



Nearly six years after India erected a formidable regulatory wall to shield its domestic companies from opportunistic foreign acquisitions during the COVID-19 pandemic, the Government of India has initiated a strategic recalibration. On March 15, 2026, the Department for Promotion of Industry and Internal Trade (DPIIT) issued [Press Note No. 2 \(2026 Series\)](#), formalising the Union Cabinet's [Press Release](#) from March 10.

This landmark amendment modifies Paragraph 3.1.1 of the Consolidated FDI Policy, transitioning India's approach to investments from Land Bordering Countries (LBCs) from a blanket restriction to a nuanced, threshold-based framework. Press Note 2 (PN2) represents a pragmatic acknowledgement of global economic realities, seeking to balance national security imperatives with the pressing need for foreign capital, technological integration, and ease of doing business.

#### The Genesis of the Restrictions: The Press Note 3 (2020) Era

To understand the magnitude of the 2026 update, one must look back to April 2020. As the pandemic disrupted global markets and depressed valuations, the Indian government issued Press Note 3 (PN3). The directive mandated that any FDI from countries sharing a land border with India or investments where the "beneficial owner" was situated in or was a citizen of such a country required prior government approval.

While the policy successfully prevented hostile takeovers (primarily targeting Chinese capital), it introduced what the financial sector termed "Knightian uncertainty." Because PN3 did not define the threshold for "beneficial ownership," the regulatory net caught everything. A multinational private equity fund with even a fractional, indirect exposure to a Chinese Limited Partner (LP) found its Indian investments stalled in a prolonged government approval queue.

Furthermore, the phrase "situated in" created immense collateral damage. Global professionals, third-country nationals (such as American or European executives), and Non-Resident Indians (NRIs) stationed in places like Hong Kong or mainland China were technically barred from freely investing in Indian securities or participating in equity-linked incentive plans. Deal timelines stretched, compliance costs soared, and Indian startups and manufacturers were often starved of critical early-stage capital.

#### The Catalyst for Change: Why 2026?

By 2026, the economic landscape had shifted. India's aggressive push to become a global manufacturing hub, bolstered by Production-Linked Incentive (PLI) schemes in electronics, solar energy, and advanced manufacturing, required not just domestic capital but also deep-pocketed foreign investments and access to specialised global supply chains. Furthermore, India's trade deficit with China had crossed the \$100 billion mark, highlighting the paradox of importing finished goods while restricting the capital that could help build domestic manufacturing capacity for those very goods.



The blanket restrictions of 2020 had served their purpose but were now causing friction. The government recognised that a mature economy requires a targeted scalpel rather than a broad sword. This realisation culminated in the drafting of PN2 (2026), which shifts the regulatory stance from "pre-approval for all" to "proportionality, disclosure, and monitoring."

Deconstructing Press Note 2 (2026): Key Policy Shifts

Press Note 2 introduces several critical amendments that untangle the structural complexities of cross-border investments.

### 1. Anchoring Beneficial Ownership to the PMLA Framework

The most celebrated reform in PN2 is the objective definition of "Beneficial Owner" (BO). The policy now officially links the BO definition to Section 2(1) (fa) of the Prevention of Money Laundering Act (PMLA), 2002, and Rule 9(3) of the PML (Maintenance of Records) Rules, 2005.

By aligning with the PMLA, the government has effectively established a **10% materiality threshold**. Investors from LBCs with a non-controlling beneficial ownership of up to 10% are now permitted to invest via the **automatic route**, provided the sector itself allows automatic FDI. This objective benchmark eliminates the ambiguity that previously forced funds to seek government clearance for minuscule, indirect LP exposures.

### 2. Mobility Relief: The End of "Situated In"

PN2 makes a highly targeted, surgical edit: it removes the words "situated in" from the policy. Under the revised framework, an investment triggers scrutiny only if the beneficial owner "is a citizen of" an LBC.

This seemingly small deletion is a massive relief for global workforce mobility. Expatriates, NRIs, and third-country nationals working or residing in neighbouring jurisdictions can now participate in India-centric investment vehicles and Employee Stock Ownership Plans (ESOPs) without regulatory friction.

