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DIPP amends FDI policy on options in equity instruments by deleting Clause 3.3.2.1

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Reacting to the strong disapproval from the industry, the Department of Industrial Policy and Promotion (DIPP) recently amended the New FDI Policy by deleting the contentious Clause 3.3.2.1 of the Policy within thirty days of its introduction. The decision to scrap the clause was taken by the DIPP following strong opposition from all the sectors over the severe implications of such a provision on legitimate foreign investments in India.

The amendment which was made by way of a corrigendum on October 31, came as a great relief for many. As by the introduction of a new clause under Chapter 3 (General Conditions on FDI) of the New FDI Policy, DIPP had restricted the exit avenues that may be available to a foreign direct investor.

According to Dr Gopakumar G Nair, intellectual property and patent and trade mark attorney, the real strength of India over the years have been a strong autonomous and non-corrupt RBI. RBI having objected to the inclusion of such bar on options as in the Clause 3.3.2.1, thus the DIPP is justified in deleting this clause.

He added that most of the global economic bastions of the west, showing serious weaknesses and even default, India and Indian investment options are bound to receive increasing attention. “While India should not panic or be unduly perturbed over M&A trend and related activities in pharma sector, the government through its respective ministries and departments, need to provide reassurance to the Indian pharma entrepreneurs that they will not be pushed into the MNC fold or compelled to sell-out to the global giants by the government's direct or indirect onslaughts or negative mindsets and actions towards the Indian pharma industry's legitimate rights to protect the interests of their stakeholders,” Dr Nair said.

According to the deleted Clause of 3.3.2.1 of the new FDI Policy only equity shares, fully, compulsorily and mandatorily convertible debentures and fully, compulsorily and mandatorily convertible preference shares, with no in-built options of any type, would qualify as eligible instruments for FDI.

Whereas, the equity instruments issued/transferred to non-residents having in-built options or supported by options sold by third parties would lose their equity character and such instruments would have to comply with the extant external commercial borrowing (ECB) guidelines.

According to reports from the Nishith Desai Associates, “The deleted provision had the effect to nullifying the equity character of an equity instrument when such instrument was issued or transferred with an in-built optionality. Having lost their equity character, such instruments were required to comply with the extant ECB regulations which was expected to create a regulatory chaos.

However they also warned that though deletion of Clause 3.3.2.1 has partially mitigated the risks arising out of options attached to equity securities issued to a foreign investor, considering RBI’s approach in the past, there is a clear need for the investor to carefully weigh its reliance on such options as an exit mechanism in light of the risks of enforceability of such provisions.