



CODIFICATION OF DEBT AND NON- DEBT INSTRUMENTS

INTRODUCTION: Pursuant to the Foreign Exchange Management Act, 1999 (“Act”), the following notifications (“Notifications”) have been issued:

Notifications issued by Central Government:

- ▲ Codification of Debt and Non-debt Instruments dated 16th October 2019.
- ▲ Foreign Exchange Management (Non-debt Instruments) Rules, 2019 dated 17th October 2019.

Notifications dated 17th October 2019 issued by Reserve Bank of India (“RBI”):

- ▲ Foreign Exchange Management (Debt Instruments) Regulations, 2019.
- ▲ Foreign Exchange Management (Mode of Payment and Reporting of Non-debt Instruments) Regulations, 2019.
- In accordance with the Finance Act, 2015 and the above amendments:
 - (i) Central Government is empowered to determine the debt instruments under the Act;
 - (ii) RBI will govern the capital account transactions, involving debt instruments; and
 - (iii) Central Government will govern the capital account transactions, not involving debt instruments.
- Pursuant to the said amendments, the Central Government and RBI have issued Notifications which will supersede all the regulations issued by the respective authorities with respect to foreign investment in India and external commercial borrowings.

SUMMARY AND IMPACT OF NOTIFICATIONS:

- In accordance with the Notification dated 16th October 2019, certain instruments have been identified as debt and non-debt instruments. Further, the Notification dated 16th October 2019 specifically states that any instrument which has not been specifically identified as either a debt or a non-debt instrument shall be *deemed to be a debt instrument*.

- **IMPACT:** It is pertinent to note that only those non-debt instruments specifically provided for, shall be governed by the Central Government and in all other cases, only RBI will have jurisdiction to govern the issue and allied matters with respect to such instrument/s.
- Various modern instruments which diverged from the conventional nature such as SAFE (Simple Agreement for Future Equity), were not governed specifically by any provision under the Act prior to the Notification dated 16th October 2019. This enabled the subscribers and issuers of such instruments to follow such valuation or pricing guidelines which may not be in conformity with the regulations on FDI issued by RBI prior to the said Notifications. This is deterrent to the foreign investors who have proposed to enter the Indian market through modern instruments, which provide certain benefits they intend to capitalize on.
- Foreign Exchange Management (Debt Instruments) Regulations, 2019 permits only (i) Foreign Portfolio Investors; (ii) Non-resident Indians (NRIs) or Overseas Citizens of India (OCIs) (on repatriation and non-repatriation basis); and (iii) Foreign Central Banks or a Multilateral Development Bank (for purchase of Government Securities) to invest in the debt instruments issued by a person resident in India.
- Therefore, while the Notification dated 16th October 2019 does not expressly restrict the issue of any instruments other than those identified in the said Notification and only categorise them as debt instruments irrespective of their nature, by virtue of the Foreign Exchange Management (Debt Instruments) Regulations, 2019, any such issue will require prior approval of RBI.

Foreign Exchange Management (Non-debt Instruments) Rules, 2019

- ▲ **MUTUAL FUNDS:** Mutual Funds which invest more than 50% in Equity Instruments and are governed by



the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996 have been included as an ‘investment vehicle’ under the Foreign Exchange Management (Non-debt Instruments) Rules, 2019.

- **IMPACT:** Under Rule 23 (7) (i) (B) of the Foreign Exchange Management (Non-debt Instruments) Rules, 2019, an investment by an ‘investment vehicle’ shall be deemed to be ‘indirect foreign investment’ if the Sponsor or the Manager or the Investment Manager: (i) is not owned and not controlled by resident Indian citizens or (ii) is owned or controlled by persons resident outside India.
- This implies that all the restrictions on foreign investment, including sectoral caps are applicable to the mutual funds satisfying the aforesaid criteria. This would compel various mutual funds to sell off their investments to ensure compliance of the sectoral caps.
- ▲ **VALIDITY OF ISSUE OR TRANSFER:** Rule 4 of Foreign Exchange Management (Non-debt Instruments) Rules, 2019 lays down an obligation has been placed on the Indian entity or an investment vehicle, or a venture capital fund or a firm or an association of persons or a proprietary concern to not receive any investment in India from a person resident outside India or record such investment in its books unless the same has been permitted by RBI in consultation of Central Government and in accordance with the aforesaid Rules.
- ▲ **IMPACT:** The language used in the provision ‘record such investment in its books’ is general and creates ambiguity since there is a restriction placed on the company to not record an issue/ transfer of non-debt instruments unless all the necessary conditions including the reporting requirements have been satisfied and the filings have been approved by the concerned authority/ies.

