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India's Foreign Investment Regime: The Draft Foreign Exchange Management (Foreign Investment) Rules, 2026

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On 21 July 2026, the Reserve Bank of India (RBI) released the draft Foreign Exchange Management (Foreign Investment) Rules, 2026 (Draft FI Rules) for public consultation, proposing a comprehensive overhaul of the existing Foreign Exchange Management (Non-debt Instruments) Rules, 2019 (NDI Rules).

The proposed reforms give effect to the Union Budget 2026-27 announcement to modernise India's foreign investment regime. Consistent with that mandate, the existing framework was reviewed by a committee constituted by the Central Government, which led to the preparation of the Draft FI Rules based on the committee's recommendations and stakeholder consultations.

The overarching design of the Draft FI Rules is a simplified, principle-based framework intended to reduce interpretational issues and regulatory complexity. The key aspects of the proposed reforms are discussed below:

Key Changes under the Draft FI Rules

a) **Regulatory Authority**: A defining feature of the Draft FI Rules is the express bifurcation of regulatory responsibility. Under the NDI Rules, Rule 2-A vested the RBI with the power to administer and interpret the rules, including issuing directions, circulars and clarifications for their effective implementation.

   The Draft FI Rules retain the RBI as the administering authority, with the power to interpret the rules and issue regulations, directions and clarifications. However, they carve out a distinct role for the Department for Promotion of Industry and Internal Trade (DPIIT), which is now empowered to interpret the foreign investment policy and issue directions, circulars and clarifications in relation to it. Consistent with this approach, the Draft FI Rules are also linked to the FDI Policy (Annexure II), which sets out the applicable sectoral caps and other conditions governing the receipt of foreign investment in India.

b) **Definition of 'Equity'**: The Draft FI Rules define the term 'equity' as: (i) instruments classified as equity by the eligible investee entity, other than an investment vehicle, as per applicable accounting standards; (ii) unit of an investment vehicle as per regulations issued by the Securities and Exchange Board of India (SEBI); and (iii) 'participating interest or right' in oil fields or mines of an Indian company or an LLP.

   Accordingly, the definition of 'equity' shifts from a prescribed list of "equity instruments" to instruments classified as equity under the applicable accounting standards. The Draft FI Rules also do not provide for the acquisition of immovable property, unlike the NDI Rules.

c) **Definition of "Eligible Investee Entity"**: The NDI Rules used separate definitions for different categories of eligible investee entities. In contrast, the Draft FI Rules consolidate these under the umbrella term "eligible investee entity", comprising: (i) companies or body corporates; (ii) limited liability partnerships (LLPs); (iii) investment vehicles registered with the SEBI; and (iv) partnership firms and proprietary concerns. This shifts the framework from entity-specific schedules to a consolidated approach applicable across all eligible investee entities.

d) **Introduction of the Term "Foreign Investment in Equity"**: The Draft FI Rules introduce the term "foreign investment in equity" to mean investment in the equity of an eligible investee entity by a person resident outside India, whether made: (i) directly, or (ii) indirectly. Indirect foreign investment in equity may be made through: (i) an FCE (*defined below*), or (ii) another non-resident that is owned or controlled by, or under common "ownership" or "control" with, the investing person.

For this purpose, "ownership" means beneficial holding of more than 50% of the relevant non-resident entity, while "control" means the right to appoint a majority of the directors or to control management or policy decisions, whether exercised directly or indirectly, individually or in concert. Such control may arise through shareholding, management rights, shareholders' agreements, voting agreements that entitle them to 10% or more of the voting rights, or in any other manner.

This definition effectively incorporates the concept of "indirect or downstream foreign investment", which was previously addressed under Rule 23 of the NDI Rules.

e) **From FOCC to "Foreign Controlled Entity"**: The Draft FI Rules replace the concept of a "foreign owned and controlled company" (FOCC) with that of a foreign controlled entity (FCE). The key distinction lies in the assessment of ownership and control. Under the NDI Rules, ownership was construed as the "*beneficial holding of more than 50% of the equity instruments of the concerned company*", while control was defined as "*the right to appoint majority of the directors or to control the management or policy decisions including by virtue of their shareholding or management rights or shareholders agreement or voting agreement" for a company*".

