Improving investor interest
– Recent Legislative and Regulatory Measures

It is a well recognized fact that clear and efficient laws provide confidence to the investing community. Such investments can be by domestic entities or foreign entities or investment overseas by domestic entities. In the recent past, India has embarked upon a number of legislative and regulatory measures that are certain to create a positive impact on the investment climate prevailing in the country and capable of boosting the confidence of investors. A few such measures are also on the anvil. I would like to invite the attention of the audience to a few of them.

Insolvency and Bankruptcy Code, 2016

The recent enactment of a comprehensive legislation relating to insolvency of corporates, firms and individuals has been a much awaited move. The Insolvency and Bankruptcy Code, 2016 (IBC) lays down a resolution process that is time bound and undertaken by professionals. It creates an institutional mechanism for insolvency resolution process for businesses operated by companies, individuals or any other entities, either by coming up with a viable survival mechanism or by ensuring their prompt liquidation. The preamble to the Code makes clear the objective of the new law as one to *consolidate and amend the laws relating to reorganisation and insolvency resolution of corporate persons, partnership firms and individuals in a time bound manner, for maximisation of value of assets of*

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such persons to promote entrepreneurship, availability of credit and balance the interests of all the stakeholders.

Through this enactment, the Parliament has codified the laws governing insolvency and bankruptcy of both corporates and individuals, which were spread over a number of legislations. A key innovation of the new Code is its four pillars of institutional infrastructure comprising of Insolvency professionals, Information Utilities, Adjudicating Authorities (NCLT & DRT) and Insolvency and Bankruptcy Board of India.

The Financial Resolution and Deposit Insurance Bill, 2016 (Draft)

The IBC 2016 about which I spoke so far does not provide for resolution of the corporates providing financial services. The need for jurisdictions having a specialized resolution regime applicable to financial service providers has also been recognized internationally. Recently, a draft Bill for this purpose has been recommended by a working group constituted by the Central Government. This Bill aims to establish a framework to carry out the resolution of certain categories of financial service providers in distress, to provide deposit insurance to consumers of certain categories of financial services and for designation of Systemically Important Financial Institutions by the Central Government for resolution. The draft Bill on Financial Resolution and Deposit Insurance not only consolidates the resolution provisions presently scattered in different statutes, but also introduces new requirements like classification of financial service providers into various categories of risk to viability, submission of resolution / restoration plans, etc. and new methods for resolution, on the lines of prevalent international practices. It also proposes

creation of a new specialized authority called the Resolution Corporation, which will be tasked with the responsibility of carrying out speedy and efficient resolution of financial service providers. The authority will also take over the deposit insurance activity presently undertaken by the DICGC. The overall mechanism contemplated under the Bill would certainly bring in more clarity as to the rights of investors in the event of resolution of the investee financial service provider and is expected to improve investor confidence in the Indian financial market.

Amendments to the SARFAESI Act and DRT Act

Slow pace of recovery of financial debts has been imposing considerable strain on the financial position of the lenders, thus raising concerns for any investor, existing or prospective, of such lenders. Specialized laws establishing Debt Recovery Tribunals (DRTs) and empowering secured creditors to enforce security interest without the intervention of court, have been in vogue for several years now. While, such mechanisms have definitely facilitated faster recovery, there can be no doubt that much more needs to be done. In this context, some of the changes made to those laws recently are worth mentioning. For instance, certain procedural improvements have been made with respect to the functioning of DRTs like (i) stricter time lines for filing of written statement, conclusion of hearings, etc. to expedite adjudication; (ii) filing of recovery application, documents and written statements in electronic form; and (iii) uniform procedure for conduct of proceedings. Further, specific provisions have been enacted in those laws to clarify regarding the priority of secured creditors over state dues.

Another important change brought about is enabling 'Debenture trustees' to approach DRTs to recover unpaid debts due under listed debt securities as well as to invoke the provisions of SARFAESI Act to enforce the security interest without the intervention of courts. These measures confer additional recovery avenues for the benefit of debenture holders.

Other Legislative Changes

Legislative changes have also attempted to improve the investment horizon in asset reconstruction companies (ARCs). The restriction which existed on a holding company sponsoring an ARC has since been removed. The sponsors of ARCs are now required to be only fit and proper as per RBI guidelines. Further, apart from qualified buyers, non-institutional investors specified by RBI could also invest in security receipts issued by ARCs.

