INDIA'S FOREIGN INVESTMENT FRAMEWORK SET FOR REFORM UNDER THE DRAFT FEMA (FOREIGN INVESTMENT) RULES, 2026

Update by: Mallika Noorani | July 23, 2026

BACKGROUND

India's foreign investment regime has been principally governed by the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 ("**NDI Rules**"). While the NDI Rules consolidated the regulatory framework governing foreign investment in non-debt instruments, the regime evolved into a technically complex framework, with the classification and regulatory treatment of investments often dependent on the listing status of the investee entity.

Recognising the need to modernise the foreign investment framework, the Government of India, in the Union Budget 2026–27, announced a comprehensive review of the NDI Rules with the objective of introducing a simpler, more contemporary and investor-friendly regime aligned with India's evolving economic priorities. Pursuant to this announcement, the Ministry of Finance has released the draft Foreign Exchange Management (Foreign Investment) Rules, 2026 ("**Draft Rules 2026**") [1] for public consultation.

[1] Draft Rules 2026: https://www.rbi.org.in/scripts/BS_PressReleaseDisplay.aspx?prid=63204

KEY CHANGES

The Draft Rules 2026 shift away from the broad bucket of non-debt transactions to target foreign investment in equity:

1. **FOCC replaced with the FCE framework:** The Draft Rules 2026, replace the existing Foreign Owned or Controlled Company ("**FOCC**") regime with the concept of a Foreign Controlled Entity ("**FCE**"). Significantly, the FCE framework appears to apply only to sectors specifically notified for this purpose. If retained in its present form, downstream investment and holding company structures operating outside such notified sectors may no longer be subject to the existing FOCC compliance framework, potentially resulting in a materially lighter regulatory burden.

2. **Expanded definition of '*Control*' :** The Draft Rules 2026 broaden the concept of 'control' for the purposes of determining indirect foreign investment. In addition to the traditional tests of ownership and control, voting agreements conferring 10% (ten percent) or more of the voting rights are proposed to constitute control. This expansion could have significant implications for minority private equity and venture capital investments, particularly where customary shareholder rights or governance arrangements are structured through voting agreements, given that this test operates in determining indirect foreign investment through the ownership and control chain.

3. **Equity classification aligned with accounting standards:** The Draft Rules 2026 move away from the current instrument-based approach, which specifically identifies equity shares, compulsorily convertible preference shares, compulsorily convertible debentures and warrants as equity instruments. Instead, the classification of an instrument as 'equity' would now depend on its treatment under the applicable accounting standards. Consequently, the accounting characterisation of hybrid instruments, including under Ind AS, is likely to assume greater significance in determining FEMA compliance and structuring considerations. Notably, the proposed definition of equity also extends to a participating interest or right in oil fields or mines, bringing such interests within the scope of the foreign investment framework.

4. **Uniform thresholds for FDI and FPI:** The Draft Rules 2026 introduce a uniform numerical threshold to distinguish foreign direct investment (**"FDI"**) from foreign

portfolio investment (**"FPI"**). Investments conferring 10% (ten percent) or more of the equity of an Indian company or a limited liability partnership (**"LLPs"**) are proposed to be treated as FDI, while investments below the 10% (ten percent) threshold would be classified as FPI. This marks a departure from the NDI Rules, where investments in unlisted companies were generally treated as FDI irrespective of the size of the holding.

5. **Expanded scope of eligible investee entities:** The Draft Rules 2026 expand the range of entities eligible to receive foreign investment. In addition to companies and LLPs, the framework expressly covers registered partnership firms, proprietary concerns and specified SEBI-regulated investment vehicles, including alternative investment funds, real estate investment trusts, infrastructure investment trusts and mutual funds or exchange traded funds, in each case as registered and regulated under the applicable SEBI regulations. The manner in which the prescribed threshold of more than 50% (fifty per cent) investment in equity applies across these vehicles is expected to be clarified.

6. **Liberalisation of intra-family gifts:** Rule 6A(3) of the Draft Rules 2026 proposes to permit transfer of equity instruments by way of gift between natural persons who qualify as 'relatives' under the Companies Act, 2013, without requiring prior regulatory approval. Where such a gift is made on a repatriation basis by a donor who holds the equity on a non-repatriation basis, the transfer is subject to two conditions, namely that the donee is a close 'relative' as per the Companies Act, 2013 and that the value transferred in a financial year remains within the limits applicable under the Liberalised Remittance Scheme.

7. **Codification of the overseas listing framework:** The Draft Rules 2026 incorporate a dedicated framework governing the issuance and listing of equity instruments by Indian public companies on permitted international stock exchanges. The proposed provisions, set out under annexure I therein, also clarify the pricing methodology and book-building process applicable to overseas listings by unlisted public companies.

8. **Express recognition of SPV share swaps:** The Draft Rules 2026 expressly recognise cross-border share swap transactions involving special purpose vehicles (**"SPVs"**). This clarification is expected to provide greater flexibility for

multinational group restructurings, mergers and acquisitions, and other cross-border corporate reorganisations involving intermediate holding entities.

9. **Liberalisation of National Pension System investments:** The Draft Rules 2026 expressly permit non-resident Indians and overseas citizens of India to subscribe to the National Pension System (**"NPS"**). The framework also provides for repatriation of accumulated pension corpus and annuity proceeds, subject to the applicable regulatory conditions.

GOVERNMENT CLARIFICATION

The Draft Rules 2026 also seek to delineate the respective jurisdiction of different regulators and clarify certain interpretational issues.

1. **IFSC carve-out:** The Draft Rules 2026 clarify that they do not apply to foreign investments made in entities established or incorporated in an International Financial Services Centre (**"IFSC"**), which continue to be governed under the applicable IFSC regulatory framework.
2. **Delineation of regulatory jurisdiction:** The Draft Rules 2026 clearly allocate regulatory responsibilities between the Reserve Bank of India ("**RBI**") and the Department for Promotion of Industry and Internal Trade ("**DPIIT**"). While the RBI is responsible for operational matters, including modes of payment, reporting requirements and exchange control administration, DPIIT continues to administer and interpret the Foreign Investment Policy.
3. **Beneficial ownership safeguards:** The Draft Rules 2026 clarify that the beneficial owner of a portfolio investment made through an international exchange route cannot be a resident Indian citizen. A limited exception is provided for Indian resident broker-dealers and investment bankers acting solely in an intermediary capacity for foreign investors.

CONCLUSION

Clarifications awaited: While the Draft Rules 2026 substantially simplify and consolidate India's foreign investment framework, certain aspects would benefit from greater regulatory guidance before the framework is finalised. In particular, stakeholders are likely to seek further clarity on the operational mechanics for the reclassification of FPI into FDI under Rule 8(1)(d), the implementation of the Foreign Controlled Entity framework across regulated sectors, and the interplay between the general pricing provisions and sector-specific valuation requirements. The public consultation process presents an opportunity to address these issues and provide greater certainty to market participants.

Looking ahead: The Draft Rules 2026 represent one of the most significant reforms to India's foreign investment regime since the introduction of the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019. By rationalising the classification of foreign investments, broadening the scope of eligible investee entities, aligning the definition of equity with accounting principles and codifying several existing regulatory positions, the proposed framework seeks to create a more coherent, principle-based and investor-friendly regime. If implemented in their present form, the Draft Rules 2026 have the potential to materially simplify foreign investment structuring and compliance, while enhancing regulatory certainty for domestic businesses and global investors alike.

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