In contrast, the Draft FI Rules move away from a uniform definition of ownership and control. Instead, they require the relevant sectoral regulators, in consultation with the Central Government, to prescribe these definitions. Where no such sector-specific definitions are prescribed, ownership and control will be determined in accordance with the applicable law governing the relevant FCE, namely: (i) the Companies Act, 2013, in the case of Indian companies; (ii) the Limited Liability Partnership (LLP) Act, 2008, in the case of Indian LLPs; or (iii) the applicable SEBI (Alternative Investment Funds) Regulations, 2012, in the case of alternative investment funds.

As a result, the test for downstream investment will become sector-specific, and an entity's status as an FCE may vary depending on the applicable regulatory framework. Investors will therefore need to assess the relevant sectoral regime rather than rely on the single, uniform test prescribed under the NDI Rules.

The NDI Rules also restrict FOCCs from using funds borrowed in the domestic market to make downstream investments, requiring such investments to be funded through foreign capital or internal accruals. Interestingly, the Draft FI Rules do not expressly replicate this restriction in the context of FCEs. However, as Annexures II and III of the Draft FI Rules have not yet been released, it would be premature to conclude that the restriction has been dispensed with altogether.

If the restriction is ultimately omitted, it could represent a significant liberalisation of India's foreign investment regime by permitting acquisition financing to be sourced domestically. Such a move would also align with the broader regulatory policy of expanding access to financing M&A transactions in India and complement the RBI's recently announced measures permitting Indian banks to finance domestic acquisitions. It could also broaden the acquisition financing landscape by reducing reliance on traditional sources of funding, such as private credit funds, foreign portfolio investors and other alternative capital providers.

f) **Foreign Direct Investment (FDI) and Foreign Portfolio Investment (FPI)**: Under the NDI Rules, FDI captured any foreign investment in an unlisted Indian company, as well as investment constituting 10% or more of the post-issue paid-up equity capital of a listed Indian company, whereas FPI was defined to mean investment of less than 10% in a *listed* Indian company.

The Draft FI Rules simplify these definitions by treating all foreign investments of 10% or more in an Indian company (regardless of whether such company is listed or unlisted) or an LLP as FDI, and all foreign investments below 10% as FPI. Accordingly, the Draft FI Rules remove the distinction that tied the FDI / FPI characterisation to a company's listing status.

g) **Simplification of the Investment Framework**: As discussed above, the NDI Rules adopted a fragmented approach by prescribing separate definitions for different categories of investee entities and governing investments by different classes of investors (such as Foreign Venture Capital Investors, NRIs, OCIs) through separate schedules. The Draft FI Rules seek to simplify this framework by consolidating these provisions under Rules 6A and 6B and linking them to the FDI Policy issued by the Government of India (Annexure II) and the regulations and directions issued under the Rules (Annexure III).

While Annexure I sets out the framework for the direct listing of equity shares of Indian companies on international stock exchanges, Annexure III, which is intended to contain the regulations and directions issued under the Draft FI Rules, has not yet been released.

Rule 6A of the Draft FI Rules further consolidates the permissible modes through which a non-resident or an FCE may make foreign investment, on either a repatriation or non-repatriation basis, as summarised below:

MODE	DETAILS
Subscription	Subscription to issue of shares by an Indian entity.
Purchase	Acquisition of shares from a resident or a non-resident.
Gift	Transfer of equity by way of gift between natural persons, provided that for acquisition under repatriation basis or non-repatriation basis, shares shall be subject to the following conditions: (i) the recipient must be a close relative within the meaning of the Companies Act 2013; and (ii) the value of equity transferred in a financial year must be within the limits prescribed under the Liberalised Remittance Scheme.
Pledge	Pledge of shares of an Indian company. Any invocation of the pledge is subject to the applicable FDI/FPI conditions prescribed under Annexure II.
Swap	Investment in the equity of an Indian company may be made by way of a swap of equity of an Indian company or the equity capital of a foreign company, where the 'equity capital' has the meaning assigned under the FEM (Overseas Investment) Rules, 2022. An investment vehicle may also issue its units to a non-resident against the swap of equity of a special purpose vehicle proposed to be acquired by the investment vehicle.

h) **Pricing Guidelines and Compliance Requirements**: Rule 21 of the NDI Rules prescribed separate pricing mechanisms for the issue of equity instruments, transfers from residents to non-residents, and transfers from non-residents to residents, with pricing for listed companies governed by the applicable SEBI regulations.