[Foreign Exchange Management \(Debt Instruments\) Regulations, 2019](#)

- ▲ Foreign Portfolio Investors (“**FPIs**”) are permitted to invest in the following which are deemed to be debt instruments on repatriation basis while they were earlier designated as ‘instruments other than capital instruments’:

 - Commercial Papers (“**CPs**”) issued by an Indian Company: *It is pertinent to note that the erstwhile regulations issued by RBI on foreign investment (“**Erstwhile Regulations**”) state that FPIs are not to be allowed to make any further investment in CPs after 3rd February 2015.*
 - Units of domestic mutual funds or Exchange-Traded Funds (“**ETFs**”) which invest less than or equal to fifty percent in equity.
 - Other Instruments, *namely*, Debt instruments issued by banks, eligible for inclusion in regulatory capital and Municipal bonds: *These were not expressly permitted earlier for investment by FPI under the Erstwhile Regulations.*
 - Security Receipts (“**SRs**”) issued by Asset Reconstruction Companies: *The Erstwhile Regulations contained provisions with respect to limit of investment in each tranche and in case of unlisted corporate debt securities, securitised debt instruments and residual maturity.*

CONCLUSION

- ▲ While the prescription of Notifications is primarily for the purpose of segregating the jurisdiction between Central Government and RBI for governing different forms of foreign investment, certain amendments made to the Erstwhile Regulations and the FDI policy have not been taken into consideration. For instance, the Foreign Exchange Management (Non-debt Instruments) Rules, 2019, has not taken into consideration, the



amendments made to the FDI policy with respect to (i) permitting 100% investment through automatic route in single brand retail trading; (ii) Coal mining, which were effective from 28th August 2017.

- ▲ Although all the reforms made including the issue of Notifications has been propagated in the interest of ease of doing business, during the transition

period, additional burden could be inflicted on the business which, especially in case of foreign investments has a long term impact.

MARADU FLATS JUDGMENT –A LESSON FOR TRANSGRESSORS

OVERVIEW

- ▲ Alfa Ventures Private Limited and other builders constructed high rise residential apartment buildings (“**Residential Apartments**”) during 2006 in Maradu Panchayat, Kerala. The builders constructed the Residential Apartments after obtaining necessary permission from Maradu Panchayat, issued in accordance with the Kerala Municipal Building Rules, 1999. Violation of Coastal Regulation Zone Act was detected in the construction of the Residential Apartments at Maradu by the Senior Town Planner, Vigilance Wing during their inspection to Maradu Panchayat. The Principal Secretary directed Maradu Panchayat to revoke the building permit granted for construction of the Residential Apartments. Pursuant to which, Maradu Panchayat issued Show Cause Notice to the concerned builders to remove the buildings which were falling within the prohibited area of Coastal Regulation Zone (“**CRZ**”) Category.
- ▲ The builders filed Writ Petition before the Learned Kerala High Court and prayed for quashing the Show Cause Notice. The Learned High Court ruled in favour of the builders on various ground which *inter alia* included that the said land fell under CRZ II, as per the Coastal Zone Management Plan (“**CZMP**”) prepared in 2011, where construction was permissible. Subsequently Maradu Municipality filed a Writ Appeal before the Kerala High Court against

the Impugned Judgment and the same was dismissed by the Kerala High Court. Kerala Coastal Zone Management Authority (“**KCZMA**”) aggrieved by the order of the Learned High Court filed a Review Petition against the dismissal of the Writ Appeal and the same was also dismissed. The KCZMA filed a Special Leave Petition before the Hon’ble Supreme Court and the Learned Supreme Court constituted a three (3) member Committee to hear the affected parties and prepare a report regarding the legality of the construction of the Residential Apartments.

