Big money and easing target foreign investors

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Among the various factors which have contributed to the Indian growth story, infusion of funds from foreign investors would rank near the top. To fulfil the country's much-touted potential as an economic superpower in the years to come, regulatory focus in the recent past has been on streamlining the procedure for such inflows.

A strong motivation for such reform is the need to finance large-scale infrastructure projects. The government intends to invest US$1,000 billion during the Twelfth Five-Year Plan (2012-2017), with half of that amount expected to be financed by the private sector.

A slew of reforms liberalizing regulations pertaining to investment in the infrastructure sector by foreign players have been introduced. Among them is a five-fold increase of the investment limit for foreign institutional investors (FIIs) in non-convertible debentures (NCDs) and bonds issued by Indian companies in the infrastructure sector – from US$5 billion to US$25 billion.

More recently, persons defined as qualified foreign investors were allowed to invest up to US$3 billion in units of mutual fund debt schemes, within the ceiling mentioned above.

Sweetening the pot

However, because this class of investments entailed certain onerous conditions, such as a minimum residual maturity requirement of five years and a lock-in of investment for a period of three years, the response from FIIs had been lukewarm. To remedy this, the Reserve Bank of India (RBI) on 3 November issued a circular altering the requirement of residual maturity so as to permit investment in an instrument with an original maturity period of five years.

This measure will bring the bonds in closer alignment with FIIs' penchant for papers with a short tenor. The duration of the lock-in period for the investment, which was a major deterrent, has been slashed to one year, which is expected to be welcomed by the foreign investor community at large.

The circular further permits FIIs that fall within the limits of the overall investment ceiling to invest in bonds and NCDs issued by companies categorized as infrastructure finance companies by the RBI. It is hoped that providing a greater range of investment options will pique the interest of FIIs.

Big brother not watching

The procedural requirement of obtaining the RBI's prior approval in respect of share transfers through the foreign direct investment (FDI) route, stipulated by the Foreign Exchange Management Act, 1999 (FEMA), and its supporting regulatory framework, has been eased in another RBI circular, released on 4 November.

In the case of share transfers, the RBI sought to resolve the prevailing uncertainty over which set of regulations is required to be followed in the event of conflict between pricing norms under FEMA and the Securities and Exchange Board of India (SEBI) framework. This circular has clarified that prior approval of the RBI will no longer be required for transfers between residents and non-residents which are not in line with FEMA pricing guidelines, provided that SEBI pricing guidelines are adhered to.

This waiver of the need for prior approval is also subject to fulfilment of various conditions, which include compliance with FDI policy and filing of required forms with the authorized dealer (AD) bank, along with a compliance certificate issued by a chartered accountant.

Another category of share transfers which can enjoy the exemption from the RBI's prior approval are share transfers by companies in the financial sector. Transactions involving such transfers need to fulfil certain requirements, including compliance with sectoral caps and other conditions stated under FEMA and FDI policy. In addition, a "no-objection" certificate in respect of the proposed transaction must be obtained from the sectoral regulator concerned.

Besides simplifying share transfers under the FDI route through eliminating the multiplicity of approvals, the RBI seems to be inclined to move towards a trust-based system of self-regulation by progressively placing the onus of compliance on AD banks.

Keeping options open

In a move that will be greeted with a collective sigh of relief by the foreign investor community, the Department of Industrial Policy and Promotion, in a clarification to its recently released consolidated FDI policy, has deleted the contentious paragraph which outlawed, from the ambit of FDI, any instrument with in-built options.

This clause would have had the effect of prohibiting foreign investors from availing of any options, which currently are widely used in investment agreements.

With its unceremonious burial, it is hoped that investor sentiment will regain its buoyancy as manifested by resurgent FDI inflows.

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