Apart from the above, there were a number of legislative measures of substantial significance to the investor community. For instance, a Constitutional amendment was brought in the previous year for enabling a single Goods and Service Tax throughout the country. In the year 2015, Parliament passed the Arbitration and Conciliation (Amendment) Act providing for various changes to the arbitration laws, with a view to making arbitration quicker, reducing interference by courts and to make India a more attractive destination for foreign investors. In order to take forward and accelerate the agenda of the “Ease of Doing Business” and “Make in India”, the Commercial Courts, Commercial Division and Commercial Appellate Division of the High Courts Act, 2015 was promulgated, which provides for the constitution of Commercial Courts and the establishment of

Commercial Divisions and Commercial Appellate Divisions in the High Courts to adjudicate Commercial Disputes for achieving the motive of swift and speedy enforcement of contracts, recovery of monetary claims and compensation for damages suffered to increase investment and economic activity in our country. Other two notable legislative measures important from an investment perspective are Benami Transaction (Prohibition) Amendment Act, 2016 and Real Estate (Regulation and Development) Act, 2016. The Benami Transaction (Prohibition) Amendment Act, 2016 aims to control the menace of black money and its by-product Benami transactions, with the new stringent law and its effective implementation. The Real Estate (Regulation and Development) Act, 2016 (RERA) is designed to provide uniform regulation, protect consumer interests, help speedy adjudication of disputes, improve accountability of developers and boost transparency. It should help to make the Indian real estate sector more attractive for foreign and domestic investment.

Foreign Investment

Now, let me discuss some of the recent regulatory measures relating to foreign investment. In today's world, no country can be an island oblivious of the developments in the world around it. With globalization and trade reforms, countries are globally integrated and have trade linkages with each other. Free trade enables lower prices for consumers, increased exports, benefits from economies of scale and a greater choice of goods. In developing nations, including India, free trade has increased the gap of Current Account Deficits as imports exceed exports. To bridge this deficit and also to bridge the gap between domestic savings and investments,

India requires forex flows from overseas. These flows help India reach its economic potential by providing capital to finance new industries and enhance existing industries, boosting infrastructure, productivity, and employment opportunities in the process. In other words they aid development and fuel domestic growth. Inward flows can be in the form of debt, equity, deposits or personal remittances.

India continues to be among the top ten countries in terms of foreign direct investment (FDI) inflows globally and the fourth in developing Asia, as per the World Investment Report 2016 by the United Nations Conference for Trade and Development (UNCTAD). India also jumped 16 notches again to 39 among 144 countries in the World Economic Forum's Global Competitiveness Index 2016 that ranks countries on the basis of parameters such as institutions, macroeconomic environment, education, market size and infrastructure among others.

External Commercial Borrowings (ECB)

Considering the macroeconomic developments and the experience gained in administering ECBs over the years, a liberalized regime for debt capital was introduced through a four track approach for ECBs. The overarching principles of the revised framework are: (a) fewer restrictions on end-uses and higher all in cost ceilings; (b) expand the list of eligible lenders to include long term lenders like sovereign wealth funds, insurance companies and pension funds; (c) small negative list of end use restrictions; (d) nudge borrowers towards rupee denominated debt and (e) permit higher interest for long term foreign currency borrowings. Recognizing the needs of the infrastructure sector, long term borrowing in

foreign currency denominated ECB with a minimum average maturity of ten years has been permitted (subsequently reduced to five years in alignment with OECD requirements). Access to alternative sources of credit to eligible borrowers without its concomitant forex risks was made feasible with the introduction of masala bonds.

Foreign Direct Investment (FDI)

Foreign investment is one area which economies around the world look at with at most precision. Which sectors to open up to foreign funds, how much control to cede to foreign investors and what all clearances to mandate are some questions that pose challenges to most Governments. In India the policy on foreign investment is framed by the Central Government. On an annual basis, it issues a consolidated circular detailing the policy stance. The sectoral limits, approval routes and investment linked conditionalities are laid down in the policy stance. It also issues Press Notes as and when changes in the policy are proposed. Regulations are issued under the Foreign Exchange Management Act, 1999 (FEMA) to give a legal backing to these policies.