Rule 8(2) of the Draft FI Rules simplifies this framework by prescribing that: (i) for listed companies and investment vehicles, pricing will be determined in accordance with the applicable SEBI regulations; (ii) for public companies listed on an international stock exchange, pricing will be determined in accordance with Annexure I of the Draft FI Rules; and (iii) in all other cases, pricing will be determined using any internationally accepted arm's length methodology, duly certified by a chartered accountant, a SEBI-registered merchant banker or a cost accountant.

The pricing guidelines continue to be inapplicable to: (i) rights issues; and (ii) foreign investment made on a non-repatriation basis.

i) **Listing on International Stock Exchanges**: The framework for the direct listing of Indian companies on international stock exchanges under the Draft FI Rules is largely carried forward from the NDI Rules. As per both the NDI Rules and the Draft FI Rules, international stock exchanges and the issuance or offer of equity by a public company is prescribed in alignment with the Companies (Listing of Equity Shares in Permissible Jurisdictions) Rules, 2024. They also retain the existing eligibility restrictions under the NDI Rules, including those relating to capital-market debarment, wilful defaulter status, pending inspections or investigations, and fugitive economic offender status. Further, the beneficial owner must not be resident in India, and the existing book-building pricing mechanism for initial listings has been retained too.

j) **Liberalisation of Pledges over Shares of an Indian Entity**: The NDI Rules currently permit the creation of a pledge over the equity instruments of an Indian company under the automatic route, subject to the conditions prescribed under the NDI Rules and the Master Direction – Foreign Investment in India (Master Direction). Broadly, this is permitted in the following circumstances:

(i) a promoter of an Indian borrowing company may pledge the shares of the borrower or its resident associate companies as security for an external commercial borrowing availed by the Indian borrowing company; and
(ii) a person resident outside India holding equity instruments in an Indian company may pledge such shareholding in favour of: (a) a bank in India; (b) a non-banking financial company in India; or (c) an overseas bank.

The Draft FI Rules appear to signal a shift from the current prescriptive framework towards a more principles-based approach. Rule 6A(4) permits a person resident outside India or an FCE to make a foreign investment by way of pledge, provided that any transfer of equity instruments upon invocation of the pledge complies with the applicable entry routes, sectoral caps, sectoral conditions prescribed under the foreign investment policy, and the pricing guidelines under the Draft FI Rules.

Notably, unlike the NDI Rules, the Draft FI Rules do not expressly restrict the categories of lenders or entities in whose favour a pledge over Indian equity instruments may be created. This could provide greater flexibility to non-residents in structuring financing transactions and raising debt against Indian equity securities.

However, as Annexures II and III to the Draft FI Rules have not yet been released, it remains unclear whether these restrictions will be retained through regulations, directions or guidelines issued by the RBI or the Central Government, or whether they will be relaxed to provide greater flexibility for non-residents to raise financing under automatic route, both in India and overseas.

k) **Onus of compliance**: Importantly, the NDI Rules placed the onus of compliance with the applicable sectoral caps and attendant conditions with the Indian investee entity. In contrast, the Draft FI Rules place responsibility for compliance with the Draft Rules on both the foreign investor and the eligible investee entity.

A Step Towards Simplification?

The Draft FI Rules represent a significant step towards simplifying and rationalising India's foreign investment framework by consolidating a fragmented, schedule-based regime into a more principle-based framework. At the same time, much of the operational detail has been delegated to the regulations, directions and the foreign investment policy, many of which are yet to be released. In particular, the ownership and control framework for FCEs will depend on sector-specific prescriptions, while the regulations and directions contemplated under Annexure III remain awaited. Accordingly, the extent to which the Draft FI Rules simplify the existing regime will become clearer only once the supporting framework is notified.

The Draft FI Rules are currently open for public consultation. As per the RBI's Press Release dated 21 July 2026, stakeholders may submit comments and feedback through the 'Connect 2 Regulate' section of the RBI's website or by email by 31 August 2026, with the subject line 'Feedback on Draft Foreign Investment Rules'. The Draft FI Rules will be finalised after considering the feedback received during this consultation process.

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