Report of the Dr Arvind Mayaram Committee
On rationalizing the FDI / FII Definition

Ministry of Finance
Department of Economic Affairs
June 2014
**Background**

1. While presenting the Union Budget for 2013-14, the Finance Minister announced as follows:

   “In order to remove the ambiguity that prevails on what is Foreign Direct Investment (FDI) and what is Foreign Institutional Investment (FII), I propose to follow the international practice and lay down a broad principle that, where an investor has a stake of 10 percent or less in a company, it will be treated as FII and, where an investor has a stake of more than 10 percent, it will be treated as FDI. A committee will be constituted to examine the application of the principle and to work out the details expeditiously.”

2. Pursuant to the announcement, a Committee was constituted by Government of India under the Chairmanship of Dr. Arvind Mayaram, Secretary DEA, Ministry of Finance to implement the announcement made by the Hon’ble Finance Minister. A copy of the order constituting the Committee and the terms of reference is placed at Annex 1.
Methodology

3. The Committee held 4 meetings viz. on April 4, 2013, July 26, 2013, November 12, 2013 and January 9, 2014. In view of the sensitivity and special significance of NRIs as a class of investors, and the fact that this is the only class of investors which can also undertake non-repatriable investments, it was decided that the issues involving investments made by NRIs would be looked into separately. In addition to the above meetings, discussions were held by the Secretary (EA) with DG RBI, SEBI and DIPP on various aspects including the sectoral caps in different sectors. The proposals to liberalise sectoral caps in some sectors has been separately carried forward by DIPP, duly approved by the appropriate authority and placed in the public domain as Press Note 6 of 2013. In parallel, based on the recommendations of the SEBI constituted Chandrashekhar Committee, the Foreign Portfolio Regulations have been notified on January 7, 2014.
**Conceptual Framework**

4. The available literature on the subject was studied and the following conceptual framework was adopted for framing the recommendations.

4.1 Foreign Direct investment (FDI) is characterised by

- A lasting interest i.e. existence of a **long term relationship**, **significant degree of influence**. Normally, ownership of **10 percent or more of the ordinary shares OR voting power** signifies this relationship.
- Involves both **initial and subsequent transactions**

4.2 Portfolio Investment (FPIs and NRIs in our context) is characterised by

- Portfolio investment is **distinctive** because of the **nature of the funds raised**, the **largely anonymous relationship** between the issuers and holders, and the **degree of trading liquidity** in the instruments
- It covers, but is not limited to **securities traded on organized or other financial markets**.
Foreign Portfolio Investment (FPI)

Recommendations

5. The following are the recommendations:

5.1 The various forms of portfolio investments have been merged under the definition of Foreign Portfolio Investment (FPI) and investor classes presently regulated as FIIs and QFIIs are also included in these.

5.2 Any investment by way of equity shares, compulsorily convertible preference shares/debentures less than 10 percent of the post-issue paid up equity capital of a company or less than 10 percent of the post-issue paid up value of each series of convertible debentures of a listed / to be listed Indian investee company by eligible foreign investors shall be treated as Foreign Portfolio Investment (FPI).

5.3 Investments by foreign investors under private placement /arrangement less than 10 percent of post issue paid up capital shall be treated as FPI. This would be subject to the transaction being undertaken at a price determined according to the SEBI (ICDR) Regulations.

5.4 Regulatory framework for investment by NRIs is proposed to be reviewed later in tune with definition of Overseas Citizenship Scheme.

5.5 Necessary checks and balances need to be placed to ensure that the Foreign Portfolio Investors do not act in concert or a single FPI investor does not
circumvent the regulatory framework by splitting the investment or by acting in concert with others. This will need to be specifically ensured in the SEBI Regulatory framework for FPIs. In particular, FPI will be subject to the prevailing SEBI (SAST) Regulations.

5.6 The monitoring of the individual FPI limit of less than 10 percent will be done as hitherto by SEBI. The compliance with the FPI aggregate limit is as of now being done by RBI based on the reports of daily transactions of the FPIs (FIIs earlier) by their respective custodians, and this will continue.

5.7 Further, the onus of adherence to the aggregate FPI limit will also be cast on the Investee Company which can be asked to get the compliance to the foreign investment limit verified by the Statutory Auditor on a half-yearly basis and in case of non-compliance bring such instances of non-compliance to the notice of RBI.
Foreign Direct Investment (FDI)

Recommendations

6. The following are the recommendations:

6.1 Foreign investment of 10 percent or more through eligible instruments made in an Indian listed company would be treated as FDI. All existing foreign investments below the threshold limit made under the FDI Route shall however, continue to be treated as FDI.

6.2 An investor may be allowed to invest below the 10 percent threshold and this can be treated as FDI subject to the condition that the FDI stake is raised to 10 percent or beyond within one year from the date of the first purchase. The obligation to do so will fall on the company. If the stake is not raised to 10% or above, then the investment shall be treated as portfolio investment.

6.3 In case an existing FDI falls to a level below 10 percent, it can continue to be treated as FDI without an obligation to restore it to 10% or more, as the original investment was an FDI.

