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# WITNESS

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# Liberalization of FDI Norms for NBFCs – Heralding a Positive Transformation

■ **Girish Rawat**

## LIBERALIZATION OF NBFCs

Non-Banking Finance Companies (NBFCs) have grown exponentially in the last few years. The liberalization movement in India had generated industrial growth and led to the mushrooming of NBFCs across the nation. Several policies and regulatory changes have been made for ensuring smooth operations of the NBFCs.

In continuation of the announcement made by the Hon'ble Finance Minister during the Budget 2016-17 speech to allow foreign direct investment (FDI) beyond the 18 specified NBFC activities, the Union Cabinet chaired by the Hon'ble Prime Minister has given its approval to amend the regulations governing foreign investment in the NBFCs. The amendments are aimed at improving the ease of doing business in India in the financial services sector.

## NBFC ACTIVITIES UNDER THE AUTOMATIC ROUTE

The proposed amendment in the existing Foreign Exchange Management (Transfer or Issue of Security by the Person Resident

Outside India) Regulations, 2000 on NBFC will enable inflow of foreign investment in other financial services beyond the 18 specified NBFC activities under the automatic route, provided such services are regulated by any financial sector regulators such as Reserve Bank of India (RBI), Securities and Exchange Board of India (SEBI), Pension Fund Regulatory and Development Authority (PFRDA) and other Government agencies etc. Further, foreign investment in other financial services, which are not regulated by any regulators/Govt. agency, will require prior government approval.

Presently, FDI is permitted under the automatic route in the 18 NBFC activities, as given below. FDI in financial activities not covered under the below mentioned NBFC activities requires prior Government approval.

Merchant Banking, Under Writing, Portfolio Management Services, Stock Broking, Asset Management, Venture Capital, Custodian Services, Factoring, Leasing & Finance, Housing Finance, Credit Card Business, Micro Credit, Rural Credit, Investment Advisory, Financial Consultancy, Credit Rating Agencies, Forex Broking, Money Changing Business



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It is pertinent to note that recently, the government has allowed 100 per cent FDI in Asset Reconstruction Companies (ARC) under automatic route, to give a boost to this sector which has gained lot of significance and has become critical in view of the declining asset quality of banks.

## ELIMINATION OF MINIMUM CAPITALIZATION NORMS

Further, the minimum capitalisation norms as mandated under the Consolidated FDI policy for foreign investment in the NBFCs engaged in the 18 specified NBFC activities have been eliminated as most of the financial sector regulators have already prescribed their respective minimum capitalisation norms. For instance, RBI has prescribed that NBFCs in India to have a net owned fund of not less than INR20 Million. Similarly, SEBI under the SEBI (Merchant Bankers) Regulations, 1992 requires that a Merchant Banker set up in India to have a net worth of at least INR50 Million. Further, SEBI under the SEBI (Stock Brokers and Sub-Brokers) Regulations, 1992 requires that a Stock Broker dealing in Currency Derivative to have a net worth of at least INR 10 Million.

According to the extant Consolidated FDI Policy, the FDI is allowed on automatic route for only 18 specified activities after fulfilling the prescribed minimum capitalization norms mentioned therein. The minimum capitalization norms applicable to all fund based NBFCs are as follows:

For FDI upto 51% : US\$ 0.5 million, to be brought upfront

For FDI above 51% and upto 75% : US \$ 5 million, to be brought upfront

For FDI above 75% and upto 100%: US \$ 50 million out of which US \$ 7.5 million to be brought upfront and the balance in 24 months

Similarly, the minimum capitalization norms applicable to all permitted non-fund based NBFCs is US\$ 0.5 million, to be brought upfront irrespective of the level of foreign investment.

It is pertinent to mention that the minimum

capitalization norms for the NBFCs sector in certain cases are not in consonance with the capitalized norms prescribed by the specific sector regulator, thereby, resulting in ambiguity and confusion.

## SUMMING UP

The proposed amendments are a welcome step towards liberalization of the NBFC sector, and would induce FDI and spurt economic activities.

The proposed amendments to the Consolidated FDI policy and Foreign Exchange Management (Transfer or Issue of Security by the Person Resident Outside India) Regulations, 2000 is expected to remove any air of ambiguity with regards to foreign investment across financial services. Although, the sectors are monitored and supervised by appropriate regulatory bodies, the stride in expected growth was missing due to obscurities in the FDI policies across the sectors. In the current scenario, there is precision regarding the scope of investment especially for international companies and foreign controlled entities, who want to explore Indian markets and leverage its potentialities, without battling with the legal complexities and the governing regulatory bodies.

The removal of the capitalization norms under the Consolidated FDI Policy will also encourage foreign investments in financial services. The earlier capitalization norms restricted free trade and often acted as a deterrent to foreign groups to invest in financial services with lesser amount of capital. This proposed amendment has offered significant comfort to financial service providers who are involved in investment and funding activities, since now they are no longer obliged to retain minimum capitalization as mandated by the extant Consolidated FDI Policy, if their scope of business operations is limited in nature. Further, it would also help in clearing out the ambiguity and confusion created by difference in the capitalization norms prescribed under the extant Consolidated FDI Policy and the respective sector regulator. [v](#)



**Girish Rawat** is a Partner with Dhir & Dhir Associates. He heads the banking, finance and capital market team in the Firm. Girish is a qualified lawyer and company secretary with extensive experience of over a decade and is widely recognized and recommended for his work by many international chambers including Legal 500, Asia Law Profiles, IFLR 1000, Financial Monthly, Corporate Livewire etc.