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Unpacking RBI's draft foreign investment rules 2026: What dealmakers need to know about the new framework

On July 21, the Reserve Bank of India (RBI) released the draft Foreign Exchange Management (Foreign Investment) Rules, 2026 (Draft Rules), proposed to supersede the Foreign Exchange Management (Non-debt Instruments) Rules, 2019 (NDI Rules).

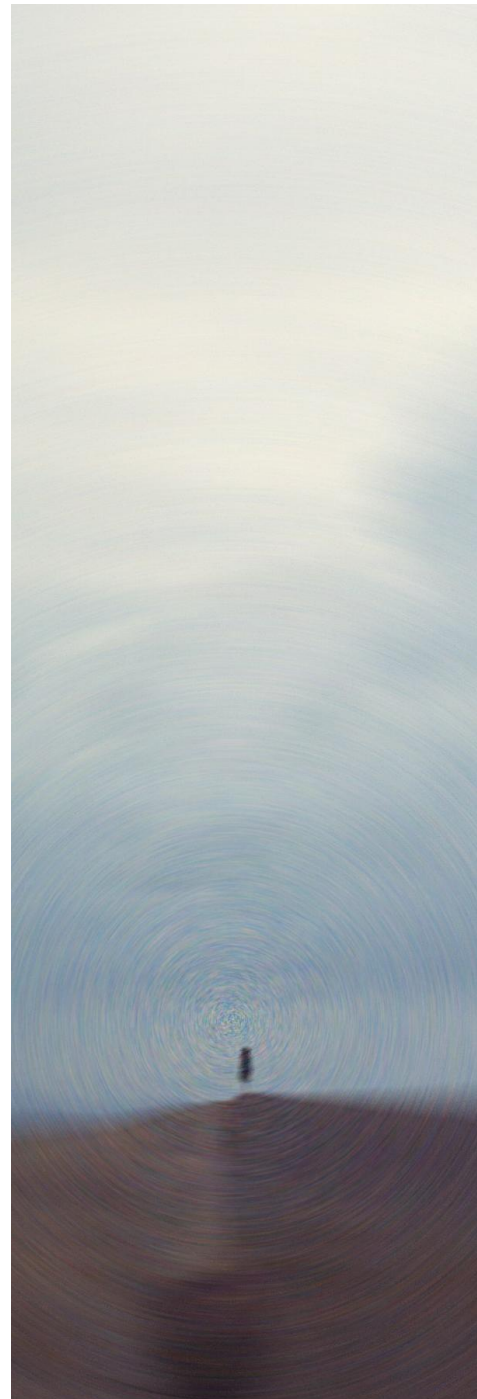
The Draft Rules aim to consolidate and simplify India's foreign investment framework. However, they also introduce new thresholds and definitions that could affect structuring of cross-border M&A, VC, and PE transactions. A few such key changes are discussed below.

Pricing: No Longer Negotiable?

Under the NDI Rules, pricing follows a floor-and-ceiling approach based on the direction of issue or transfer. Issuances to or transfers by a non-resident cannot be priced below fair market value. Conversely, transfers from a non-resident to a resident cannot be priced above fair value. Within these boundaries, parties can negotiate pricing to reflect factors such as control premiums, strategic value, and negotiated risk allocation.

The Draft Rules appear to standardise pricing by requiring foreign investment and its transfer to occur at fair market value. While the valuation methods remain unchanged, the Draft Rules suggest a shift from the “not less than / not more than” guardrails to a single “determined price” outcome.

This shift matters because parties typically negotiate commercial outcomes, within the permitted floor and ceiling, using mechanisms such as price adjustments and earn-outs. If RBI now requires the transaction price to exactly match the certified fair market valuation without room for upward or downward manoeuvring, it could constrain common cross-border deal terms. The RBI should clarify whether customary pricing mechanisms can continue, and whether the “determined price” standard is residency agnostic.



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Under the NDI Rules, any foreign investment in an unlisted company regardless of size, and of 10% or more in a listed company qualifies as foreign direct investment (FDI), whereas investments below 10% in listed companies are considered foreign portfolio investment (FPI). The Draft Rules remove the listed versus unlisted distinction and apply a single threshold across companies, and introduce the FPI construct for limited liability partnerships (LLPs), i.e., any foreign investment of 10% or more in a company or LLP is FDI, and anything below 10% is FPI.