6.4 Foreign Investment in an unlisted company irrespective of threshold limit may be treated as FDI.

6.5 In a particular company, an investor can hold the investments either under the FPI route or under the FDI route, but not both.
Other recommendations

Foreign Venture Capital Investors

7. There are two basic issues with FVCI investments. Firstly, it is the nature of activities eligible for FVCI investment. RBI has been currently restricting FVCI investors to invest in 10 sectors and has also proposed to the Government to enhance this to 13 sectors. The origin of this restriction is nebulous as it does not figure in the SEBI (FVCI) Regulations and also is not mandated in the FEMA 20 Schedule 6. This seems to have crept into practice when the tax pass through status in the Income Tax for the domestic venture capital Funds was restricted to 9 sectors in the Budget of 2009. This has since been modified in 2013 and therefore the restriction is without any basis and there is a need for a relook. The second issue is of exemption from pricing guidelines on exit of FVCI investors. FVCI investors in essence are FDI investors and in fact indistinguishable but for the nomenclature. The exemption from pricing guidelines therefore needs justification to avoid arbitrage on this count. A separate team of SEBI, RBI and DEA can look into all the aspects of FVCI investment and rationalise the same.
Other recommendations

NRI Investors

8. This set of investors has a special place in the foreign investment regime since NRI funds flow even through deposits and remittances. Special privileges are also available to NRIs in terms of the Overseas Citizenship Act and the provision to make ‘non-repatriable’ investments under Schedule 4 of FEMA 20. This position would remain and following measures may be explored to reinforce the same:

8.1 There is a case for treating ‘non-repatriable’ investment as ‘domestic’ and exempting it from FDI related conditions. The present reporting system of such transactions is not very robust, but it can be strengthened by RBI.

8.2 NRIs have set up large businesses abroad and may prefer investing through corporate entities. Overseas Corporate Bodies was one such vehicle, but for various reasons, that has been derecognised in late 2003. With suitable safeguards and checks, this can be revived in a different form and NRI investments enhanced.
Conclusion

9. It should be the endeavour to simplify the classification of foreign investment and enable basically two classes of foreign investors in the long run viz. Portfolio Investors and FDI Investors, and at best carve outs therein for NRIs, in view of their special status.
Committee for rationalizing the definition of FDI and FII

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<th>S. No</th>
<th>Name</th>
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<tr>
<td>1</td>
<td>Dr. Arvind Mayaram</td>
<td>Secretary, DEA</td>
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<td>Chairman</td>
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<td>2</td>
<td>Shri Saurabh Chandra</td>
<td>Secretary, DIPP</td>
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<td>3</td>
<td>Shri H. R. Khan</td>
<td>Dy. Governor, RBI</td>
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<td>Shri S. Raman</td>
<td>WT Member, SEBI</td>
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<td>Shri I.S. Bains</td>
<td>Joint Secretary, MOIA</td>
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<td>Smt Pragya S. Saksena</td>
<td>Joint Secretary, D/o Revenue</td>
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<td>7</td>
<td>Shri P K. Mishra</td>
<td>Joint Secretary, D/o Economic Affairs</td>
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Notes:
1. The post of CEA has been lying vacant
2. Dr K P Krishnan AS EA attended the last two meetings by invitation.
OFFICE MEMORANDUM

Subject: Constitution of the Committee for rationalizing the definition of FDI and FII- reg.

Following has been announced in the Budget Speech 2013-14 [Para 95]:

“In order to remove the ambiguity that prevails on what is Foreign Direct Investment (FDI) and what is Foreign Institutional Investment (FII), I propose to follow the international practice and lay down a broad principle that, where an investor has a stake of 10 percent or less in a company, it will be treated as FII and, where an investor has a stake of more than 10 percent, it will be treated as FDI. A committee will be constituted to examine the application of the principle and to work out the details expeditiously.”

2. In accordance with the budget announcement, a committee is hereby constituted, to examine and work out the details of the application of the principle followed internationally for defining FDI and FII, as indicated below:

a. Secretary, Department of Economic Affairs - Chairperson
b. Secretary, DIPP - Member
c. Chief Economic Advisor, DEA - Member
d. Mr. H. R. Khan, Dy. Governor, RBI - Member
e. Mr. S. Raman, Member SEBI - Member
f. Joint Secretary, Department of Revenue - Member
g. Joint Secretary, Ministry of Overseas Indian Affairs - Member
h. Joint Secretary (Investment) D/o Economic Affairs - Member Secretary

3. This issues with the approval of the Finance Minister.

(G.K. Sinha)
Under Secretary to the Government of India
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...Contd/-2
Copy to:
1. Sh. Saurabh Chandra, Secretary, DIPP, Udyog Bhawan, New Delhi
2. Sh. Raghuram G. Rajan, Chief Economic Advisor, DEA, North Block, New Delhi.
3. Mr. H. R. Khan, Dy. Governor, RBI, Mumbai.
4. Mr. S. Raman, Member SEBI, Mumbai.
5. Joint Secretary, Department of Revenue, North Block, New Delhi.
6. Joint Secretary, Ministry of Overseas Indian Affairs, Akbar Bhawan, Chanakyapuri, New Delhi.