

## Research Articles

February 04, 2025

### RE-EVALUATING PRESS NOTE 3 OF 2020: SHOULD INDIA'S LAND BORDERS STILL DEFINE FOREIGN INVESTMENT BOUNDARIES?

The Government of India released the Press Note No. 3 (2020 Series) ("PN3") on April 17, 2020, introducing the requirement of prior government approval in case of any foreign direct investment ("FDI") from entities of countries that share land-borders with India, or where the beneficial owner of an investment into India is situated in or is a citizen of such land-bordering countries. Originally introduced as a safeguard for "*curbing opportunistic takeovers / acquisitions due to the current COVID-19 pandemic*", over the last half a decade, the PN3 has become an important part of India's FDI policy and assumes centre-stage when negotiating and structuring foreign investments into India.

As of April 2024, media publicly reported that out of the 526 FDI proposals submitted to the government for approval, 124 investment proposals have been accepted and 201 were rejected. While these figures may seem modest, they highlight how the PN3 has solidified its role in shaping India's foreign investment framework.

This prompts a critical question: after several years of implementation, should PN3 be revisited to better align with India's commitment to enhancing ease of doing business? To streamline the approval process, the Department for Promotion of Industry and Internal Trade ("DPIIT") issued Standard Operating Procedures ("SOP") on November 9, 2020, and August 17, 2023. Currently, the DPIIT is actively seeking stakeholder feedback on improving FDI policies, including PN3, signalling the government's openness to revising the framework to attract more foreign investment while addressing emerging challenges.

Drawing from our experience, we offer key recommendations to align the PN3 framework with India's objectives of fostering growth, safeguarding national interests, and enhancing ease of doing business.

**Firstly**, in order to ensure clarity and consistency in the PN3 framework, it is essential to establish a uniform threshold for determining "beneficial ownership of an investment". Currently, the SOP dated August 17, 2023, ties 'significant beneficial ownership' to the 10% shareholding threshold under the Companies Act, 2013. However, for FDI applications not attracting PN3, foreign investors must declare that neither they nor their beneficial owners are from countries sharing land borders with India, with no defined threshold for "beneficial owners". This ambiguity leads to varied interpretations and inconsistent declarations, often dictated by the preferences of authorized dealer banks.

To resolve this, the government should prescribe a clear threshold, allowing beneficial ownership to be assessed on a look-through basis at the foreign investor level. For listed entities within the ownership structure, in our view, the assessment should stop at the listed company, given the practical challenges in identifying individual beneficial owners of such entities. Aligning the PN3 framework with the processes under the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 and the Prevention of Money Laundering Rules, 2005 would streamline compliance and reduce uncertainty for investors.

**Secondly**, drawing inspiration from the framework of the Committee on Foreign Investment in the United States (CFIUS), which evaluates all foreign investments that impact U.S. national security – especially in critical sectors like technology, defense and infrastructure, the Indian government could consider an exemption for FDI in the form of acquisition of non-controlling stakes (i.e., investments below 25% on a fully diluted basis) in sectors where 100% FDI is allowed under the automatic route. This would incentivize increased foreign investment, particularly in startups and early-stage companies, where minority stakes are more prevalent.

**Thirdly**, follow-on investments by investors from land bordering countries who held shares in Indian companies prior to PN3) could be exempted from prior government approval if made solely to maintain their pre-PN3 shareholding – whether through exercise of investor protection rights available to them or through participation in a rights / bonus issue). Such exemptions would protect the existing foreign investors from dilution while preserving the legislative intent.

In case a blanket exemption in such instances is not amenable to the government, then as an alternative, for Indian subsidiaries with parent entities incorporated / beneficial owners situated in land-bordering countries, a "fast track approval" mechanism for follow-on investments by the parent could be considered to ensure timely capital infusion without forcing reliance on external funding that might dilute the group's stake.

**Lastly**, akin to the past practices of the Foreign Investment Promotion Board, the government could periodically release key statistics on PN3, including the number of applications, approvals, rejections, and associated sectors. Additionally, non-confidential reasons for rejections and the average approval timeline could be shared. This will help stakeholders gain insight into the long-term legislative intent of the PN3, shape precedent, and provide increased certainty to potential foreign investors.

## Research Papers

### Fintech

January 28, 2025

### Private Investments in India

January 27, 2025

### Horizon Technologies

January 21, 2025

## Research Articles

### Re-Evaluating Press Note 3 Of 2020: Should India's Land Borders Still Define Foreign Investment Boundaries?

February 04, 2025

### INDIA 2025: The Emerging Powerhouse for Private Equity and M&A Deals

January 15, 2025

### Key changes to Model Concession Agreements in the Road Sector

January 03, 2025

## Audio

### Securities Market Regulator's Continued Quest Against "Unfiltered" Financial Advice

December 18, 2024

### Digital Lending - Part 1 - What's New with NBFC P2Ps

November 19, 2024

### Renewable Roadmap: Budget 2024 and Beyond - Part I

August 26, 2024

## NDA Connect

Connect with us at events, conferences and seminars.

## NDA Hotline

Click here to view Hotline archives.

## Video

### What India's Transition to New Data Protection Law Means for Global Businesses

January 23, 2025

As we step into 2025, brimming with optimism for India’s growing deal-making activity, revisiting PN3 is a crucial move towards striking a balance between the intent of safeguarding national interests and the need to boost foreign investment. By making targeted amendments, the government can foster a more transparent, predictable, and investor-friendly environment, which will pave the way for a more robust and dynamic investment landscape in India.

Authors

- Parina Muchhala, Member, M&A and Private Equity Practice
- Harshita Srivastava, Co-Lead, M&A and Private Equity Practice

You can direct your queries or comments to the relevant member.

DISCLAIMER

The contents of this hotline should not be construed as legal opinion. View detailed disclaimer.

This Hotline provides general information existing at the time of preparation. The Hotline is intended as a news update and Nishith Desai Associates neither assumes nor accepts any responsibility for any loss arising to any person acting or refraining from acting as a result of any material contained in this Hotline. It is recommended that professional advice be taken based on the specific facts and circumstances. This Hotline does not substitute the need to refer to the original pronouncements.

This is not a Spam mail. You have received this mail because you have either requested for it or someone must have suggested your name. Since India has no anti-spamming law, we refer to the US directive, which states that a mail cannot be considered Spam if it contains the sender's contact information, which this mail does. In case this mail doesn't concern you, please unsubscribe from mailing list.

India 2025: The Emerging  
Powerhouse for Private Equity and  
M&A Deals

January 16, 2025

“Investment return is not enough”  
Nishith Desai with Nikunj Dalmia (ET  
Now) at FI18 event in Riyadh

October 31, 2024