Between the lines...

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Highlights

i. Foreign holding in Insurers' Parent not to be counted as FDI
ii. Composite caps on foreign investment
iii. NBFC takeovers to be approved by the RBI
iv. Legal successor superior to nominee of shares

I. Foreign holding in Insurers' Parent not to be counted as FDI

The Ministry of Finance (MOF) has come out with a notification dated July 3, 2015 making an amendment to Indian Insurance Companies (Foreign Investment) Rules, 2015 (**'Rules'**).

Earlier, as per notification dated February 19, 2015 issued by MOF, a requirement was imposed that the promoter of an Insurance company should also be Indian owned and controlled.

Rule 2 (l) of the Rules defines the term India Ownership. It states,

"Indian Ownership" of an Indian Insurance Company means more than 50 per cent of the equity capital in it is beneficially owned by resident Indian citizens or Indian companies, which are owned and controlled by resident Indian citizens;

Now by the above notification, a proviso to Rule 2 (l)of the Rules has been added, which states:

"Provided that the manner of computation of foreign holding of such Indian promoter or Indian Investor Company shall be in accordance with clause (p) of rule 2."

Rule 2 (p) states that total foreign investment in an Indian insurance company would be the sum total of direct and indirect foreign investment by foreign investors in such company, calculated in accordance with Insurance Regulatory and Development Authority (IRDA) regulations read with Para 4.1.4 of the Consolidated FDI policy of the Government of India.

Regulation 11 of Insurance Regulatory and Development Authority (Registration of Indian Insurance Companies) Regulations, 2000 provides that for the purpose of calculation of equity capital held by foreign company, account need not be taken of the equity holdings in an Indian promoter company held by Foreign Institutional Investors.

Thus, even if foreign portfolio investment in the parent company exceeds 50%, the parent company investment in the Indian insurance company will not be considered as foreign owned and controlled.

Source: https://www.irda.gov.in/ADMINCMS/cms/frmGeneral_List.aspx?DF=NTFCN&mid=4.3

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The clarification from the MOF comes after many firms complained about the confusion created by the earlier government view that the parent companies of the Indian insurers have to be managed and controlled by Indian firms even though foreigners were permitted to raise their stakes to 49% from 26% in such Indian companies. With this amendment, international insurers, having stakes in Indian insurance companies can brush aside their worries about the prospects of not being able to raise their holdings in the Indian joint ventures.

II. Composite caps on foreign investment

The Government has notified the composite caps for simplification of Foreign Direct Investment (FDI) policy to attract foreign investments. All sectors other than banking and defence sectors can now get up to 49 per cent foreign institutional investment through the automatic route. In sectors under government approval route, any transfer of ownership due to foreign investment will require government approval.

As per the new norms, all direct and indirect overseas investments, whether portfolio or FDI, will be subject to a composite foreign investment cap for that particular sector. An FII/FPI/QFI (Schedule 2, 2A and 8 of FEMA (Transfer or Issue of Security by Persons Resident Outside India) Regulations, as the case may be) may invest in the capital of an Indian company under the Portfolio Investment Scheme which limits the individual holding of an FII/FPI/QFI below 10 percent of the capital of the company and the aggregate limit for FII/FPI/QFI investment to 24 percent of the capital of the company. This aggregate limit of 24 percent can be increased to the sectoral cap/statutory ceiling, as applicable, by the Indian company concerned through a resolution by its Board of Directors followed by a special resolution of the shareholders and subject to prior intimation to RBI. The aggregate FII/FPI/QFI investment, individually or in conjunction with other kinds of foreign investment will not exceed sectoral/statutory cap.

It is also clarified that total foreign investment shall include all types of foreign investments, direct and indirect, regardless of whether the said investments have been made under Schedules 1 (FDI), 2 (FII), 2A (FPI), 3 (NRI), 6 (FVCI), 8 (QFI), 9 (LLPs) and 10 (DRs) of FEMA (Transfer or Issue of Security by Persons Resident Outside India) Regulations.

Foreign Currency Convertible Bonds and Depository Receipts, having underlying of instruments which can be issued under Schedule 5, being in the nature of debt, shall not be treated as foreign investment. However, any equity holding by a person resident outside India resulting from conversion of any debt instrument under any arrangement shall be reckoned as foreign investment.

Portfolio investment, up to aggregate foreign investment level of 49% or sectoral/statutory cap, whichever is lower, will not be subject to either government approval or compliance of sectoral conditions, provided such investment does not result in transfer of ownership and/or control of Indian entities from resident Indian citizens to non-resident entities.

Source: http://pib.nic.in/newsite/PrintRelease.aspx?relid=123320

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The composite foreign investment caps will now encompass all types of foreign investments — foreign direct investment (FDI), foreign institutional investors (FIIs), foreign portfolio investors (FPIs), non-resident Indians (NRIs), foreign venture capital investors (FVCIs), qualified foreign investors (QFIs), limited liability partnerships (LLPs) and depository receipts (DRs). Following this, Indian companies can now have just two kinds of capital-Indian and foreign-ending the categories that made the FDI policy complicated.

