

Corpsec Hotline

May 02, 2007

BLOCKING THE PREFERRED ROUTE: RESTRICTION ON USE OF PREFERENCE SHARES FOR FOREIGN INVESTMENTS

In a move that could significantly alter the manner in which foreign investments ("FI") into India are structured, the Ministry of Finance, Government of India, through its press release dated April 30, 2007 ("**Press Release**"), directed that all preference shares, other than compulsorily convertible preference shares, viz. non-convertible, partially convertible or optionally convertible preference shares, issued on or after May 1, 2007 ("**Effective Date**"), would be regarded as **debt** and not share capital for the purposes of investment into India and therefore issuance or transfer of the same would be subject to the terms and conditions of the **external commercial borrowing ("ECB")** guidelines. It further stipulates that all compulsorily convertible preference shares issued or transferred to foreign investors would now be aggregated with equity shareholding for determining the sectoral caps as provided in the extant FI policy of India, with effect from the Effective Date.

Further, in terms of the Press Release, any foreign investment, prior to the Effective Date, in non-convertible, partially convertible or optionally convertible preference shares would not be calculated along with equity shares for determining the sectoral caps **until** such preference shares reach their maturity.

Background

Prior to the Press Release, for the purposes of the regulations related to foreign exchange and FI, all types of preference shares were considered a part of the share capital of a company, pursuant to the Companies Act, 1956, and were not considered to be under the purview of the ECB guidelines and the caps, eligibility and end use restrictions as provided therein.

Though a great amount of FI in India happens by way of investment into the equity capital of a company, because of the treatment of preference shares as share capital and the flexibility afforded by the same, optionally convertible preference shares became a popular instrument for the purpose of FI into India. This was especially so since preference shares have priority over equity shareholders upon winding up, earn a fix rate of dividend and constitute a part of the share capital of a company and were also not equated with ECBs (which is essentially debt), promoters and foreign investors alike, have been amenable to the use of preference shares to structure investments into India resulting in a win-win situation. This was particularly true about investments made by private equity and venture capital investors, who have been regularly using preference shares in order to achieve the complex structures.

Implications of the Press Release

- Due to optionally convertible, non-convertible or partially convertible preference shares, issued or transferred on or after the Effective Date, being regarded as ECBs, the ECB guidelines shall be applicable to such an issuance or transfer and compliance with its provisions, including provisions such as borrower and lender eligibility, end-use restrictions, all-in-cost restrictions and minimum average maturity, limits on the maximum amounts being payable as dividends (which would now be lower than the ones earlier payable on preference shares) would become mandatory.

Moreover, ECB guidelines also permit pre-payment of ECBs only to the extent of USD 400 million for this financial year (i.e. April 1, 2007 to March 31, 2008) without the prior approval of the Reserve Bank of India.

- This move may affect the investment structures for FI, especially ones that are devised for private equity and venture capital investors and although remote, there may be a possibility of a reduction in the amount of FI into India in the short to medium term due to the new regulations.

In view of the above, we await the formal press note and any rules and regulations attendant thereto and indications of the manner in which this policy could evolve in the future.

Sources: [Press Note - Guidelines for Foreign Investment in Preference Shares](#)

- **Diptee Deshpande & Ruetveij Pandya**
You can direct your queries or comments to the authors

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

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

Research Papers

Compendium of Research Papers

January 11, 2025

FAQs on Setting Up of Offices in India

December 13, 2024

FAQs on Downstream Investment

December 13, 2024

Research Articles

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

The Revolution Realized: Bitcoin's Triumph

December 05, 2024

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

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

October 31, 2024

Analysing SEBI's Consultation Paper

based on the specific facts and circumstances. This Hotline does not substitute the need to refer to the original pronouncements.

list.

on Simplification of registration for FPIs

September 26, 2024

Scope of judicial interference and inquiry in an application for appointment of arbitrator under the (Indian) Arbitration and Conciliation Act, 1996

September 22, 2024