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LIBERALIZATION OF FDI NORMS IN THE FINANCIAL SECTOR

Government of India has so far succeeded in building a favorable platform to attract overseas investments in India by liberalizing the FDI norms over the year 2016 in several sectors such as manufacturing, defense, e-commerce, civil aviation etc.

FDI under Automatic Route:

In line with the Government's initiative to relax the FDI norms in India, the Reserve Bank of India (RBI) has, vide a notification dated October 20, 2016 ('Notification'), allowed FDI of upto 100% in 'Other Financial Services' under the automatic route. 'Other Financial Services' include activities which are regulated by any financial sector regulator such as RBI, Securities and Exchange Board of India (SEBI), Insurance Regulatory and Development Authority (IRDA), Pension Fund Regulatory and Development Authority (PFRDA), National Housing Bank, or any other financial sector regulatory authority as may be notified by the Government of India.

The said Notification provides that such foreign investment would be subject to conditionalities, including minimum capitalization norms, as specified by the concerned Regulator/Government Agency. Further, downstream investment by any entity engaged in 'Other Financial Services' will be subject to extant sectoral regulations and provisions of the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000.

FDI under Approval Route:

The Notification also sets out that foreign investment will be allowed up to 100% under the Government approval route in financial services activities which are not regulated or partly regulated by any financial sector regulator or where there is lack of clarity regarding regulatory oversight. Further, foreign investment in an activity which is specifically regulated by an Act, is to be restricted to foreign investment levels/limits, if any, specified in that Act.

Elimination of the Minimum Capitalization Norms:

Prior to the said Notification, FDI upto 100% under the automatic route was allowed in only 18 (eighteen) specified NBFC activities. Foreign investment in any of the said 18 NBFC's was subject to certain minimum capitalization norms prescribed by the concerned regulator (dealt with below) as well as certain other additional capitalization related conditionalities prescribed by the RBI being met.

The additional capitalization related conditionalities pertaining to the 18 NBFC activities prescribed by the RBI, that has now been done away with included the requirement of bringing US $ 0.5 million upfront for FDI up to 51%, bringing US $ 5 million for FDI more than 51% and up to 75%, and US $ 50 million for FDI more than 75% out of which US $ 7.5 million was to be brought upfront and the balance within 24 months for fund based NBFCs. For non-fund based activities classified as Investment Advisory Services, Financial Consultancy, Forex Broking, Money Changing Business and Credit Rating Agencies, US $ 0.5 million was to be brought upfront regardless of the level of FDI provided such an entity engaged in non-fund based financial activities did not set up a subsidiary for any other activity(ies) or participate in any equity of an NBFC holding company.

Pursuant to the Notification, FDI in any of the said 18 listed NBFC activities would have to now meet with the concerned regulator prescribed conditions and minimum capitalization requirements. For instance (a) services such as Micro Credit, Rural Credit, Money Changing Business, Leasing and Finance, Credit Card Business, which are regulated by the RBI, the conditionalities would be to have a capital adequacy of INR 20 million, however for Factoring Services the requirement is that of a minimum net owned fund of INR 50 million; (b) services regulated by SEBI would have norms such as (i) Merchant Banking and Credit Rating Agencies – minimum networth of INR 50 million; (ii)

Underwriting – minimum networth of INR 2 million; (iii) Portfolio Management Services – minimum networth of INR 20 million; (iv) Investment Advisory Services and Financial Consultancy Services – minimum networth of INR 2.5 million; (v) Custodian Services – minimum networth of INR 500 million; (vi) Asset Management Companies – minimum networth of INR 500 million; (vii) Venture Capital – minimum capitalization requirement of INR 10 million; and (c) for Housing Finance which is regulated by National Housing Bank, the condition would be that the capital adequacy of its Tier I Capital and Tier II Capital should not be less than 12% of aggregate risk weighted average and the total of the Tier II Capital should not exceed 100% of Tier I Capital.

Way Ahead:

The amendment brought about under the Notification is a step in the right direction as it has clarified the position on FDI in other financial services activities that were not included in the list of 18 NBFC activities, for example commodity broking, asset finance companies, infrastructure debt funds, depository participants, etc.

Further, elimination of minimum capitalization requirements under FDI Policy should boost FDI inflow in entities engaged in financial services since FDI in such entities would now be subject to the conditionalities and minimum capitalization norms predetermined by the concerned regulator(s) which will be comparatively lower and less stringent than the minimum capitalization norms under the extant FDI Policy.

However, there is a lack of clarity as to whether the aforesaid amendment will have a retrospective effect. Prior to the Notification, the defined 18 NBFCs were required to comply with the minimum capitalization requirement of USD 50 million for foreign capital more than 75% out of which USD 7.5 million was required to be brought upfront and the balance amount within a period of 2 years. Thus, considering the said requirement of raising balance capital within 2 years, it is unclear whether the said current amendment will retrospectively be applicable to such NBFCs which have raised foreign capital of more than 75% within last 2 years and are yet to complete the requirement of raising the balance capital.