# FEMA Seminar
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Topic 1

# NDI RULES : A GREY AREA IN EQUITY SWAPS

# FACTUAL BACKGROUND

1. Indian Co. entered in to an Equity Swap Agreement with a US Co. in FY 2023-24.

FDI Leg of Swap: Issue of Equity shares of Indian Company to US Co.

ODI Leg of Swap: Issue of Equity shares of US company to Indian Co.

# REPORTING

- For FDI Leg : Filing of FC-GPR Return in RBI's FIRMS Portal
- For ODI Leg : Physical filing of Form FC with the designated AD Bank

The 2 Equity Issues gave rise to a FEMA issue

# Interpretation of ‘Equity Instrument’

The case turned on the Interpretation of ‘Equity Instrument’ in the NDI Rules

R. 2 (k) of NDI Rules: ‘Equity Instruments’ means equity shares, convertible debentures, preference shares and share warrants issued **by an <u>Indian company</u>** ( *emphasis mine*)

# Interpretation of ‘Equity Instrument’….contd

Equity swap permitted u/para 1(d) (i)of Schedule I to NDI Rules:
as it stood prior to amendment by FEM (NDI) (Fourth Amendment ) Rules,2024 wef. 16 August 2024

# 1 (d) (i) of Sch.I as it stood before 16 Aug 2024.

An Indian company may issue, subject to compliance with the rules prescribed by the Central Government and the regulations specified by the Reserve Bank from time to time, equity instruments to a person resident outside India against :

**(i) Swap of equity instruments** or

(ii) Import of capital goods or machinery or equipment excluding second hands .....

(iii) Pre operative or pre- incorporation expenses .....

# Rejection Comment on FC- GPR by Bank /RBI in FIRMS Portal

1. ` As per R. 2(k), EQUITY INSTRUMENT means “SHARES/ DEBENTURES/ WARRANTS issued **by an Indian company”.**
2. Para 1 (d) (i) of Schedule I I says an Indian company may issue “equity instruments” to a PROI against “swap of equity instruments” Hence the PROI also must issue shares of an Indian Co.

# The Conundrum

- How can a PROI ( a foreign company) issue the shares of an Indian co., just because NDI Rules define “equity instruments’ as share issued by an Indian Co.?

# My Arguments

1. The entire scheme of the NDI Rules is to permit and regulate ONLY INBOUND INVESTMENTS – FDI,FPI, NRI /OCI, VC & other NR Investments in securities & IP

**No OUTBOUND Investment is covered by NDI Rules** .

2. How can a PROI issue an Indian Co's shares ?

3. Even if it could be done, the ODI Leg of the Swap will then be reduced to a domestic Transaction.

# To Reconcile

**A harmonious interpretation** to reconcile these contradictions can be the following :

A] the first time " equity instrument" occurs in Para 1 (d ) ( i) the FDI Leg is indicated, whereby the Indian Company issues its shares to the PROI:

[ defined as "equity instruments" vide R .2 (k)]

# To Reconcile .....contd

B] The second time “equity instrument” occurs in Para 1 (d ) ( i ) in the context of Swap, **the definition u/s 2 (k) should not be applied.** This time, it should be understood in the generic sense, I e, shares of the foreign co. issued by the “PROI’ to the Indian co. This will complete **the ODI Leg of the Swap**.

# The definition in R. 2 (k) is not absolute

- R. 2 begins with the caveat, “In these Rules, *unless the context otherwise requires”*
- Indeed the context here does require otherwise, when it comes to the ODI Leg of Swap.

**I am glad to say that my reasoning was accepted by RBI.**

# The Latest

- The NDI ( Fourth Amendment) Rules, 2024 substituted sub –para (d) of Para 1 of Sch.I with a new sub-para (d).
- **No attempt was made to clarify that equity instrument means 2 different things in R.2 (k) and in Para 1 (d) (i).**
- Instead, a new sub-clause (iv) was appended to sub-para (d) to the effect that “equity instruments” may be issued by an “Indian company against **Swap of Equity Capital of a Foreign Company** in compliance with the FEM ( Overseas Investment) Rules, 2022.

# To Sum up

- To sum up, the lacuna/ anomaly survives, but nonetheless, swap agreements can now be put through without the foreign company having to issue an Indian Co.'s shares, or having to seek prior approval of RBI for the swap agreement.

Thank you !