CLASSIFICATION OF MARADU PANCHAYAT

- ▲ Coastal Zone Management Authority had issued notifications classifying land near the water bodies as CRZ I, CRZ II, CRZ III and CRZ IV. The CZMP was prepared based on CRZ Notification dated 19th February 1991 and as per the CZMP issued during the year 1991, Maradu Panchayat area fell within CRZ – III that indicates the area of 200 meters from the High Tide Line, where no construction was permitted. Thereafter, Maradu Panchayat was upgraded into Maradu Municipality in the year 2010.
- ▲ Pursuant to the issuance of the CRZ Notification in the year 2011, revised CZMP was prepared and as per the same, Maradu municipality fell within the Greater Cochin Development Area and the same was classified as CRZ– II, where construction is allowed.



- ▲ The Supreme Court was of the view, that this is a case of apparent violations on part of the builders, as the construction was objected by the relevant government authority even during the construction of the Residential Apartments. Despite the objections the builders continued to construct on the land classified as CRZ-III, which was a no development zone and no construction was permitted therein. Subsequently, the Court also reiterated that the local authority has granted permission to construct the Residential Apartments without the concurrence of KCZMA and the same was inconsistent with the restrictions laid down under Rule 23 (4) of the Kerala Building Rules 1999. The Supreme Court held that the construction was wholly impermissible and unauthorized as the area fell within CRZ – III and the construction was within prohibited area.
- ▲ The Supreme Court following the report submitted by the three (3) member Enquiry Committee held that the permission granted by the Maradu Panchayat was illegal and void. It ordered for the demolition of the five (5) Residential Apartments within one (1) month from the date of judgment.
- ▲ The above ruling was pronounced to give protection to the environment and the vision of the Supreme Court in this matter has been to curb the violations that may lead to man-made disasters.
- ▲ The impact of the ruling is on flat owners, whose livelihood and life time investment became a question although the Supreme Court with a view to consider the plight of the flat owners, passed an interim order ordering payment of Rs. 25,00,000.00 (Rupees Twenty-Five Lakhs Only) as compensation to the flat owners by the respective builders.
- ▲ In view of this ruling, the well-established principle of *Caveat Emptor* (buyer beware) has gained more relevance as before purchasing any property or land, a party should ensure that a thorough check on the title to the property is conducted including the verification of the CRZ Notification, 2011 to

understand which category of CRZ the land falls under and the nature of use of land, so as to ensure that construction on the said lands are permissible.



LEX REVISORS

1. Resignation of statutory auditor in listed companies

The Securities Exchange Board of India (“SEBI”) vide its circular dated 18th October 2019 requires auditors who tender their resignation to issue limited audit report/s within 45 (forty five) days from the end of a quarter/ financial year for such period before such resignation. Further upon such resignation, the listed entity shall obtain information from the resigning auditor in a format as specified in Annexure A of the said Circular.

[For details refer to: https://www.sebi.gov.in/legal/circulars/oct-2019/resignation-of-statutory-auditors-from-listed-entities-and-their-material-subsidiaries_44703.html]

2. SEBI’s New Framework for Issuance of Depository Receipts

The SEBI on 10th October 2019 issued a circular governing the framework for the issuance of depository receipts (“DR Circular”). Per the DR Circular only a listed company is allowed to issue permissible security and such security can be issued or transferred only in permissible jurisdictions which shall be detailed by the Central Government from time to time. Further the DR Circular requires the depository receipts (“DRs”) to be listed in specified “international exchanges” in “permissible jurisdictions”. The DR Circular elaborates the eligibility criteria, obligations of listed company, permissible holder, voting rights, pricing, obligations on Indian depository etc.

[For details refer to: https://www.sebi.gov.in/legal/circulars/oct-2019/framework-for-issue-of-depository-receipts_44609.html]

3. IRDAI’s Master Circular on scheme of insurance advertisements

To protect the interests of the insured and to enhance their level of confidence on the nature of sales material, the Insurance Regulatory and Development Authority (“IRDA”) has issued a Master Circular on 16th October 2019 under Section 34 (1) of the Insurance Act, 1938 updating the restrictions placed on advertising of insurance policies. The Circular prescribes the minimum standards to be adhered to in addition to the compliance with the IRDA (Insurance Advertisements and Disclosure) Regulations, 2000 and the code of conduct prescribed by the Advertisement Standards Council of India (“ASCI”) and any other laws, regulations as applicable.

[For details refer to: https://www.irdai.gov.in/ADMINCMS/cms/whatsNew_Layout.aspx?page=PageNo3933&flag=1]

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