the government.
- 2.5. With respect to activities that are regulated by a statute, foreign investment in entities engaged in such activities will be restricted to the foreign investment limits specified in such statute, if any. Further, under the revised regulatory framework, downstream investments will need to comply with the provisions of FEMA 20.

## III. ANALYSIS

- 3.1. The recent changes give the government and regulators great discretionary power to determine whether financial service activities are unregulated, partly regulated or if there exists a lack of clarity regarding regulatory oversight. As technology advances and the financial services industry matures, with newer and more complicated business models being adopted, determining the extent of regulation of an activity by regulators may become increasingly difficult.
- 3.2. Whether or not the recent changes are investment friendly, would depend on the manner in which the government and regulators exercise their discretion and the extent to which they decide to bring business models under the approval route, potentially depriving businesses the advantage of the general permission for

100% (hundred percent) automatic foreign investment available under the foreign direct investment policy for activities not specifically covered by it.

- 3.3. Another cause for concern under the revised regime is that if the government determines that an investment would fall under the approval route, it has the further discretion to determine the conditions on which it may go through and the discretion to determine minimum capitalization requirements. The revised framework leaves the door open for great uncertainty that has the potential to lead to complications in deals at a late stage if such conditions and minimum capitalization requirements are perceived as onerous.
- 3.4. Only time will provide a clear picture of the net impact that the recent changes will have on foreign investment in the financial services sector, largely depending on the approach taken by the government and regulators going forward.

***\*This is an update for general information purposes only and does not constitute legal advice. Please contact us if you require further clarifications on this subject.***

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