Recasting India's Foreign Investment Framework: Key Features of the Draft FI Rules, 2026

INTRODUCTION

The Ministry of Finance, on July 21, 2026 released a draft of the proposed Foreign Exchange Management (Foreign Investment) Rules, 2026 (***Draft FI Rules***) for public consultation. Once notified, the Draft FI Rules will supersede the existing Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 (***NDI Rules***), marking a significant restructuring of India's foreign investment framework, both in style and substance.

KEY FEATURES OF THE DRAFT FI RULES

- The main body of the Draft FI Rules is not too lengthy, containing only nine Rules, but the Draft FI Rules come with three Annexures, which cover the following:

  - *Annexure-I*: Direct Listing of Equity of Companies Incorporated in India on International Stock Exchange Scheme;
  - *Annexure-II*: Foreign Investment Policy (***FDI Policy***) issued by the Government of India (as amended from time to time); and
  - *Annexure-III:* Regulations, directions issued by the RBI, applicable on foreign investment or transfer thereof.

  Annexure I is appended to the Draft FI Rules released by The Ministry of Finance, but Annexures II and III are yet to be released.

- The NDI Rules regulate different categories of non-resident investors differently, with separate schedules for (i) FPIs, (ii) non-resident individuals who invest on repatriation basis, (iii) Investment by NRI or OCI on non-repatriation basis, (iv) other non-resident investors like Sovereign Wealth Funds (SWFs), multilateral agencies, endowment funds, insurance funds, pension funds and foreign central banks, and (v) foreign venture capital investors. The NDI Rules also regulate equity investments into Indian companies differently from investments into LLPs or investment vehicles.

  The Draft FI Rules do away with the categorisation followed by the NDI Rules and regulate all foreign investments in the "equity" of an "eligible investee entity" or transfer thereof, uniformly. The Draft FI Rules define an "eligible investee entity" to expressly include investment vehicles (REITs, InvITs, AIFs, Venture Capital Funds, Mutual Funds and ETFs registered with SEBI), partnership firms and proprietary concerns registered under Indian Partnership Act, 1932 and applicable domestic laws respectively. The Draft FI Rules defines "equity" to include instruments classified as equity under applicable accounting standards by the eligible investee entity (for entities that are not investment-vehicle); units of investment vehicles under SEBI regulations; and participating interests or rights in oil fields or mines of an Indian company or LLP.

- Under Rule 23 of the NDI Rules, downstream investment is defined to mean "*investment made by an Indian entity which has total foreign investment in it, or an Investment Vehicle in the capital instruments or the capital, as the case may be, of another Indian entity.*"

  Indirect foreign investment is defined to mean downstream investment received by an Indian entity from:

  - another Indian entity (IE) which has received foreign investment and is not owned and controlled by resident Indian citizens; or
  - an investment vehicle whose sponsor or manager or investment manager is not owned and controlled by resident Indian citizens.

For purposes of Rule 23 of the NDI Rules, ownership means the beneficial ownership of 50% or more of such Indian company or LLP as applicable. However, "control" is based on the definition given in the Companies Act, 2013 and is therefore not subject to any fixed percentage of shareholding.

The Draft FI Rules have now introduced a new term, namely a 'Foreign Controlled Entity' (***FCE***). An "FCE" means a resident company or an LLP or an investment vehicle which is owned or controlled by a person resident outside India. The Draft FI Rules provide that "Ownership and Control" shall be provided for by the respective sectoral regulators in consultation with the central Government. Therefore, SEBI will stipulate what 'Ownership and Control' means for an "investment vehicle" registered with SEBI. In the absence of any such stipulations, "ownership" and "control" of an FCE shall be determined in accordance with the applicable Indian laws (the Companies Act, 2013 for Indian companies or LLP Act, 2009 for an Indian LLP or SEBI AIF regulations for AIFs etc.) under which the FCE is incorporated;

The Draft FI Rules define "foreign investment" to include both direct and indirect foreign investment and does not distinguish between direct and indirect foreign investment or regulate downstream investment separately from direct foreign investment.

- Under the NDI Rules, investment in an LLP is not treated as FDI. Schedule VI of the NDI rules provides that a non-resident who is not an FPI or an FVCI can invest in an LLP provided the LLP is operating in sectors or activities where foreign investment up to 100 per cent is permitted under automatic route and there are no FDI linked performance conditions.

  The Draft FI Rules permit FDI in LLPs, on par with FDI in companies. FDI is defined to mean foreign investment of ten per cent or more in the equity of a company or an LLP.

- The Draft FI Rules explicitly exclude its application to investments made by persons resident outside India (PROIs) in a financial institution in an International Financial Services Centre (***IFSC***). The NDI Rules do not have such express exclusion, but do not regulate or restrict such investments either.

ELP Comments

- *Even though Annexure II (FDI Policy along with sectoral conditions) and Annexures III (applicable RBI regulations) which will constitute the substantive operative framework of the Draft FI Rules are yet to be released and, the first draft of the Draft FI Rules reflects a conscious effort to simplify, consolidate and clarify India's foreign investment regime by addressing several interpretational issues that had arisen under the NDI Rules.*
- *The Draft FI Rules propose to give sectoral regulators such as SEBI and IRDA the freedom to prescribe ownership thresholds and control tests for foreign controlled entities, which is a pragmatic change that could result in more realistic and utilitarian regulation of foreign investment into entities regulated by such regulators.*

We hope you have found this information useful. For any queries/clarifications, please write to us at insights@elp-in.com or write to our authors:

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