This will immediately benefit sectors such as multi-brand retail and pharmaceuticals that do not have sub-limits within the overall limit and will henceforth not need approval for increasing portfolio investment up to 49 per cent of the total holding.

In case of banking and defence sector, the carve-out for portfolio investment within the overall foreign limit will continue.

III. NBFC takeovers to be approved by the RBI

The Reserve Bank of India has issued notification no. RBI/2015-16/122 dated July 09, 2015 stating that henceforth, prior written permission of the Reserve Bank shall be required for the following:

a) any takeover or acquisition of control of an NBFC, which may or may not result in change of management;

b) any change in the shareholding of an NBFC, including progressive increases over time, which would result in acquisition/ transfer of shareholding of 26% or more of the paid up equity capital of the NBFC. Prior approval would, however, not be required in case of any shareholding going beyond 26% due to buyback of shares/ reduction in capital where it has approval of a competent Court. The same is however required to be reported to the Reserve Bank not later than one month from its occurrence;

c) any change in the management of the NBFC which would result in change in more than 30% of the directors, excluding independent directors. Prior approval would not be required for those directors who get re-elected on retirement by rotation.

Irrespective of the above change, NBFCs shall continue to inform the Reserve Bank regarding any change in their directors/ management as required under the framework of laws presently applicable to NBFCs.

Furthermore, a public notice of at least 30 days shall be given by the NBFC before effecting the sale of, or transfer of the ownership by sale of shares, or transfer of control, whether with or without sale of shares. Such public notice shall be given by the NBFCs and also by the other party or jointly by the parties concerned, after obtaining the prior permission of the Reserve Bank.The public notice shall indicate the intention to sell or transfer ownership/ control, the particulars of transferee and the reasons for such sale or transfer of ownership/ control. The notice shall be

published in at least one leading national and in one leading local (covering the place of registered office) vernacular newspaper.

Source: https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=9934&Mode=0

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Though the intent of the RBI is to exercise effective control over NBFC, it may at times pose undue hardship to the NBFCs. It is not clear whether an application is to be preferred to the RBI in cases where the events may occur due to reasons beyond the control of the promoters. For example, if 51% shares of an NBFC is being acquired by a bank/ financial institution under a strategic debt restructuring scheme which scheme is regulated by the RBI itself, will it still require the prior consent of the RBI?

IV. Legal successor superior to nominee of shares

In a contrast to its earlier judgment in the case of Harsha Nitin Kokatevs. The Saraswat Cooperative Bank Ltd. & Ors., 2010(112) Bom. LR 2014, the High Court of Bombay in the case of Jayanand Jayant Salgaonkar and Ors. vs. Jayashree Jayant Salgaonkar and Ors., [2015] 190 CompCas 44 (Bom) held,

"a nomination only provides the company or the depository a quittance. The nominee continues to hold the securities in trust and as a fiduciary for the claimants under the succession law. Nominations under Sections 109A and 109B of the Companies Act and Bye-Law 9.11 of the Depositories Act, 1996 cannot and do not displace the law of succession, nor do they open a third line of succession."

Earlier in the judgment of Kokate (supra), the High Court of Bombay interpreting Section 109A of the Companies Act, ruled that the rights of a nominee to shares of a company would override the rights of heirs to whom property may be bequeathed. In other words, what one writes in one's will would have no meaning if one has made a nomination on the shares in favour of someone other than the heir mentioned in the will.

The said judgment of the Bombay High Court in Kokate was in stark contrast to the decisions of the Hon'ble Supreme Court in various cases wherein the Supreme Court had held that the amount in any head can be received by the nominee, but the amount can be claimed by the heirs of the deceased in accordance with law of succession governing them. In other words, nomination does not confer any beneficial interest on the nominee. The said judgment in Kokate required that shareholders to be alert to changing their nominations every time they changed their will.

The Bombay High in the present case of Jayanand Jayant Salgaonkar without deciding into the merits of the case, has put rest to controversy created by the Kokate case, wherein the Court held,

"The decision in Kokate does not consider the decisions of the Supreme Court in Khanchandani, Shipra Sengupta or Challamma, or those of learned single Judges of this Court in Nozer Gustad Commissariat and Antonio Joao Fernandes. Each one of these was binding on the Kokate court. The view taken in Kokate is contrary to, and does not consider any of these. It is, for that reason, per incuriam."

Hence, it is once again clear that nomination means only naming a person for holding an office for the time till he discharges his respective duties. Thus in nomination, there is no complete transfer of ownership but merely an appointment for the specific purpose.

Source: www.bombayhighcourt.nic.in

VA View

However, it is not yet conclusive whether this judgment delivered in the context of securities can be considered to be a law for nominations under laws governing other assets, more so because of the divergent language used in the special statutes governing such assets.

For example, Sections 38 and 39 of the Insurance Act, 1938 as amended by Insurance Laws (Amendment) Act, 2015 have introduced the concept of a beneficial nominee. In view of this, it is arguable that under insurance policies, beneficial nominee's rights exclude all others' rights, irrespective of any provision in succession law or other law or even a provision in the will. Therefore, how rights of legal heirs would be interpreted vis-à-vis Insurance Act, 1938 remains an issue despite the Salgaonkar Judgement.

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