Investment can be received in the form of equity shares, compulsorily convertible preference shares (CCPS) and compulsorily convertible debentures (CCDs). These instruments can contain an optionality clause subject to a minimum lock-in period of one year but without any option or right to exit at an assured price.

The inflows on account of foreign investment was US$ 36.485 billion in the financial year 2015-16. In the recent past regulations on investments

have been liberalized to ensure increased flows. Following the revisions in the foreign direct investment (FDI) policy announced by the Government, the regulations have been amended so that wherever sectoral limits / caps on foreign investment are in place, such limits / caps are required to be reckoned within a composite manner aggregating both Foreign Direct Investment (FDI) and Foreign Portfolio Investment (FPI). In addition “control” and “ownership” have been defined for the purpose of arriving at the indirect foreign investment in an Indian company and guidelines have been issued for calculating the ‘total foreign investment’ to be taken as the sum total of direct and indirect foreign investments. Regulations have also been amended to simplify FDI linked conditionalities, increase sectoral caps and include certain sectors under automatic route. This liberalization had a positive impact on sectors viz., manufacturing, insurance, railway construction, defence, plantation, real estate business, e-commerce in single brand retail, etc. In addition, foreign investment in limited liability partnership (LLP) has been permitted under the automatic route for sectors where 100 per cent FDI is allowed without attendant FDI-linked performance conditionality.

Ease of Doing Business

Several steps have been initiated for facilitating the ease of doing business and contributing to an ecosystem that is conducive to the growth of start-ups. Accordingly, a dedicated mailbox was set up to provide assistance and guidance to the start-up sector. Further, online submission of Form A2 for outward remittances has been enabled. Certain transactions related to start-ups which were clarified / notified are as under: (i) issue of

shares without cash payment through sweat equity was permitted provided that the scheme has been drawn either in terms of regulations issued by SEBI or the Government; (ii) issue of shares against legitimate payment owed by the investee company, remittance of which does not require permission of the Government or the Reserve Bank was permitted, (iii) start-up enterprises were permitted to collect payments on behalf of their subsidiaries abroad; (iv) companies have been permitted to have an escrow arrangement or paying the consideration on a deferred basis for an amount up to 25 per cent of the total consideration for a period not exceeding 18 months in respect of transfer of shares between a resident and non-resident; (v) startup companies were allowed to issue innovative FDI instruments like convertible notes and (vi) start-ups were permitted to access rupee loans under ECB framework with relaxations in respect of eligible lender, end-use and cost of borrowing, etc.

The move towards automation and use of technology for reporting and monitoring has been extended to Foreign Inward Investment and all FDI related returns have been replaced with online filing on the Government's e-Biz portal.

Non-Resident Indians Deposits (NRI Deposits)

India has always been a favored investment destination for its diaspora. The flows in the form of deposits (FCNRB and NRE) has been steady in the recent years. As on Dec 2016, the outstanding FCNR (B), NRE and NRO deposits were US$ 20.859, US$ 77.418 and US$ 11.458 billion, respectively. Flows in respect of personal remittances were US$ 44.083 billion and US$ 37.656 billion in the last two financial years.

To further facilitate the account holders, policies were changed to permit transfer across non-resident ordinary rupee (NRO) accounts. Further, NRIs and persons of Indian origin (PIOs) have been permitted to open NRO accounts jointly with other NRIs / PIOs. While permitting remittances outside the country from the balances held in NRO accounts maintained by NRIs and PIOs, ADs are now required to obtain a declaration that the remittances represent the account holder's legitimate receivables in India and do not represent any borrowing from any other person or transfer from any other NRO account. Non-residents having a business interest in India can open a repatriable special non-resident rupee (SNRR) account with balances commensurate with business operations. An Indian company receiving foreign investment under the FDI route has been permitted to open and maintain a foreign currency account with an AD in India provided it has impending foreign currency expenditure. The account needs to be closed immediately after the requirements are completed or within six months from the date of opening of such account, whichever is earlier.