### 3. The Dual Test: Distinguishing Ownership from Control

While the 10% equity threshold opens the door for minority investments, the government has tightened the hinges regarding control. PN2 introduces an explicit test for "ultimate effective control."

If an LBC citizen or entity possesses rights that enable them to exercise control over the investor entity or the Indian investee company, the automatic route is voided, regardless of the equity percentage. In the realm of venture capital and private equity, this means standard affirmative voting rights (AVRs), veto rights over strategic business decisions, or board seat appointments held by LBC investors will likely still trigger the government approval route. The focus is on substantive influence, not just formal shareholding.



#### 4. Aggregated and Indirect Ownership

The policy adopts a strict "look-through" approach. Regulatory authorities will assess multi-layered ownership structures to ensure that citizens or entities of bordering countries do not bypass the rules by pooling investments or structuring them through intermediary tax havens (like the Cayman Islands or Mauritius). If the cumulative rights or entitlements breach the threshold or grant control, the investment will be flagged.

##### The Strategic 60-Day Fast-Track Window

Recognising the urgency of capital deployment in critical sectors, PN2 introduces a time-bound approval mechanism. Investments requiring government approval will now be processed and decided within **60 days** if they are directed toward specific, capital-intensive manufacturing sectors:

- Capital goods
- Electronic capital goods
- Electronic components
- Polysilicon and ingot-wafer manufacturing

These sectors are the lifeblood of India's green energy and tech hardware ambitions. However, this expedited clearance comes with a strict caveat: the majority shareholding and overall control of the Indian investee company must remain with resident Indian citizens (or Indian entities owned and controlled by resident Indians) at all times. This ensures that while foreign capital and technology are welcomed to build domestic capacity, the strategic reins remain firmly in Indian hands.

##### From Gatekeeping to Surveillance: The New Reporting Regime

From a regulatory design perspective, PN2 shifts India's approach from pre-investment gatekeeping to post-investment surveillance.

For minority, non-controlling investments that now fall under the automatic route (the <10% bracket), the compliance burden has not disappeared; it has simply evolved. PN2 mandates that Indian investee companies receiving such capital must report the relevant details to the DPIIT via a prescribed Standard Operating Procedure (SOP). This allows the government to maintain high-definition visibility over capital flows and aggregate LBC exposure across the economy without choking the deal pipeline at the entry stage.



## Practical Implications for Stakeholders

The rollout of PN2 will have immediate downstream effects on deal-making in India:

- **For Indian Startups and Enterprises:** Access to foreign capital will become significantly faster and cheaper. Companies will no longer lose out on vital bridge rounds due to the prolonged approval timelines caused by a lead investor's fractional LBC exposure.
- **For Global Private Equity and Venture Capital:** Fund managers will have an easier time structuring their pools of capital. However, term sheet negotiations will become highly nuanced. Legal teams will need to carefully balance the desire to grant LPs protective rights against the risk of those rights being interpreted as "control" under the new FDI guidelines.
- **For M&A and Secondary Transfers:** The policy explicitly states that any subsequent transfer of ownership (existing or future FDI) that results in the beneficial ownership crossing into the restricted LBC territory will require prior government approval. Exit strategies and secondary market sales must be carefully vetted.

The Final Hurdle: Awaiting the FEMA Notification

While the Cabinet has approved these changes and DPIIT has issued the Press Note, the legal architecture is not fully operational until the Reserve Bank of India (RBI) amends the Foreign Exchange Management Act (FEMA) Non-Debt Instruments (NDI) Rules. Until that notification is published, the existing PN3 framework technically remains the law of the land. However, the market is already pricing in the new reality, and deal structures are being aggressively reworked to align with PN2.

Conclusion

DPIIT's Press Note 2 of 2026 is a masterclass in regulatory evolution. It acknowledges that in a highly integrated global economy, capital is fluid, and supply chains are deeply interconnected. By replacing the blunt instrument of blanket bans with a sophisticated framework based on quantitative thresholds, anti-money laundering standards, and active surveillance, India has signalled its maturity as a global investment destination.

The policy keeps the gates heavily guarded against strategic overreach and hostile control, but smartly opens a fast lane for the minority capital, global talent, and technological partnerships required to fuel India's next decade of economic growth.

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