A large share of foreign investments into India (including early-stage funding) involves minority stakes below 10%. The NDI Rules treat these as FDI, while the Draft Rules would treat them as FPI. This reclassification raises operational questions. Under the existing framework, FPI investment requires SEBI registration and compliances.

If regulators apply similar requirements to sub-10% investments in unlisted companies and LLPs, it could raise entry barriers for foreign angel and seed investors. The RBI should clarify the operational implementation of this change including whether sub-10% stakes in unlisted companies and LLPs require SEBI registration, whether sectoral caps and conditions will continue to apply to these investments, and how parties should handle compliance when an investor crosses the 10% threshold across funding rounds.

Defining Equity: The Hybrid Instrument Question

The Draft Rules move away from an instrument-oriented taxonomy and instead regulate foreign investment in “equity” by linking equity (for non-investment vehicles) to what the investee entity classifies as equity under applicable accounting standards. This is a material change for VC and PE transactions that commonly use hybrid instruments such as compulsorily convertible preference shares and compulsorily convertible debentures, which have long qualified as equity for exchange control purposes, but may be classified as debt or split between debt and equity components depending on their terms under accounting standards.

Tying regulatory treatment to accounting classification could introduce avoidable uncertainty. A cleaner outcome would be an inclusive definition that expressly treats commonly used convertible instruments as equity, while retaining flexibility to capture new structures.

Indirect Investment: Clarifying the 10% Control Test

The Draft Rules specifically include indirect foreign investments within the scope of “foreign investments”, in a departure from the current regime of downstream investments that are governed through a separate framework in the NDI Rules.

Under the Draft Rules, a non-resident may make an indirect foreign investment through: (i) a foreign controlled entity (FCE), or (ii) another non-resident which is owned or controlled by the investing non-resident or which is under the common control or ownership as the investing non-resident.

FCEs, as defined under the Draft Rules, appear akin to the existing “foreign owned and controlled (FOCC)” concept under the NDI Rules. However, limb (ii) proposes a revised definition of “control” to include the right to manage or direct policy decisions through shareholding or other agreements granting 10% or more of voting rights, diluting the control thresholds currently in place in the NDI Rules.

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Given the placement of the 10% control test, the diluted threshold appears limited to indirect foreign investments. In VC and PE transactions, minority investors often negotiate minority protection rights and affirmative votes on reserved matters, which do not, by themselves, amount to control over management or policy decisions. If a 10% voting stake is treated as “control” for indirect foreign investment purposes, it could expand foreign investment compliance across holding structures and joint ventures where no single investor controls the entity.

RBI should clarify whether 10% test should be read along with other parameters of control as ordinarily understood is a company law sense, and contexts in which it applies.

The Missing Chapters

Several topics addressed in the NDI Rules do not appear in the Draft Rules, including treatment of share-based employee benefits, foreign venture capital investor pathways, cross-border mergers and demergers, escrows, deferred consideration and indemnity holdback, acquisition and transfer of immovable property by non-residents etc. RBI should clarify the regulatory position on these areas prior to the supersession of the NDI Rules to avoid regulatory and compliance gaps.

The Path Forward

Today, the NDI Rules reproduce large parts of the foreign direct investment policy (FDI Policy) (including sectoral caps and conditions). When the FDI Policy changes, RBI amends the NDI Rules to operationalise the changes. Under the Draft Rules, the FDI Policy is incorporated by reference (rather than embedded text). This approach allows policy updates to take effect without waiting for legislative amendments, thereby ostensibly reducing redundancy and implementation timelines.

However, the FDI Policy is updated by the Department for Promotion of Industry and Internal Trade while NDI Rules are updated by the RBI. Therefore, the current consolidated framework offers significant ease in tracking policy changes. Going forward, if the mechanism proposed in the Draft Rules is implemented, the government should also provide a consolidated database of updates to the foreign investment rules and the FDI Policy.

Further, the government must address open issues, including issuing clarifications on pricing flexibility and positions on escrows, deferred consideration and indemnity holdback, treatment of sub-10% investments in unlisted companies and LLPs, and confirmation that commonly used hybrid instruments remain within the equity regime. A clear roadmap is also required for topics covered under the NDI Rules but missing in the Draft Rules.

Separately, the Draft Rules signal a broader shift towards placing compliance responsibility on both resident and non-resident parties, which dealmakers must reflect in their diligence and documentation.

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