Overseas Investment

India's external sector management has gained strength over the last few years with a prudent and pragmatic approach to policy aimed at supporting India's inherently strong macroeconomic fundamentals, which has made India as one of the most attractive destination for foreign investors. At the same time, the growth in magnitude and spread (in terms of geography, nature and types of business activities) of overseas direct investment (ODI) from India reflect the increasing appetite and capacity of

Indian business sector in availing the opportunities thrown up by the rapid globalization. The robustness of direct investment flows – both inward as well as outward, serve as an indicator of the maturity and degree of integration of India in the global economy.

While the average of total Financial Commitments (FC) under ODI for 2014-15 and 2015-16 at around US$ 30 billion was lower than the average of preceding two years (US$ 40 billion), the outlook and potential for growth in outward FDI from India remain positive as seen by encouraging trend in proposals. Actual outflows, which are asynchronous with the Financial Commitment have also varied over the period.

Overseas investment provides an important gateway for domestic businesses to enter the global marketplace and in recent times, India has taken some significant steps to make its presence felt in the global arena. The increased ODI have also resulted into greater macro-economic co-operation between India and other countries, transfer of technology and skill, sharing of R&D and promotion of brand India.

At the same time, the increasing degree of uncertainty in a continuously changing, and in recent times- often a disruptively changing global business environment, also poses some challenges for Indian businesses with respect to their ODI.

The policy and regulatory approach has been to balance the need to pave the way for growth of Indian businesses to keep pace with the changing demands of businesses and improve the “ease of doing business” for Indian companies – with the need for managing the potential

systemic risks- within the confines of the broad policy based on a calibrated approach to the management of capital account.

While the FEMA notification on outward FDI regulates all acquisition of overseas securities denominated in foreign currency, the focus is primarily to regulate acquisition / incorporation of overseas entities by the Indian corporates.

The broad approach has been to facilitate outward foreign direct investment by domestic companies through joint ventures and wholly owned subsidiaries up to 400% of their net worth; restrictions apply only in respect of investments abroad in real estate and banking. Investment which is also termed as financial commitment can be in form of equity, loan, guarantee and raising funds through pledge of shares, domestic and overseas assets. Further, resident individuals are enabled to undertake outward FDI within LRS limit of US$ 250,000.

Current issues

During last one decade or so, cross-border businesses involving multi-layered structure of entities have been a common phenomenon. Such layered structure of entities may be a plain vanilla two-tier structure or a complex multi-layered structure. Further, some of the business models resulting in inward FDI through the overseas entities established under ODI are posing major policy challenges including those pertaining to possible tax evasion, money laundering and round tripping.

The World Investment Report of United Nations Conference on Trade and Development (UNCTAD) has observed that tax avoidance practices by

Multinational Enterprises (MNEs) are a global issue, relevant to all countries. Such structures are created, typically, based on either for transfer pricing reasons or for financing their subsidiaries. While these could be established for tax avoidance purposes, such structures often involve investments in offshore investment hubs as holding entities, through which further investments are made in the step down subsidiaries. Needless to say that even though the motivations range from genuine business / commercial considerations to taxation benefits which are available to any global investors, at times the underlying motive could be to create opacity through a labyrinth of structures for reasons unjustified which evokes concerns.

Treaty shopping and parking of capital and passive incomes in tax havens leads to erosion of the tax base of the countries. Concerns have been raised about the minimization of tax burden by MNEs using legal arbitrage opportunities that arise out of gaps and frictions in the interactions of various domestic laws and / or tax treaties.

The international community has taken note of abusive tax practices employed by tax payers to create double non-taxation or taxation at low rates. Base Erosion and Profit Shifting (BEPS) have often been used as a tax avoidance strategy used by MNEs for shifting profits from high tax jurisdiction to low tax jurisdiction.

While efforts are on to further rationalize and simplify the extant regulations for undertaking ODI, it would achieve a meaningful impact after the aforementioned issues are resolved effectively.

Conclusion

To conclude, India, with its strong and modern legislative structure, effective legal systems, sound macroeconomic policies, adherence to responsible fiscal management, low and declining Current Account Deficit, stable monetary and financial sector management, robust economic growth prospects, remains an attractive proposition for FDI. India has also found its own niche in ODI. The policy environment is alive to the potential growth in investments, whether domestic, foreign or overseas and remains ready to make adjustments.

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